evidenced this when otherwise AAA rated institutions were downgraded (ABN AMRO) or went bankrupt (Lehman Bros). Further, unlike *sukuk* investors, those who invest in conventional bonds are seldom interested in what is being financed through the bond issue which is generally unacceptable in Islam.

A number of sharia scholars, most notably Muhammad Taqi Usmani, stress that what distinguishes Islamic bonds from their conventional counterpart is that Islamic bonds must involve the funding of trade in or the production of real assets.[44] Accordingly, merely funding the purchase of securities would involve second order financing akin to lending for derivatives, the subsequent gearing being speculative and increasing uncertainty (*gharar*).[45] Alternatively, Islamic bonds structured through *Murabaha,* for instance, involve commodities purchased on behalf of the client and sold to the client, the ownership (though temporary) is taken to justify the financier's mark up. Similarly, *ijara* bonds (i.e. *sukuk ijara*) involve the leasing of real assets, with the use of the assets justifying the payment of rental to the owner. The one thing all these contracts are deemed to have in common is the fact that they have underlying assets for which the financing is sought or advanced. *Sukuk* are even distinguished from their conventional asset-backed securities (ABS) counterparts in that conventional ABS may have as their underlying assets different types of loans,[46] all of which are interest bearing and, therefore, may make the product fundamentally different from *sukuk*,[47] and given that debts are not deemed proprietary under the sharia, they are not legally permissible securities.[48] The key distinction, therefore, between Islamic finance and conventional finance is *not* whether the finance is asset backed or not but rather that Islamic finance does not yet recognise debt rights (receivables) as proprietary whilst conventional finance does. This distinction is discussed in detail in chapter 6.

3.6 The four *madhahibs* (schools) of Islamic jurisprudence

In chapters on *gharar, riba and bay al dayn*, where relevant, I refer to views of the four schools of Sunni Islamic jurisprudence: Hanafi, Shafie, Maliki and Hanbali. This is done to present the current positions pertaining the validity (or invalidity) of the issue in discussion. It is important, therefore, that a brief explanation of the background of the four schools is given.

Before that, however, it is important to note the distinction between the primary sources of the sharia (Divine law) and *Fiqh* (man-made jurisprudence). The sharia comprises the *Quran* and the *sunna* while *Fiqh* derives from the secondary sources: *Ijma* (consensus) of the Muslim community on an issue, *Qiyas* (analogical deduction), *Ijtihad* (independent reasoning),

Urf (customs and practices of the people) *Maslaha/Istislah* (social welfare and equity). The jurisprudence of the four schools fall under the category of derived man-made law and hence is not divine law or immutable in nature. Only the primary sources of the sharia – *Quran* and *sunna* – are immutable and accordingly will be given the most focus and weight in this book. Where I refer to the *Fiqh*/scholastic opinions and differences, I do so mainly to highlight the current position on the issue and practice under discussion as well as to provide a platform to bounce off in offering an alternative theory of application today that is in line with the spirit of the sharia. This methodology is, in fact, in line with that of Abu Hanifa himself whose school and followers were dubbed *Ahl al Rai* (people of independent opinion) whilst the other three schools were dubbed *Ahl al Sunna* (people of the tradition). The Abu Hanifa school is the oldest of the four schools and often the most progressive and facilitative of social welfare, as we shall see.

These four main schools (and many others existed then as do now) were born partly out of lack of agreement on the application of the teachings of the *Quran* and the recorded Hadith to the issues and circumstances of daily life. Not everyone felt capable of extrapolating for themselves from the primary sources on how to address the issues and circumstances they faced in daily life and, therefore, gradually, people gave their allegiance to courageous insightful individuals who were willing to put themselves to the task. Historically, the adherence to the four main (and other) schools were attributable to a dynastic order that sought to quell disagreement, and the consequent unrest it could give rise to, by creating uniformity and conformity in matters of faith that would be controlled by the state to the best possible extent (the degree of extent has differed across the ages). This happened during the period of the Mongol rulers (1220–1500) who were powerful enough to put constraints on the *ulama* (scholars) and civilian population on matters of faith – who had previously enjoyed much freedom in matters of faith in daily life.

Consequently, the *ulama* could no longer use their own independent judgement (*ijtihad*) in creative legislation and it was said that 'the gates of ijtihad were shut'. Henceforth, Muslims were obliged to conform to the rulings of past authorities. The sharia, in principle, had become a system of established rules, which could not jeopardise the more dynamic dynastic law of the ruling house. The Mongol irruption into Muslim life had been traumatic[49].

Today it is said that adherence to these schools preserves the unity of Muslims by preventing too many scattered and weak opinions, or impostors from claiming to be *mujtahids* (qualified persons to engage in independent

reasoning). Yet it is acknowledged that the differences of opinion between these schools exist for purposes of plurality and is in line with the general principle of permissibility. There is no 'right' or 'wrong' answer to many of the issues and each of the four schools is accepted as equally valid. One, therefore, may adhere to the opinion/s of any school on any matter and, otherwise, may even choose to exercise one's own reasoning, based on the *Quran* and *sunna*, on which course of action to follow. The four Sunni schools do, however, represent the generally accepted Sunni authority for Islamic (man-made) jurisprudence. They differ mainly in their methodology of extrapolating laws from the sharia sources. The Hanafi school is most distinguished among the four schools in that Abu Hanifa, founder of the Hanafi Schools resorted more to independent reasoning (*Qiyas*) after referring to the *Quran* and *sunna* than any other of the other sources of *Fiqh*.

Conclusion

This chapter set out, in brief, the principles of Islamic finance in an effort to inform the structure and ensuing paragraphs of this book. Chapters 4, 5 and 6 all flow from the concepts outlined above and chapter 8 looks at the structuring of a securitisation to be compatible with both the sharia and conventional finance. In doing so, the chapter will identify the difficulties that are faced and issues that arise, offering alternative applications and suggestions for reform with the intention of facilitating the take-off of securitisation transactions in Islamic finance. The emphasis, however, in every chapter that follows, is in compliance with the principles and spirit of the *Quran* and *sunna*, not the current views or practices of the Islamic finance industry.

4

GHARAR IN ISLAMIC LAW

It is normal for transactions, especially commercial transactions,[1] to possess a level of uncertainty or risk, of which, securitisations (the focus of this book) is no exception. Islamic law of transactions states, however, that *gharar* (loosely translated as uncertainty or speculative risk) is prohibited in commercial transactions. Of course, given the prohibition of *gharar* is not a decree of the *Quran* but a product of human ratiocination, disputes arise as to the precise meaning, application and effect of *gharar*. This chapter, therefore, considers the following issues: (i) what is *gharar*, (ii) what is its *raison d'être* or purpose, (iii) what effect does it have on Islamic contracts and structured finance, (iv) is *gharar* evidential or conceptual in nature, and (v) how does the contextual formulation of the rules on *gharar* affect application of the principle today?

These issues concern securitisation structures directly because the lack of contractual certainty or knowledge threatens the validity of a securitisation depending on the approach taken towards, and application of, *gharar*.

A comparison with the common law is undertaken for purposes of drawing lessons or useful points of reference from the concept of certainty of terms as a fundamental element of contract formation. For want of a single word that succinctly describes *gharar*, I retain usage of the Arabic term.

4.1 Origins of the prohibition

The prohibition of *gharar* in Islamic contracts is derived from the *Quran* and the *Quran* (sayings) of Muhammad. The *Quran* does not expressly prohibit *gharar* but speaks instead of the ills of gambling to which *gharar* contracts are deemed akin.[2] This is a significant clue in determining the nature of *gharar* since we know that *gharar* is that which is so uncertain or speculative as to render the contract akin to gambling. By determining the nature of a gambling contract, one may thus, gain insight into the nature of *gharar*.

The verse of the *Quran* from which the prohibition of *gharar* is derived is *Al- Maidah:* 90. It states: 'O ye who believe! Intoxicants and gambling, stones and arrows, are an abomination of Satan's handwork: eschew such that ye may prosper'. Muhammad is reported to have issued categorical statements expressly prohibiting transactions tainted by *gharar*.[3] The most commonly cited of these statements are:

> The Prophet forbade the pebble sale (sale of an object selected by throwing of a pebble) and the *gharar* sale.[4]
>
> Whoever *buys* foodstuffs let him not *sell* them until he has possession of them.[5] (emphasis added)
>
> He who sells food shall not sell it until he weighs it.[6]
>
> The Prophet forbade the sale of grapes until they become black and the sale of grain until it is strong[7].
>
> The Prophet forbade the sale of a runaway slave or animal, the sale of a bird in the air or fish in the sea, the sale of what the vendor is not able to deliver, or the unborn when the mother is not part of the transaction and milk in the udder.

The last statement above has been has been given considerable weight by sharia scholars and is interpreted as having three juristic consequences[8]: (i) a *gharar* sale is prohibited, (ii) such prohibition is total and extends to all transactions that qualify as a '*gharar* sale', and (iii) the effect of the prohibition is that a *gharar* sale is void.

Careful consideration of the above statements indicates caution extended to the seller for purposes of adhering to the principle of contractual fairness that we set out in chapter one as the underlying principle of contract and commerce. In contrast to the *caveat emptor* principle under the common law, Muhammad seems to shift the burden onto the seller to act fairly (perhaps in light of the seller's stronger bargaining power and control over the transaction in sixth- to seventh-century AD context). The statements also indicate that *gharar* sales involve a certain type of risk or uncertainty that is not readily dispelled by evidence or inspection on the part of the buyer either because the seller is in sole possession of the information required to create certainty or because of the future nature of the subject matter of the sale which renders it out of reasonable control of both parties therefore making the transaction speculative.

Given the categorical prohibition of *gharar* that has been interpreted as nullifying a '*gharar* sale',[9] yet acknowledging the fact that Islam makes allowance for both risk and/or uncertainty in a contract, it is vital that the definition of both *gharar* and '*gharar* sale' be clarified.

4.2 Defining *gharar* and the '*gharar* sale'

Gharar literally means risk or hazard and is derived from the root concept *gha-rra* meaning deception.[10] *Taghreer*, the verbal noun of *gharar*, means to *unknowingly* expose one's property to jeopardy.[11] Accordingly, *Fiqh* (Islamic jurisprudence) scholars have also defined *gharar* as ignorance[12] or the lack of knowledge pertaining to the material attributes of the terms, the subject matter of a sale, as well as the availability and existence thereof.[13] Ibn Rushd, on the other hand, defines *gharar* as the inequality in bargaining power that arises from ignorance (*jahl*) or lack of knowledge pertaining to an aspect, quality, subject matter or feature of the contract.[14] Thus, to Ibn Rushd, *gharar* is the *effect* of inequality of bargaining power rather than a condition of lack of knowledge. More recently, El-Gamal suggests that *gharar* generally encompasses some forms of incomplete information and/or deception, as well as risk and uncertainty *intrinsic* to the objects of contract[15] (emphasis added). He adds that, '*gharar* incorporates uncertainty regarding future events and qualities of goods, and it may be the result of a one-sided or two-sided and intentional or unintentional incomplete information'[16].

Indeed, few scholars have felt the need to define *gharar* or outline its ambit precisely. Whilst this suggests that *gharar* is a concept that does not attach to any defined circumstance or transaction, the lack of precise ambit or definition contributes to the controversy over the effect it has on present-day transactions in Islamic finance.

Consequently, Muslim scholars have described the '*gharar* sale' in the following ways, by derivation from the above cited sayings of Muhammad:[17]

1 *Pure speculation*. These are transactions akin to gambling and are exemplified by the 'pebble sale', that is, where one agrees to purchase whatever item hit by throwing a pebble at several items.
2 *Uncertain outcome*. These are transactions where the counter value is of not only uncertain value and/or specification but may not be realised at all, for instance, the sale of the fish in the sea, the bird in the air or the runaway slave. It is opined that the sale of goods not yet in one's possession falls into this category[18]. Risk seems greater in this category but it is less essential to the transaction and may be cured by making the sale conditional on the elimination of the relevant risk, for example, the fish being caught.[19] Among those who define *gharar* as uncertainty of subject matter is Ibn Abidin.[20]
3 *Unknown future benefit*. In such transactions, though beneficial to the purchaser, materialisation of the object of sale in the future remains

unknown. Such transactions could be deemed tainted by the characteristics of gambling especially if, for instance, the buyer optimistically paid what later materialises to be an excessive price for a harvest, catch of fish, etc. Such transactions are deemed void unless the contract is, or becomes, customary and occurs between informed parties therefore becoming innocuous and perhaps indispensable to society. This curability through customs (*urf*) and need (*hajat*) indicates the curable nature of *gharar* as well as it being a consumer protection means to an end of social welfare (*maslaha*). Among those who describe *gharar* as the unknown future consequence of a contract is Sarakhsi.[21]

4 *In-exactitude*. These transactions possess the least element of gambling (exemplified by the warning not to sell until the item/s have been weighed). Such sales may involve the deliberate blinding of one's self to risks in transactions like selling by the pound or the exchange of one heap of goods for another without measuring either.

5 *Non-existent subject matter*. In such transactions, the vendor is not in a position to hand over to the buyer the subject matter because it does not exist. Some scholars like Ibn al Qayyim[22] have given non-existence a restrictive meaning, that is, the inability to hand over the subject to the buyer whether it exists or not and regardless of whether it will come into existence in the future. However, the validation of the pre-paid contract of agriculture (*salam*) and manufacture (*istisna'*) as a consequence of social evolution and need is an indication that contractual ambit and permissibility evolves with time and that social need may facilitate an otherwise invalid contract becoming valid.

6 *Ignorance as to material terms*. Al-Sanhuri defines *gharar* sale as a contract lacking in information of its material terms. Accordingly, a *gharar* sale would take place in circumstances of:[23]

- doubt as to the existence of the subject matter;
- if the subject matter does exists, doubt as to the seller's ability to hand it over;
- where a lack of knowledge affects the identification of the genus or species of subject matter;
- where the quantity or identity of the subject matter (or the necessary conditions) of the contract are affected;
- in contracts of future performance.[24]

Note that, unlike Ibn Rushd who considers *gharar* as the inequality that arises from a contracting party's lack of knowledge, Al-Sanhuri implies that the lack of knowledge itself is *gharar*. Al-Sanhuri's view is supported by Ibn

Juzzay who lists ten cases of 'lack of knowledge' which in his view constitute the 'forbidden *gharar*' which in turn implies that *gharar* is of the 'forbidden' and 'permissible' type.[25] This distinction between permissible and prohibited *gharar* points to the fact that only *gharar* of the 'forbidden' kind is of vitiating effect. Thus, Al-Baji Al-Andalusi[26] noted that:

> the prohibition of *gharar* sales render such sales defective. The meaning of '*gharar* sale' … is any sale in which *gharar* is the major component. This is the type of sale justifiably characterised as a *gharar* sale and it is unanimously forbidden. However, minor *gharar* would not render a sales contract defective, since no contract can be entirely free of *gharar*.

From the distinction that Al-Baji draws between the effect of 'major' *gharar* on a transaction (forbidden) and 'minor' *gharar* (ineffective) it is clear that the effect of *gharar* on a transaction justifiably characterised as a '*gharar* sale' is to render it void. However, a *gharar* sale is only that which is majorly tainted by *gharar*. This makes allowance for contracts to be tainted by a degree of *gharar* without having a vitiating effect unless such *gharar* is a major component thereof. Mansuri expresses the same view in different words by classifying *gharar* transactions as 'irregular' (*fasid*) instead of valid (*sahih*) or void (*batil*). He describes an irregular transaction as one whose elements (offer and acceptance) are complete and all the essential conditions are complete but an external attribute attached to the contract has been prohibited.[27] Mansuri's approach designates all *gharar* tainted contracts as irregular until they are confirmed as void or valid which indicates an evidential, as opposed to a conceptual, nature of *gharar*.[28]

How then does one determine whether *gharar* forms a 'major component' of a contract so as to render it forbidden? Al-Dhareer lays down four criteria as comprising, what he describes as, excessive *gharar*:[29]

- It should be excessive.
- The contract is a one of exchange/commercial (non-gratuitous).
- The object of the contract is the principle item afflicted by *gharar*.
- There is no *need* compelling the conclusion of the contract.

If *any* of the above four criteria is missing then *gharar* has no vitiating effect on the contract and the contract retains validity.

It is pertinent to note the distinction between *gharar*, which renders a contract defective, and the *gharar* sale, which renders the contract void.

Until the *gharar* in a contract is deemed major enough to designate the transaction as '*gharar* sale', the contract is merely voidable pending determination of whether the transaction is tainted to the extent as to render it void.[30] To this, Professor Mustafa Al-Zarqa provides further assistance in clarifying the deciphering criteria through his definition of the (forbidden) '*gharar* sale' as that 'of probable items whose existence or characteristics are not certain, the risky nature of which makes the transaction akin to gambling'.[31] The gold in Zarqa's definition is that it ties down the risky/speculative/uncertain elements of the forbidden *gharar* sale to gambling. It follows therefore that an uncertain, speculative or future transaction not akin to gambling does not fall within the ambit of the forbidden *gharar* sale and retains validity. The definition also gives implied recognition to the fact that complete contract language is impossible and some measure of risk and uncertainty is inevitable in contractual dealings.

The pertinent points to note from the above definitions and explanations are:

- *Gharar* is of degree, the prohibited type being 'major' or that akin to gambling.
- Only *Gharar* major enough to designate a transaction as '*gharar* sale' renders the contract void.
- The vitiating effect of 'major' *gharar* can nonetheless be cured by removing the conditions causing it.

Most important of all, however, even after reviewing the varied definitions and descriptions of *gharar* and the *gharar* sale, is recognising the fact that *gharar* is neither a type of transaction nor does the prohibition pertain particularly to risk or knowledge or the requirement of contractual certainty, etc. Rather, the prohibition of *gharar* pertains to the ensuing *effect* of a transaction that characterises it as a *gharar* sale on the basis of being 'akin to gambling'. The effect is inequity between the parties yet the available literature focuses on the rules and not what the rules set out to attain or the mischief they seek to address. Muhammad sought simply to foster contractual equity between trading parties through the prohibition of *gharar*.

4.3 The principle behind the prohibition of *gharar*

In the previous section we considered that the concept of *gharar* contracts derives from the Quranic prohibition of gambling[32] and that, read in this light, Muhammad's statements indicate an aversion to (potential or actual) inequitable bargains, whether caused by the vendor's inability to deliver,

the non-existence or the unknown characteristics of the subject matter, the unknown date or future performance of the contract, etc., all of which (may) render the transaction detrimental or deceptive in nature.[33] We noted also that the outright prohibition derived from Muhammad's statements pertains to partaking in what is described as '*gharar* sale' which scholars have defined as a sale comprising an excessive element of *gharar* and all such sales are void. What follows, therefore, is an inquiry into the principle behind the prohibition.

Nabil Saleh[34] proposed that the *raison d'être* behind the prohibition against *gharar* is the prevention of detriment to the parties involved in the transaction.[35] 'Detriment' can be read as inequity effected as he goes on to explain that Muhammad prohibited *gharar* because he recognised the inequality in bargaining power of the traders over the buyers, plus their superiority of knowledge (of products and markets) and experience, and, therefore, sought to protect the weaker parties from deception. Over time, he notes, scholastic reasoning was oversimplified to the extent that non-existence of the subject matter was improperly considered a sufficient and even sole reason for nullifying the transaction without further inquiry into whether it was deceptive.[36] The renowned scholar, Ibn al-Qayyim al Jawziyyah,[37] long since denounced this confusion in his treatises[38] that

> there is no mention in the book of Allah or in the *Sunna* or in the Tradition of the companions that the sale of what is non-existent is prohibited … the *motive*[39] behind the prohibition is *not* the existence or non-existence, but … the sale producing *gharar* and what the vendor is not in a position to deliver, whether or not it exists. (emphasis added)

In light of the primary sources and juristic opinions considered above, this book proffers that the concept of *gharar* has likewise been unjustifiably been reduced to 'uncertainty', just as it was once reduced to 'non-existence' of the subject matter, while ignoring the fact that the prohibition pertains to the much broader principle: that of contractual fairness in aim of attaining equity (*maslaha*) in commercial transactions and preventing detriment (*sad al dhira'a*) to contracting parties.[40] There seems to be no literature expressly describing *gharar* as a prohibition against striking inequitable bargains but my study and understanding of the Quranic text and the sayings of Muhammad has lead me to this conclusion. El-Gamal indirectly supports this conclusion by noting that the factor common to all the categories of *gharar* expounded by Muslim scholars is, 'the possibility of unanticipated loss to at least one party may be a form of gambling or may lead to ex-post

disputation between contracting parties'. He says, therefore, that 'The prohibition of *bay al gharar* (the *gharar* sale) may thus be seen as a prohibition of unbundled and unnecessary sale of risk'.

4.4 The effect of *gharar* and the differing opinions within Islamic jurisprudence

Although the general categorisations of *gharar* (minor and major) and the effect on a transaction imputed by *gharar* have been discussed here, further categorisation and consequent effect of *gharar* in current Islamic finance circles is still based, variably, on the differing opinions of each (of the four) school of Islamic jurisprudence regarding contractual certainty and knowledge.[41]

According to al-Dhareer, whose seminal work is the most referred to in all current literature on *gharar*, jurisprudents divide the effect of *gharar* on contracts into two: *gharar* in the essence of the contract and *gharar* in the subject matter.[42] In a nutshell, *gharar* in the essence of [a] contract renders the contract void whereas *gharar* pertaining to the subject matter renders the contract voidable. However, whether pertaining to the essence or the subject matter, the premise remains that it is only excessive or major *gharar* that is of effect; minor *gharar* is inconsequential.

Thus, whereas a *gharar* sale affecting the essence of a contract is void, difference of opinion arises only as to whether the primary source of the sharia (i.e. the statement/s of Muhammad) actually prohibits a particular type of transaction or not. For instance, the *Arbun*[43] (advance-payment) sale is reported to have been prohibited by one statement of Muhammad and permitted by another statement of Muhammad. Those who accept the prohibitory statement deem all *arbun* sales void *ab initio* while those who accept the statement permitting the *arbun* sale deem it valid.[44] Alternatively, a *mu'allaq* (conditional) sale upon the occurrence of an uncertain event, for example, 'I sell you this house of mine if X sells me his' is deemed void *ab initio* by a majority of the jurists.[45] Ibn Taymiyya and Ibn al-Qayyim, both prominent Hanbali jurists allow the above type of conditional sale on the basis that there is no *gharar* in it. Note, the dissenting jurists allow the *mu'allaq* sale because they do not deem it a *gharar* sale; distinct from deeming *gharar* imputed in the transaction yet validating the transaction anyway. Presumably, had they, too, deemed *gharar* present in the contract, the conclusion would have been the same – that the transaction is void *ab initio* given that the prohibited degree of *gharar* taints the essence of the contract.

On the other hand, where *gharar* is imputed in the subject matter, the disagreement between scholars pertains not to whether the transaction is

prohibited but as to whether such *gharar* is curable or not. For instance, want of knowledge or ignorance regarding the genus is said to be the most exorbitant kind of *gharar* afflicting the subject matter because it includes ignorance of the entity, type and attributes of the object.[46] Most Muslim jurisprudents are thus of the opinion that knowledge of the genus of the subject matter being sold is a condition precedent to the validity of the contract and a contract without the requisite knowledge of the subject matter is prohibited.[47] However, a view within the Maliki[48] school of jurisprudence permits the sale of an object of unknown genus on the condition that the buyer reserves the option of inspection (khiyar-al-ru'ya) through a stipulation in the contract.[49] According to this view, an option of inspection cures the potentially deceptive character that the contract otherwise assumes and which serves the objective behind the prohibition of *gharar* – equity. Similarly, the Hanafi school of jurisprudence permits the sale of a yet unknown subject matter on the basis that the buyer (in their view) always has the right to repudiate the sale once he is in a position to inspect the object without having to stipulate this right in the contract (akin to an implied term that the subject matter will match the agreed description and/or be fit for purpose). Therefore, the Hanafi school validates the contract of sale in which the genus of the object is unknown regardless of whether or not the contract makes explicit reference to the option of inspection because the guaranteed right to repudiate the contract serves to protect the buyer from deception (hence curing *gharar*).[50] The Maliki and Hanafi approach are both pragmatic and aligned to current contractual contexts.

4.5 *Gharar*: conceptual or evidential?

The 'conceptual' and 'evidential' distinction derives from common law considerations of sufficiency of certainty in cases relating to the law of trusts. The leading case in this regard is *McPhail v Doulton*[51] which concerned the validity of a trust created 'by deed dated 17 July 1941 and through which a fund was established for the benefit of officers and employees, etc. of a company'. The House of Lords held that:

> [T]he test to be applied to ascertain the validity of the trust ought to be similar to that accepted in *Re Gulbenkian's Settlement Trusts*.'

In *Re Gulbenkian's Settlement Trusts*, a case concerning a determination of certainty of object of a trust fund, the House of Lords, per Lord Upjohn, observed that:

> Suppose the donor directs that a fund be divided equally between 'my old friends', then unless there is some admissible evidence that the donor has given some special 'dictionary' meaning to that phrase which enables the trustees to identify the class with sufficient certainty, it is plainly bad as being too uncertain.
>
> The principle is, in my opinion, that the donor must make his intention sufficiently plain as to the objects of his trust and the court cannot give effect to it by misinterpreting his intentions by dividing the fund merely among those present. Secondly, and perhaps it is the most hallowed principle, the Court of Chancery, which acts in default of trustees, must know with sufficient certainty the objects of the beneficence of the donor so as to execute the trust … So if the class is insufficiently defined the donor's intentions must in such cases fail for uncertainty.[52]

The implication of *McPhail* and *Re Gulbenkian's* is that unless the uncertainty in question is capable of ascertainment by admissible evidence, the underlying trust or contract must fail for uncertainty. If ascertainable, then the trust or contract is valid and the fact that it is capable of admitting admissible evidence makes it evidential in nature and, thus, curable. If unascertainable by admissible evidence, the uncertainty in question is conceptual and the trust or contract is void *ab initio*. Stated otherwise, conceptual uncertainty is that which, by its very nature, is incapable of ascertainment and thus no amount of evidence rendered is of any use for purposes of creating certainty. For example, if the very concept of life is uncertain, no amount of evidence can possibly help ascertain whether abortion, at any or all stages, is murder. Once the concept of life is clear, then evidence as to which trimester it took place in, whether intentional or not, whether defences such as danger to the mother's life or necessity are applicable, etc., all become admissible to ascertain the question of murder. The same is the case in contract law; as long as the concept of certainty itself remains unclear, no amount of evidence can ascertain the existence of 'sufficient certainty' for purposes of determining whether a valid contract was created. Alternatively, if the concept of intention to create legal relations is unclear, no amount of evidence could ascertain 'meeting of the minds' because it is uncertain what intending to create legal relations 'looks like'. In any case, for the minds to have 'met' thus forming a contract, the concepts underpinning a contract must be clear which probably explains why conceptual uncertainty results in the contract been deemed never to have been formed.

By analogy, if the very concept of *gharar* is uncertain then the uncertainty in question is conceptual and no amount of evidence as to the terms or aspects of the contract will provide sufficient certainty. The question, therefore, is whether the propounded rules of *gharar* in Islamic contracts and commercial transactions pertain to conceptual or evidential uncertainty.

Gharar, as a concept, is conceptual in nature. By this it is meant that if the very concept of *gharar* is uncertain, then no amount of admissible evidence can be adduced to ascertain the uncertainty in the contract. Once the concept of *gharar* is clear, then *gharar* imputed in the contract is ascertainable by admissible evidence and is, thus, evidential in nature. We also know, from the delineation and discussion in section 4.4 that the '*gharar* sale' is of two types: (i) g*harar* imputed in the essence of a contract rendering it void (such *gharar* can be said to be conceptual since it is by nature incurable by admissible evidence); and (ii) *gharar* imputed to the subject matter of the contract rendering it voidable (and curable). G*harar* imputed in the subject matter is thus evidential.

The significance of identifying and establishing the distinction between the evidential and conceptual aspect of *gharar* is, thus, of great magnitude. It clarifies the effect *gharar* has on contracts and it indicates that the prohibition against *gharar* in contracts is, partially, merely a means of preventing inequitable transactions akin to gambling as originally expressed in the *Quran*. As far as evidential *gharar* is concerned, it shifts the focus from vitiation of transactions imputed with excessive *gharar* to developing definitive processes and criteria of determining what amounts to excessive *gharar* and how best, if possible, to cure transactions of its effect. Accordingly, the *raison d'être* behind *gharar* – encouraging equitable transactions – can be interpreted to permit a necessary measure of uncertainty in contracts regardless of whether it pertains to non-existence or precise knowledge of the subject matter for purposes of commercial expedience and facilitating progress. This affects the future and development of Islamic finance in the global context by creating room for both flexibility and creativity in structuring securitisation and other financial transactions. The tendency of treating *gharar* as outright conceptual has to date only brought us to a position of rigidity and arbitrage in a financial context demanding rapid development.

4.6 Certainty under English common law: conceptual or evidential?

Certainty of terms is a fundamental element of the valid formation of a contract under English common law and, thus, a central aspect thereof. Insufficient certainty of terms could render a contract unenforceable[53] and the courts have experienced considerable difficulty in determining whether

a contract has been expressed in *sufficiently*[54] certain terms to be enforced.[55] Emphasis is added to the word sufficiently because the concept of certainty is not an absolute one, as illustrated by the cases discussing it.[56] A contract is only deemed invalid or unenforceable if its term/s is/are so vague or uncertain as to deem an agreement between the parties to be impossible.[57]

A parallel can be drawn between the requirement that *gharar* be excessive or 'major' so as to render a transaction void and a contract being so vague as to fail to give rise to a contract.[58] Further, as shall be discussed below, the nature of the transaction (whether commercial or social) is pivotal in determining the legal nature and enforceability of the transaction as well as the approach courts take towards interpreting a contract. Often, a non-commercial transaction will not trigger the issue of legal certainty as the very nature of the transaction negates an intention to be legally bound. [59]

The issue of whether a general principle of good faith exists is a good example of conceptual uncertainty since unless the parties explicitly stipulate its application with sufficient certainty as to what that duty entails, a contract to be negotiated in 'good faith' would fail because the court cannot be certain what 'good faith' is or amounts to and no amount of admissible evidence could cure that uncertainty. A discussion of the 'principle of good faith' is beyond the bounds of this chapter but suffice it to say that the denial of the English courts of its existence is based primarily on the lack of sufficient certainty upon which to determine the discharge of 'good faith' obligations.[60]

I shall not delve into what amounts to sufficient, and what does not, under the common law but rather turn to consider the almost century long debate on whether a lack of sufficient certainty renders the transaction void *ab initio* (unenforceable) or merely voidable (remediable and enforceable).[61] In doing so, I also examine whether the concept of certainty of terms under English common law is conceptual or evidential in nature.

In theory, the enquiry into whether sufficient certainty exists commences from the premise that it is for the parties to make their agreement and ensure that the terms are sufficiently certain to be enforced.[62] Therefore, whilst the courts are hesitant to appear to be making contracts for the parties, they are nonetheless reluctant to deny legal effect of agreements.[63] In practice, therefore, the courts are slow to vitiate contracts and will instead seek to balance the need for contractual certainty with the general principle that it is for the parties to make their agreement, avoiding a situation where contracting parties use allegations of uncertainty to escape bad bargains, especially where the allegedly uncertain agreement has been (partially or fully) performed. Based on the facts of the case, the courts may, therefore,

rescue the agreement if some objective evidence is available to fill the gaps.[64] Such cases indicate the evidential nature of the certainty of terms requirement because, as explained in section 4.5 and as indicated in both *McPhail v Doulton* and *Re Gulbenkian Trust*, if the uncertainty in question is incapable of admitting (admissible) evidence for purposes of ascertaining the uncertainty in question, then, by definition, the uncertainty is conceptual and the trust (or contract in the context of securitisation) must fail for uncertainty.

Cursorily, a similarity may be drawn between Islamic law's delineation between *gharar* imputed in the essence and the subject matter of the contract, on the one hand, and the common law delineation between incomplete and uncertain agreements.[65] The Islamic law position is discussed in section 4.4. Under the common law, incomplete agreements are, in some fundamental way, contingent upon a further occurrence and do not, as a general rule, form valid agreements. They may take the form of an agreement to agree aka 'a contract to make a contract'[66] or one upon which terms its operation depend are yet to be determined at the time of making the agreement.[67] Uncertain agreements, on the other hand, are apparently complete agreements but lack sufficient certainty of terms (e.g. determination of price or subject matter) that may or may not render the agreement invalid, depending on whether sufficient certainty is established.[68]

English cases pertaining to the determination of certainty of terms, traditionally, fall into two categories: those that decided that the contract was too vague or uncertain to be enforceable and those that deemed the contract valid and enforceable despite the contractual uncertainty alleged. No discerning explanation or criteria has, to date, been deciphered as to how the courts reach either of the two conclusions or how the judges determine which of the two competing views to adopt so as to fall within either of the two categories.[69] My contribution in this regard, after due consideration of the main common law cases on certainty of terms, is to offer the 'conceptual' and 'evidential' distinctions as discerning approaches the courts seem to have latently adopted in deciding the cases before them.

The first case to consider is the House of Lords case of *May & Butcher v King* [70] which is the leading, though not the first to be decided, case on certainty of terms and falls in the traditional category of 'contracts deemed too uncertain to be enforced'. The brief facts are that May & Butcher Ltd, the suppliants[71] (referred to in the judgement as appellants), alleged that they had concluded a contract with the Controller of Disposals Board under which they agreed to buy the whole tentage which might become available in the United Kingdom for disposal up to 31 March 1923. On 29 June 1921, the controller wrote to the suppliants to 'confirm the sale to you of

the whole of the old tentage which may become available … up to and including December 31, 1921' and proceeded to set out the terms of the agreement. The contractual clause in contention stated that:

> (3) The price to be paid, and the date or dates on which payment is to be made by the purchasers to the Commission for such old tentage shall be agreed upon from time to time between the Commission and the purchasers as the quantities of the said old tentage become available for disposal, and are offered to the purchasers by the Commission.

In a second letter, dated 7 January 1922, the Controller of Disposals confirmed the sale to the suppliants of the old tentage that might become available for disposal up to 31 March 1923. This letter, which varied the earlier terms in certain respects, stated with regard to the above quoted clause that 'the prices to be agreed upon between the Commission and the purchasers in accordance with the terms of clause (iii) of the said earlier contract shall include delivery free on rail … nearest to the depots at which the said tentage'.[72]

On August 1922, after the suppliants had made proposals to purchase tentage that were not acceptable to the Controller, the Disposals Board wrote to the suppliants and stated that they considered themselves no longer bound by the agreement. The suppliants then filed their petition of right which was dismissed by the House of Lords.[73]

The central issue in the case, per Lord Buckmuster, was whether or not the terms of the contract were sufficiently defined to constitute a legally binding contract. The Crown alleged that the price was never agreed and the appellants alleged that if the price was not agreed then it would be a reasonable price and, moreover, the arbitration clause in the contract was intended to cover this very question of price. In reaching the decision that a contract was never concluded between the parties and, therefore, the alleged contract was unenforceable, Lord Buckmuster remarked:[74]

> [T]he only points that arise for determination are these: Whether or not the terms of the contract were sufficiently defined to constitute a legal binding bargain between the parties in one of three respects. The Crown says, in the first place, that the price was never agreed. The appellants say that, if it was not agreed, then, according to the proper law applicable, it would be a reasonable price; and secondly they say that, even if the price was not agreed and it is not fair to assume that, therefore, a reasonable price was intended, the arbitration clause in the

> contract was intended to cover this very question of price, and that, consequently, the reasonableness of the price was referred to arbitration under the contract …
>
> Those being the contentions, it is obvious that the whole matter depends on regarding the actual words of the bargain itself. In the first place, the contract is contained in the form of a letter.
>
> What resulted was this: It was impossible to agree the prices, and, unless the appellants are in a position to establish either that this failure to agree resulted in a definite agreement to buy at a reasonable price, or that the price had become subject to arbitration, it is plain on the first two points which have been mentioned that this appeal must fail.
>
> In my opinion, there never was a concluded contract between the parties in this case at all. It has been a well-recognised principle of contract law for many years that an agreement between two parties to enter into an agreement by which some critical part of the contract matter is left to be determined is no contract at all. It is, of course, perfectly possible for two people to contract that they will sign a document which contains all the relevant terms, but it is not open to people to agree that they will in the future agree on a matter which, vital to the arrangement between them, has not yet been determined.[75]

Several points may be noted from the case of *May & Butcher* that prove helpful in the discussion. First, the contract is presumably commercial in nature as it was couched in commercial verbiage and it contained an arbitration clause which, in the early twentieth century, was a feature almost exclusively of commercial contracts. Second, the facts of the case reveal no trading history between the two parties. Third, though the parties did provide a mechanism (arbitration) to resolve any disagreement as to the price (term in contention), the arbitration clause was *part of* the contract, and given the Courts conclusion that no contract was formed to begin with, such arbitration clauses could not kick in to resolve the dispute. Apparently, therefore, the House of Lords adopted a conceptual approach to the issue of certainty (as per the description in section 4.5) and, accordingly, sought to establish certainty of the price term solely from what the parties had already made provision for in the contractual term since no recourse to any external evidence or machinery could, according to the House of Lords, resolve the uncertainty alleged. These factors become more relevant as we consider the other cases.

The conceptual uncertainty in *May & Butcher* pertains to the concept of an 'agreement to agree' and no amount of admissible evidence could cure

the contract of its uncertainty as the price was determinable by the parties' agreement in the future. Conceptually, that was impossible to ascertain in the present and the contract had to fail. Lord Ackner in *Walford v Miles*[76] expressed it succinctly as follows:

> The reason why an agreement to negotiate, like an agreement to agree, is unenforceable is simply because it lacks the necessary certainty. The same does not apply to an agreement to use best endeavours. This uncertainty is demonstrated in the instant case by the provision which it is said has to be implied in the agreement for the determination of the negotiations. How can a court be expected to decide whether, subjectively, a proper reason existed for the termination of negotiations? The answer suggested depends upon whether the negotiations have been determined 'in good faith'. However, the concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations. Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations.
>
> Thus, given the very concept of negotiating in good faith, like the concept of an agreement to agree, is uncertain, any contract to negotiate in good faith or to agree, *must fail for conceptual uncertainty*. (emphasis added)

The second case to discuss is a House of Lords case that arrived at a conclusion in line with *May & Butcher*, that is, that no agreement was formed due to a lack of sufficient certainty. The case is that of *Scammell & Nephew v Ouston*[77] where it was held that an agreement to acquire goods on hire purchase was too vague since there were many kinds of hire-purchase agreements in widely different terms, so that it was impossible to specify the terms on which the parties had agreed.

The facts are, briefly, that D wrote to P and offered to sell them a Commer van for £268, allowing for £100 out of the £268 to be paid by taking P's Bedford van in part exchange. The next day D wrote to P asking them to place an official order for the van, which P did 'on the understanding that the balance of the purchase price can be had on hire-purchase terms over a period of 2 years'. The relationship thereafter deteriorated principally due to a disagreement over the condition of the Bedford van that resulted in D refusing to take it in part exchange, as earlier agreed. P claimed that the refusal amounted to a breach of contract and brought a claim for damages. D denied liability on the basis that no contract had in fact been concluded.

The question before the court was whether the terms of the contract (specifically pertaining to contractual price and manner of payment) were sufficiently certain to have concluded a contract between the parties. If yes, then the part exchange could be enforced against D. If not, then the part exchange could not be enforceable and no damages would lie against D. The House of Lords held it was impossible to conclude that a binding agreement had been established and thus the contract was unenforceable. On the simple basis of the court's finding against a binding agreement, *Scammell* is categorised with *May & Butcher*. However, a nuance in the facts of the two cases indicates a further similarity that may have led to the same outcome in the two cases.

Viscount Maugham, delivering his judgement in *Scammell*, points out the nuance by drawing a distinction between *Scammell* and *Hillas v Arcos*. [78] He explains that *Scammell* turned on the question as to whether informal letters or like documents (non-commercial or non-legal documents) resulted in a binding agreement. Therefore, in *Scammell* unlike *Hillas v Arcos*, the facts indicated that, 'laymen unassisted by persons with legal training are not always accustomed to use words or phrases with a precise or definite meaning'.[79]

He explains that, generally:

> In order to constitute a valid contract the parties must so express themselves that their meaning can be determined with a *reasonable degree of certainty*. It is plain that unless this can be done it is impossible to hold that the contracting parties had the same intention. (emphasis is mine) …
>
> This general rule, however, applies somewhat differently in different cases. In commercial documents connected with dealings in trade, with which the parties are perfectly familiar, the court is very willing, if satisfied that the parties thought that there may be a binding contract, to imply terms and in particular terms as to the method of carrying out the contract which it would be impossible to supply in other kinds of contract.

An analysis of the facts and judgement in *Scammell* indicated that the uncertainty pertained to the concept of 'intention to form legal relations' in a contract between lay parties. Because the concept was unclear, and there was no trading history on the facts or commercial customs that could be drawn from to clarify the concept, no amount of external evidence could ascertain whether a contract had been formed or, in other words, whether the

contracting parties' minds had met. Of crucial importance was the fact that the contract was described as a sale on hire purchase – a fact that Viscount Maugham deemed a contradiction in terms. He observed that 'hire purchase offers a *mere option to purchase at completion of payment of instalments while sale passes title*' (emphasis added). Further, that the term 'hire purchase' was amenable to many forms and nuances and thus the very concept of hire purchase, on the facts of the case, was uncertainty. Consequently, the contract failed for uncertainty. Viscount Maugham observed:

> Bearing these facts in mind, what do the words 'hire-purchase terms' mean in the present case? They may indicate that the hire-purchase agreement was to be granted by the appellants, or, on the other hand, by some finance company acting in collaboration with the appellants. They may contemplate that the appellants were to receive by instalments a sum of £168 spread over a period of 2 years upon delivering the new van and receiving the old car, or, on the other hand, that the appellants were to receive from a third party a lump sum of £168, and that the third party, presumably a finance company, was to receive from the respondents a larger sum than £168, to include interest and profit spread over a period of 2 years. Moreover, nothing is said (except as to the 2-years' period) as to the terms of the hire-purchase agreement – for instance, as to the interest payable, and as to the rights of the letter, whoever he may be, in the event of default by the respondents in payment of the instalments at the due dates. As regards the last matters, there was no evidence to suggest that there are any well-known 'usual terms' in such a contract, and I think that it is common knowledge that in fact many letters, though by no means all of them, insist on terms which the legislature regards as so unfair and unconscionable that it was recently found necessary to deal with the matter in the Hire-Purchase Act 1938. These, my Lords, are very serious difficulties.

Given the conceptual difficulties faced and the lay nature of the parties, it is not difficult to understand how the court reached its decision.

The third case to look at is *Hillas v Arcos* which is in contrast to the above two cases and is the leading case in the category of cases in which the courts have held the agreement to be a valid and binding contract despite the alleged uncertainty of terms.[81] The brief facts are that A agreed to buy from R, by an agreement dated 21 May 1930, '22,000 standards of softwood goods of fair specification over the season 1930'. The contract was

also subject to certain conditions among which was that A had the option of entering into a contract with R for the purchase of 100,000 standards of delivery during 1931 – such an option to be declared before the 1st of January 1931. A purported to exercise the option on 22 December 1930 but R had already agreed to sell the whole of the output of the 1931 season to a third party. A sued for damage for breach of contract but were met by the defence that the document of May 1931 did not constitute an enforceable agreement because it did not sufficiently describe the goods to be sold to enable their identification and, also, that it contemplated in the future some further agreement upon essential terms. The House of Lords rejected the defence and held that, the option having being exercised; the agreement was complete and binding in itself and was not dependant on any future agreement for its validity.[82]

Lord Tomlin's judgement crystallises the factual distinction between *Hillas* and *Scammell* that led to the conclusion arrived at in *Hillas*. He points out that, in *Hillas*, the parties were both intimately acquainted with the course of business in the Russian softwood timber trade, and had, without difficulty, carried out the sale and purchase of 22,000 standards under the first part of the document of 21 May 1930. Second, he pointed out that the validity of the contract in contention hinged mainly on the meaning of the phrase 'of fair specification'. This implied that if the court was able to determine, and thus resolve the meaning of such a phrase, a valid contract would have been formed. Thirdly, clause 11 of the May 1930 document demonstrated the parties' intention to be bound.

In determining the meaning of the phrase 'of fair specification', Lord Tomlin held that the document of 21 May 1930 was to be read as a whole and had regard to the admissible evidence as to the course of trade. In his opinion, the true construction of the phrase was used in connection with the 22,000 standards and meant that the 22,000 standards are to be satisfied in goods distributed over kinds, qualities and sizes in the fair proportions having regard to the output of the season 1930. That is something which, if the parties fail to agree, can be ascertained just as much as the fair value of property.[83]

The purpose of setting out the above facts and judgements is to point out the role that the context (facts) of the case plays in determining the approach the court towards the issue of sufficient certainty. In *Hillas*, the context was clearly commercial, the parties were intimately acquainted with the trade and there were previous dealings from which inferences could be drawn to establish contractual certainty. On this basis, the court was amenable to admitting external and surrounding evidence so as to establish

contractual certainty and, thus, the uncertainty in question was deemed evidential in nature.

In contrast, in both *Scammell* and *May & Butcher* the parties were not 'intimately acquainted' with the trade in case. Moreover, *Scammell* was a case of laymen purporting to enter into a contractual agreement and, therefore, the court was not amenable to external evidence being adduced because of the non-commercial nature of the contract and instead focused only on the written terms of the contract. Simply stated, in commercial contexts with established customs or trading histories between the parties, there is far less likelihood that conceptual uncertainty would afflict a contract because ample means and methods are available to create the requisite level of certainty (as we shall see in section 4.6.1). The same is not true in non-commercial contexts and/or where no previous relationship existed between the parties.

Primarily, therefore, that the distinction between the decisions in *May & Butcher* and *Scammell* on the one hand and *Hillas v Arcos* on the other is not so much whether the court took a restrictive or permissive approach, respectively, to the question of certainty of terms but rather whether the court deemed the uncertainty in the particular case to be conceptual or evidential. In *May & Butcher* and *Scammell* the Court deemed the uncertainty to pertain to the concept in question (agreement to agree and hire-purchase sale/intention to create legal relations respectively) and, thus, no evidence could be adduced to cure this. In *Hillas*, on the other hand, the uncertainty pertained to the determination of price under a contract that had already been concluded in all other respects. As such, the uncertain aspect of the contract could be ascertained by admissible evidence.

Considered from the point of view that the discerning criterion is whether the court deemed the uncertainty in question to be conceptual or evidential, the decision of the House of Lords in *May & Butcher* ceases to be a legal enigma and can be safely laid to rest while the courts adopt a coherent approach in reaching decisions in the future regarding contractual certainty of terms.[84]

This coherent approach is simply that if the question of sufficient certainty pertains to conceptual uncertainty then the contract must fail unless the uncertainty can be ascertained from the agreement of the parties. This was the case in *May & Butcher* and in *Scammell.* However, if the uncertainty pertains to an aspect of an otherwise concluded contract, then the uncertainty is evidential and the contract may be cured by admissible evidence.

In final demonstration of the application of, and consequent clarity that arises from adopting, the contextual/evidential distinction, let us consider

the case of *Foley v Classique Coaches Ltd*.[85] In *Foley* the contract between the parties provided that:

> The vendor shall sell to the company and the company shall purchase from the vendor all petrol which shall be required by the company for the running of their said business at a price to be agreed by the parties in writing and from time to time.

At face value, the above term indicates a lack of certainty of terms of not only the contractual price, which is to be agreed from time to time, but also the quantity of petrol to be purchased/sold. A dispute arose between the parties and among the issues in contention was whether a valid agreement existed despite the parties' failure to reach an agreement on the price at which the petrol was to be sold. The purchasers argued that the agreement was not binding based on the lack of certainty as to the (price) term. The vendors argued that it was binding, relying on the fact that the agreement in question had been relied on for three years and that the agreement contained an arbitration clause which covered the failure to agree the price of sale of petrol. The Court of Appeal decided in favour of the vendors, that is, that a valid contract had been formed despite the apparent uncertainty as to the price at which the petrol was to be sold.[86]

The contrast between the outcomes in *Foley v Classique* and *May & Butcher* could not be starker. It will be recalled that the contract in *May & Butcher* was also a commercial agreement containing an arbitration clause that was to resolve any failure to agree the contractual price yet the House of Lords deemed the arbitration clause inoperable since no contract was deemed formed to begin with. How, then, can the contrast between *May & Butcher* and *Foley* be explained? An apparent explanation seems to be that the factor influencing the Court of Appeal's approach towards the issue of certainty of terms in *Foley* (despite having two at par yet conflicting cases previously decided by the House of Lords to follow (*May & Butcher* and *Hillas*, respectively) was that the agreement in *Foley* was not only commercial but had been relied on for the past three years. There was a trading history and an established relationship between the trading parties in *Foley* that was referred to so as to impute certainty in an otherwise uncertain term. By virtue of the established trading history between the parties and, by implication, given all the concepts engaged in the contract were sufficiently certain, any uncertainty could easily be ascertained by external admissible evidence.

Finally, *Foley v Classique Coaches* crystallises the fact, as stated by Scrutton LJ, that the principles of certainty, even as enunciated by the

HOL, are not 'universal' but rather are case/context specific. It follows, therefore, that the concept of certainty under English law is neither exclusively conceptual nor evidential but rather, either conceptual or evidential depending on the context and facts of each case. The determination of whether the uncertainty pertains to an underlying concept or merely an aspect of the contract depends on the context of the contractual agreement, the nature of contractual term/s in question and the parties' trading relationship.[87]

The contrast between the two approaches, conceptual or evidential, is perhaps best expressed by the statement of Blanchard J[88] in his commentary on *May & Butcher Ltd v King*:[89] He expresses the approach taken by the House of Lords in *May & Butcher* as follows:

> *prima facie*, if something essential is left to be agreed upon by the parties at a later time, there is no binding agreement.[90]

Later in his opinion, he disagrees with the above approach and observes that:

> No longer should it be said, on the basis of that case, that prima facie, if something essential is left to be agreed upon by the parties at a later time, there is no binding agreement. The intention of the parties, as discerned by the court, to be bound or not to be bound should be paramount.

From Blanchard J's statement we can discern that the intention to be bound is the underlying concept directing the determination of certainty. Therefore, as long as the concept of contractual intention is clear, any uncertainty as to the terms is ascertainable by adducing evidence as to the parties' intention in the particular case.

4.6.1 Curing contracts of uncertainty under the common law

We have seen that certainty of terms of an agreement affects the enforceability of the contract as a whole and effectively determines whether the contract is valid or not. Therefore, a brief consideration of a sample of means that the common law courts of England employ to cure contracts of uncertainty would be useful. It should be noted, as discussed above, that the mechanisms outlined below would apply in cases where the question of certainty of terms takes an evidential character as opposed to a conceptual character.

The general position regarding certainty of terms, we have noted, is that:

> the parties must have agreed on the essential terms or have provided the method by which these are to be determined, and these must be reasonably certain otherwise there is no contract, merely an agreement to agree or an agreement to negotiate neither of which is considered to have legal force. But if the essential terms have been agreed, the fact that the parties have agreed to negotiate as to the remaining terms does not preclude the establishment of a contract; indeed, the court may also be willing to infer an agreement to negotiate in good faith to settle the remaining terms.[91]

From the above quotation we infer that the first measure the court may adopt in creating certainty where it appears to lack is, therefore, to examine the contractual language in light of its context. By this it is meant, look at what has been said and done, the context in which the words or acts were said and done, and the relative importance of the unsettled matter in the entire scheme of the agreement.[92] The language of the contract is the principle tool used by the court in determining what the parties have agreed.[93] Generally, the contract will be interpreted in accordance with any rules of interpretation provided by the contract itself. Technical terms will be accorded their technical meaning, and any language accorded special meaning according to custom or usage will be accorded such meaning if the contract is entered into in the light of such custom or usage.[94] Extrinsic evidence is, as a rule, admissible to resolve any ambiguity, whether latent or patent,[95] thus indicating a general evidential approach to the issue of certainty of terms.

Secondly, the court also pays heed to whether the parties have themselves stipulated machinery for settling the uncertainty (also indicating the evidential/curable nature of contractual uncertainty) and the mode of cure the parties have contemplated or provided for.[96] In addition, the courts consider the following factors:

- Commercial practice and previous performance: illustrated by the case of *Hillas v Arcos*[97] (considered at length in section 4.6 above) where the contract provided for the sale of Russian timber of 'fair specification', but that did not provide for the kind, size or quality of the timber nor the mode of shipment to be used. These omissions were ascertained from previous transactions between the same parties and the custom of the particular trade. The court held that there was an intention to be bound

from the previous transactions and the uncertain terms could be ascertained by reference to previous dealings and the original contract.

- Standards of reasonableness: could alternatively be used to settle uncertain terms including standards such as 'market value'[98] or 'open market value'.[99] In the case of price of goods or services, the matter is governed by statute – The Sale of Goods Act 1979 provides in section 8 (2) that where the price is not determined in section 8 (1), the buyer must then pay a reasonable price. Section 8 (2) however applies only where the contract is silent as to the price and not where the parties agree to subsequently determine the price.[100]
- Machinery for ascertainment: a contract will not be void for uncertainty if the contract stipulates a mechanism for ascertaining the uncertain. The provided mechanism could be an arbitration clause[101], an agreement to appoint a valuer to determine the price or any other method agreeable to the parties. In the recent case of *Bruce v Carpenter and others*, the court observed that in determining contractual certainty the court must also determine whether the machinery set out by the parties was essential to the ascertainment of the term in question (in this case ascertainment of contractual price through a named expert's valuation) or whether certainty could be established by applying objective standards, for instance, by reference to a fair price.[102] The approach taken in *Bruce* reflects the evidential approach to certainty of terms whereas where the court chooses to adopt a conceptual approach to certainty of terms, as in *May & Butcher*[103] for instance, then a provision of any such machinery in the contract is of no value should the court determine that no agreement was formed due to lack of certainty.[104]
- Severability of term: if the uncertain clause or term is meaningless or can be done without, the court can order it to be severed from the rest of the contract leaving the rest of the contract valid.[105]
- Other Implied terms: the court will be willing to read into a contract terms not expressly spelt out between the parties on several other grounds depending on whether such terms are either implied in fact or in law.

Terms implied in fact are those that are implicit in express terms such as those deemed too obvious to need stating;[106] or are necessary to give business efficacy to the contract[107]but the term sought to be implied must be such that without it the contract would be commercially non-viable;[108]

Terms implied in law are either terms implied as rules of the common law or statute law. We are here concerned more with terms implied under the common law, for instance, fitness and merchantable quality implied in

contracts of sale of goods in the nineteenth century prior to the enactment of the Sales of Goods Act.[109] Where such terms are not already implied as a matter of law by the courts, they will do so as a matter of policy where the term is one which the law should imply as a necessary incident of a defined contractual relationship.[110] For instance, in a contract for labour and materials, that the materials will be of proper quality and fit for purpose[111] and in a contract for supply of services, that they will be performed with such care and skill as is reasonable (having regard to the degree of experience the provider holds out as possessing).[112]

All of these curing mechanisms are open to be employed by Islamic law to cure contracts lacking sufficient certainty of terms, as per the *gharar* principle, where applicable.

4.7 Historical context and the rules of *gharar*

Appreciating the context within which the Quranic verses were revealed and Muhammad's statements were made is an essential (and universally accepted) component of interpreting the rules of Islamic law that were created to express the principles behind them.[113] It is vital, therefore, for an appropriate application of *gharar*, to look at the context within which the prohibition was extrapolated by Muhammad from the Quranic verses on gambling. Muhammad's sayings cited as prohibiting *gharar* depict transactions involving items of daily use or even basic necessities such as food, livestock or currency metals, used directly or indirectly for sustenance. The context of the prohibition is 6th–7th-century desert Arabia afflicted by harsh weather, scarce water and limited food sources making it common for tribes to experience food shortages or for traders to try and deceive consumers so as to maximise gains by exploiting people's need. Even as better times fell on the Arabs and food was better available among the people of Quraysh, through combining mercantile trading with livestock breeding, money was still coveted and loved dearly by the Arabs, as mentioned in several verses of the *Quran*.[114] Sharp market practices in hope of making quick gains proliferated amongst traders[115] and the emergence of Islam amongst the Arabs of Makkah found an atmosphere of cut-throat capitalism and high finance at a time when merchants were beginning to wrest some of the power which had once been solely in the hands of the kings and the aristocrats[116]. This new prosperity drew Muhammad's attention to the disparity between rich and poor and made him deeply concerned with problems of social justice. Muhammad's uncle, Abu-Lahab imposed a two-year food ban on Muslims from 617–619 AD in hope of subduing them back to the tradition of their forefathers. Finding this treatment unbearable, and having lost his beloved

wife Khadija that year,[117] Muhammad fled Makkah to Madina along with several hundred followers.[118] In those conditions, the migrants left whatever possessions they had behind and were completely at the mercy of their hosts (*Ansaar*) in Madina. In founding a new community of Muslims in Madina, Muhammad stressed the principles of justice and equity in all human affairs, let alone contractual dealings; a policy measure to protect the weak from the potentially harmful clout of the strong and wealthy and as a means of emphasising that everyone was entitled to what was lawfully theirs regardless of race, tribe, class or gender. Justice and equality are the two fundamental themes underlying the message of Islam as the foundation of the Muslim community and in the sphere of transactions these principles are expressed through the rules of *gharar* (and *riba*).

4.8 Present context application of Islamic law of transaction

Chapter 5 refers to the Quranic distinction between commercial and non-commercial transactions for the purposes of applying rules of *riba*.[119] *Gharar*, on the other hand, concerns only commercial transactions much like the concept of certainty of terms concerns commercial transactions. Social and family arrangements are not subject to the rules of *gharar* as the parties are taken either to have an understanding of the transactional terms or not to have intended to be bound. This demarcation is evidenced by the fact that any discussion on *gharar* (be it in books or fora) pertain to commercial transactions. Islam is not alone or unique in stressing the paramount need to protect contracting parties in commercial or non-commercial transactions. Under the common law a demarcation has always been drawn between commercial and non-commercial contracts with a more cautious approach being adopted towards the latter as discussed in section 4.6 above. In fact, these principles and laws have been in place, used and refined, for several decades in England while Muslims are still grappling with the definition of *gharar* and making necessary distinctions between its application in different contexts and contracts.

In today's context, sophisticated legal and regulatory frameworks are either available or may be put in place to facilitate equity in commercial or financial transactions. It is open to parties to opt to enter into the transactions only after consideration of their circumstances and consequences of the transaction coupled with legal and financial advice. Moreover, market mechanisms may be invoked as an objective standard of ensuring equity.[120] In most developed financial jurisdictions, for instance, securitisation transactions (as all other financial transactions) are subject to regulatory standards that by implication guard against financial transactions falling foul of

gharar (uncertainty/speculation). The more pertinent inquiry is whether these regulatory standards also guard against inequity?[121] We have stressed that the principle behind *gharar* indicates that preventing uncertainty and speculation is not a goal but rather a means to facilitating contractual equity between the parties. Viability of the application of current financial regulatory (or other) standards to Islamic finance securitisations so as to satisfy the principle behind *gharar* can today be facilitated by the sharia boards present in all Islamic finance institutions. These sharia boards ought to be, and are increasingly becoming, internal regulatory bodies within banks and financial institutions that enforce accountability and transparency (over and above ensuring an adherence to the requisite form of nominal contracts) and thereby safeguarding the best interest of the investors by eliminating excessive risk or speculation. In fact, the scope and role of sharia boards has the potential of evolving into a unified regulatory body that monitors and regulates sharia compliant transactions. It is envisioned that through such an enhanced role, the balance between form and substance will be better attained and, if accomplished, it will spur more sustainable growth within Islamic finance. A detailed discussion of sharia boards and their roles is, however, beyond the scope of this book.

Conclusion

Appreciating the rules of *gharar* in the context of their formulation and adopting an evidential approach to *gharar*, as some schools of Islamic jurisprudence have, is of great consequence for securitisation as it no longer threatens to automatically vitiate the structure but merely puts the parties on guard against insufficient certainty of contractual terms that would call the transaction's validity into question. It also implies that securitisation transaction involving physical assets not a yet in existence or not yet actually owned would not be rendered automatically void and such validity would be determined on a case-to-case basis guided by the yardstick of whether the transaction is, in effect, akin to gambling.

In this spirit, Islamic finance should utilise the principle of *gharar* to ensure contractual equity without hindering the practice and evolution of commercial and financial transactions. The balance between the two is fine but one that Muslim societies must consider striking. Consideration may also be given to the role of sharia boards and their capacity to contribute constructively to the growth and development of Islamic Finance through their embodiment as a corporate governing body as opposed to their current 'certifying' role.

5

RIBA

MEANING, SCOPE AND APPLICATION

A cardinal principle of Islamic law of contract is the prohibition of *riba*. Any study or consideration of an Islamic finance-related subject is, therefore, incomplete without a discussion of the meaning of *riba*, the principle underpinning it and its application in commercial transactions today. *Riba* has been translated, and applied, as a prohibition of interest charged on loans. To say so, however, is to not only oversimplify the matter but to misconstrue it all together because the concept of *riba* applies to more than just loans; it applies equally to all transactions be they loan or sale or lease.[1]

Riba, as a concept within Islamic law of contract,[2] is a vitiating factor that aims at attaining transactional equity by requiring exchanges to be bargains by way of mutual consent as a basis for eliciting consideration.[3] The principle of *riba* is, therefore, one that regulates the elicitation of consideration: only commercial[4] exchanges may elicit consideration.[5] Non-commercial exchanges (family and social arrangements or otherwise unenforceable agreements) may not elicit consideration. Evidence of the established validity of this demarcation in Islam is furnished by a universally accepted contract – the wedding contract (*Aqd al-nikah*). The *Quran* and the teachings of Muhammad establish the contractual nature of a marriage. Both primary sources emphasise the necessity of dowry (*mahr*) as a gift to the lady upon marriage (*nikah*). Muhammad repeatedly advised that dowry must be extended and a wedding feast (*walima*) prepared. Neither the dowry nor the feast need be extravagant or lavish – every man is to prepare and present what his capacity can afford. This corresponds with the fact that in a contract, consideration need not to be adequate; it need only be

sufficient, as per English common law.[6] The description of *mahr* as a 'gift'[7] as opposed to contractual consideration is interesting to note because it is in consonance with the distinction between social contracts that cannot elicit consideration *as of right* and commercial contracts that can. The same distinction exists under the common law.[8]

In direct reference to *riba*, the *Quran* expressly distinguishes between commercial and non-commercial transactions for purposes of application of the *riba* principle.[9] Commercial transactions are *prima facie* deemed to be bargains of mutual consent between the parties with an intention to be bound and thus contracts eligible to claim consideration/gain *because* of this presumed equitable nature. Non-commercial transactions, on the other hand, are *prima facie* ineligible to stipulate consideration (though consideration may gratuitously be extended by the promisee) not because they are inequitable but because of their potential to result in inequity given the transaction is either not conducted at arm's length or is lacking in mutual consent as a result of a social need. Any claim for or receipt of consideration/gain in a non-commercial transaction renders it potentially inequitable and thus voidable. Thus, it is the claim for consideration/gain in non-commercial transactions that the *Quran* describes as *riba*[10] and all such *riba*-tainted transaction are rendered 'defective'[11] (not void) and may be cured of the vitiating effect by altering its nature to 'commercial'.[12]

Evidently, the understanding expressed above is in contrast to the current understanding of *riba* as interest or any increased returns on loans/credit extended. Islamic commercial banking and finance demonstrates, in practice, the non-viability of defining *riba* as interest and of prohibiting the charge of an increased return for financial and debt transactions especially given the acknowledged cost of finance and the risks undertaken by the lender.[13] This reality is manifested in the prevailing practices of the Islamic finance industry which, whilst compelled not to charge interest explicitly, elicit 'profit margins' and 'fees' of various kinds and amounts under the guise of 'profit-sharing', 'service fees' or 'rent'.

In recognition of the apparent contradiction between the theory, as currently interpreted, and commercial practice, El-Diwany[14] (broadly) advocates for the return to the gold and silver standard of money (these being the original media of exchange and only true measures of value) so as to guard against the proliferation of *riba* transactions. He presents a proposal for an Islamic banking and financial system based on no interest to be conducted solely via contracts of exchange and investment. Thus, according to El-Diwany, riba *is* interest. He justifies the equation of *riba* to interest on the basis that Islam discourages the mere transfer of wealth[15] (i.e. loans) for a gain

and encourages instead the creation of wealth[16] through trade and exchange (e.g. the investment or use of £50 to create £51 and more). His position is not peculiar and is predicated on the traditional and seldom questioned definition and scope of the term *riba* as any increased return on money lent whatever the loan's nature or purpose, which in turn implies a theoretical preference of equity over debt finance. Suffice it to say now that El-Diwany's characterisation of money lending as involving the mere transfer of wealth is inaccurate because whilst Islam may discourage the mere transfer of wealth at an increase (i.e. consideration *demanded* for no bargain), money lending is not purely a transfer of wealth process. Loans create value through the provision of credit and financing commercial endeavours, both being vital to the functioning of any robust economy, including Muslim economies. Loans also involve undertaking a risk of default, inflation, devaluation, loss of liquidity, incurring the costs of capital adequacy and the opportunity cost of lending it to debtors toward which Islam is not inequitable as to deny the lender due compensation[17]. Given money lending took place in both the pre- and post-Islam Arabia, the prohibition of *riba* could not have intended to discourage money lending, for reports have it that prominent companions[18] of the Prophet were well-known moneylenders. If indeed money lending was similar to the mere transfer of wealth, and Islam discourages such transfer of wealth, it follows that Islam would have discouraged money lending. Islam does not. The *Quran* merely prohibited the practice of *riba* – which, as this chapter will show, is neither defined nor limited to the *form* a transaction takes (money lending) or to increased returns (charging interest or receiving gains from loans). *Riba*, as is discussed in this chapter, is any illicitly or inequitably elicited gain – the fundamental distinction between a valid and invalid contract.

Further, it is a well-accepted fact that it takes money to create money, therefore, just as one would invest in a business so as to earn profit, so may one borrow money to trade, invest, or otherwise employ the money borrowed towards earning a profit. Money lending for commercial purposes is part and parcel of the wealth creation process as is any business or commercial investment undertaking. El-Diwany's 'transfer v creation of wealth' theory, therefore, cannot be the operational factor behind the prohibition of *riba*.

It is in light of the above backdrop that this chapter undertakes an analysis of the concept of *riba* with the aim of reconciling the apparent conflict between the principle of *riba* and the rule prohibiting interest so as to clarify the effect of *riba* in structuring sharia compliant securitisations.[19] In summary, an analysis beyond the literal interpretation of the textual wording prohibiting *riba* reveals the following possibilities:

- That *riba* is not so much a matter of interest on loans (*dayn*) than it is a matter of distinguishing unlawful gain[20] from legitimate gain especially because the *Quran* does not use *riba* in reference to loans but in reference to the unjustified (illegitimately or illicitly) taking of others' wealth, generally.[21]
- The *Quran*'s distinction between *bay'* and *riba* implies a distinction between a legitimate and non-legitimate transactions for purposes of drawing consideration or profit making. *Riba*, generally, pertains to the prohibition against eliciting illegitimate gains in any transaction,[22] whether they be debt, sale, lease or a combination thereof in nature. Such transactions lack the element of mutuality or that of being a bargain.[23]
- The no-gain rule of *riba* is only one limb of the *riba* principle. This limb of the rule discourages the *elicitation or receipt* of increased returns in non-commercial transactions and encourages, instead, being charitable and generous in one's dealings with others in the non-commercial context.
- The zero-gain principle does not apply to commercial transactions; in commercial transaction it is universal fact that consideration may be drawn/profit made. Instead, the *riba* principle applies to commercial transactions indirectly through the rule that, all transactions must be equitable/bargains. This is the second limb of the *riba* principle.
- Commercial transactions encompass commercial credit, which include loan, sale and lease finance.[24]
- Loans, being commercial transactions, are eligible to draw a benefit from the transaction just as any other commercial transaction but subject to application of the second limb of *riba*.[25] This means increased returns may be charged on commercial loans as consideration as long as the transaction is equitable.

The rest of this chapter considers and substantiates the above set out premise.

5.1 *Riba* redefined

The Quranic verses on *riba* are categorical in their discouragement of the practice of *riba* and in their admonition of those who engage in *riba* practices (both the giver and recipient). The primary sources, however, do not define what *riba* is. The commentary number 324 to verse Al-Baqara: 275 of the *Quran*, by Abdullah Yusuf Ali reveals as much:

> *Riba* is condemned and prohibited in the strongest possible terms. There can be no question about the prohibition. When we come to the

> definition of *riba* there is room for difference of opinion. 'Umar Ibn Khattab,[26] according to Ibn Kathir, felt some difficulty in the matter, as the Apostle left this world before the details of the question were settled. This was one of the three questions on which he wished he had more light from the Prophet.

The definitions that exist in Islamic scholarship are merely a matter of deduction and independent reasoning by individual scholars. It is this *what* of *riba* that is examined and redefined here. In doing so I refer to the primary sources of the *riba* principle and am inspired by the observation made by Ibn al-Qayyim, 'There is nothing prohibited except that which God prohibits … To declare something permitted prohibited is like declaring something prohibited permitted'.[27]

The most oft-quoted verse in the *Quran* on *riba* states, in Baqara: 275, that:

> Those who eat *riba* shall rise up before Allah like men whom Satan has demented by his touch, for they claim that *bay'* (sale) is like *riba*; and Allah has permitted sale and prohibited *riba*.

The verse implies a pertinent distinction exists between *bay'* and *riba*. The obvious question, therefore, is: what *is* the difference between *bay'* and *riba*? The Arabic term *al-bay'* literally means 'the sale'[28] denoting the contract of sale. Technically, *al-bay'* denotes the concept of trade or commerce (producing profit for one party and contractual benefit for the other). *Riba*, on the other hand, literally means increase or multiplication and has come to be interpreted, narrowly, as stipulated increase on loans. Narrowly is used here because there is nothing in the Quranic or in Muhammad's usage that limits the term *riba* to 'increase in loan repayments'. In fact, the above meanings of both *al-bay'* and *riba* prove inadequate by the very standards of the *Quran*.

Bay', as used in the *Quran*, does not simply mean sale or even trade in the limited sense of buying and selling or commerce, rather it denotes any 'trade of life', that is, any lawful profession or commercial endeavour. This meaning is explicit in the *Quran*, in *al-Jum'a*: 9–10, which says:

> O you who believe! When the call is proclaimed for the prayer on the day of *Jumaa'* (Friday) come to the remembrance of Allah and leave off trade (*bay'*). That is preferable for you if you did but know! Then when the prayer is finished, you may disperse through the land, and

> seek the Bounty of Allah, and remember Allah much that you may be successful.

If *bay'* simply meant sale, or trade in the literal sense of buying and selling or business, the only people addressed by this verse to set aside 'business' and attend Friday prayer would be trade and businesspeople (literally). Yet, it is accepted fact that Friday congregational prayer has been decreed, in this verse, for all men whatever their profession, occupation or status. In this sense, bay is extended not only to business trading but, generically, to cover all and any lawful engagement or commercial endeavour within which banking and finance validly falls. The *Quran* in *al-Jum'a*:10 confirms this conclusion by asking the very same people it addresses to leave their *bay'* and come to prayer, to thereafter disperse and 'seek of the bounty of Allah'. If *bay'* strictly meant trade for profit then the latter verse would have asked the people it had earlier asked to leave their 'trade' to return, specifically, to their *bay'* in the limited 'trade' sense. The word the *Quran* uses to signify trade (in the strict buying and selling sense) is *tijara*.[29] For instance: 'O ye who believe! Eat not up your property among yourselves in vanity: But let there be amongst you trade (*tijara*) by mutual consent: Nor destroy yourselves: for verily Allah hath been to you, Merciful!'[30]

The meaning of *riba* is also best understood by referring directly to its use in the *Quran*. Its designated literal meaning – increase or multiplication – is demonstrated in *al-Rum*: 39, is the first verse to be revealed on *riba* and it states:

> That which ye lay out for increase (*riba*) through the property of (other) people, has no increase (*riba*) with Allah, but that which ye lay out for charity (*zakat*), seeking the Countenance of Allah, it is these who will get a recompense multiplied.

In essence, this verse on *riba* discourages the seeking of worldly gains from others (through one's property) and encourages instead the seeking of spiritual gains from Allah though the extension of charity to others.

Consequently, several questions arise from the above verses.

1 If Islam is not against growth, increase or multiplication of wealth and *riba* literally means growth or increase, what does *riba* pertain to that it should be so vehemently prohibited?
2 What does the *Quran* imply by contrasting *riba* to charity, on the one hand, and by distinguishing *riba* from *al-bay'* (commerce), on the other?

Given that there are many more precise words denoting charging or stipulating an increase on loans, why does Allah use the words *akl*[31] (consume/devour) or *akhdh*[32] (taking) in relation to *riba*? Is it merely coincidental that both words, *akl* and *akhdh* denote non-consensual taking/devouring of others' property and have no commercial or contractual connotation?
3 If Allah intended *riba* to mean, specifically, interest charged on loans why is that not clearly stated or any mention of loans made in any of the verses pertaining to *riba*?
4 Does commercial lending and finance fall within the concept of *al-bay'* and is, therefore, according to the *Quran*, distinct from *riba*?
5 What distinguishes commercial from non-commercial transactions for purposes of legitimising any gain made or consideration drawn?

These questions are answered in what follows.

5.1.1 **Riba** ***according to the*** **Quran**

A careful and contextualised read of the Quranic verses mentioning *riba* indicates that the word (*riba*) is used repeatedly to encourage people to cease their obsession with increase sought in material wealth (of others) and seek, instead, to spend in the cause of God (through charity). This is, as we considered above, demonstrated clearly in the first verse revealed on *riba* in *Quran*, *al-Rum*: 39 which states:

> That which ye lay out for increase (*riba*) through the property of (other) people, has no increase (*riba*) with Allah, but that which ye lay out for charity (*zakat*), seeking the Countenance of Allah, it is these who will get a recompense multiplied.

Evidently, the verse contrasts *riba* with charity; one seeking monetary returns, the other seeking not monetary returns but recompense through the pleasure of Allah. No indication is made of loans and increased returns on loans and therefore an objective contextualised reading of the verse (in light of the context of society before and during Muhammad's time) defies the association or restriction of *riba* to increased returns on loans.

The second verse that was revealed on *riba* was *al-Nisa*: 161, which recalls the inequitable practices of Bani Israel (the people of Israel):

> And their taking of riba though they were forbidden it and their devouring people's property wrongfully. And we prepared for those among them who deny (the Truth) a grievous punishment.

This verse is claimed by some Muslims to infer that *riba* means an increased return on loans as was the practice among Jews. There is nothing, however, both in the text of the *Quran* and in the explanations of Muhammad (or his trusted companions) that substantiates this claim. Indeed, if the inference was correct, Umar, a very close companion of Muhammad and the second caliph, a mere three years after Muhammad's demise, would not have been so distraught and confused as to the meaning and application of *riba*, as pointed out in section 5.1.

The third verse on *riba*, *al-Imran*: 130, states:

> O you who Believe! Do not consume *riba*, double and multiplied, and be conscious of God that you may prosper.

Again, this verse, by the use of 'double and multiplied' has been taken to imply the custom prevalent among Jews and Arab moneylenders to charge compounding interest at (often) exorbitant rates. Nonetheless, we have emphasised that the verses are themselves not specific about the form of practice *riba* embodies. The verse(s) simply set out the principle against unjust taking ('consuming') of people's wealth or property in a non-commercial, non-consensual manner.

This brings us to the most oft-quoted set of verses revealed on *riba*. The profound sense one gets from a study of these verses is that the prohibition is a spiritual admonition pertaining to the taking, eating or devouring of another's/others' wealth without mutual consent. To this, the protesting retort was, such *Riba* (increase/gain) taken is like that acquired through *bay'* (trade)! In response, the *Quran* in *al-Baqara*: 275 provided, 'Those who consume riba will not stand except as one whom Satan has, by his touch, driven to madness. That is because they say: "*bay'* (trade) is like *riba*" but Allah hath permitted *bay* and forbidden *riba*'.

The *Quran*, therefore, clarifies that the spiritual admonition to relent on seeking material gains and the encouragement to seek spending freely in the cause of Allah, is qualified by allowing (indeed encouraging) the acquisition of gain/profit through (consensual) commercial engagement and exchanges. For completeness of the contrast the verses provide, I quote below all the relevant verses pertaining to the concept of *riba* in the *al-Baqara* chapter (272–281). Notice, in particular, the contrast between verses 274 and 275.

> 272. It is not you (O Messenger), to set them on the right path, but Allah sets on the right path whom He pleases. Whatever of good ye give benefits your own souls, and ye do not spend except seeking the

'Face' of Allah. Whatever good ye give, shall be rendered back to you, and ye shall not be dealt with unjustly.

273. (Charity is) for those in need, who, in Allah's cause are restricted (from travel), and cannot move about in the land, seeking (For trade or work): the ignorant man thinks, because of their modesty, that they are free from want. Thou shalt know them by their (Unfailing) mark: They beg not importunately from all and sundry. And whatever of good ye give, be assured Allah knoweth it well.

274. Those who (in charity) spend of their goods by night and by day, in secret and in public, have their reward with their Lord: on them shall be no fear, nor shall they grieve.

275. Those who eat *riba* will not stand except as stand one whom the Evil one by his touch hath driven to madness. That is because they say: '*bay*' is like *riba*', but Allah hath permitted trade and forbidden *riba*. Those who, after receiving direction from their Lord, desist, shall be pardoned for the past; their case is for Allah (to judge); but those who persist are companions of the Fire: They will abide therein (for ever).

276. Allah will deprive *riba* of all blessing, but will give increase for deeds of charity: For He loveth not creatures ungrateful and wicked.

277. Those who believe, and do deeds of righteousness, and establish regular prayers and regular charity, will have their reward with their Lord: on them shall be no fear, nor shall they grieve.

278. O ye who believe! Fear Allah, and give up what remains of your demand for *riba*, if ye are indeed believers.

279. If ye do it not, take notice of war from Allah and His Messenger. But if ye turn back, ye shall have your capital sums: Deal not unjustly, and ye shall not be dealt with unjustly.

280. If one is in difficulty (financially), grant him time till it is easy for him to repay. But if ye remit it by way of charity, that is best for you if ye only knew.

281. And fear the Day when ye shall be brought back to Allah. Then shall every soul be paid what it earned, and none shall be dealt with unjustly.

The next verse[33] deals in great detail with future credit obligations (*dayn*) and simply encourages that they be written and witnessed in a manner resembling a common law deed (that dispenses with the need for consideration). It explains in great detail the manner and evidential procedure such contracts for future obligations should comply with so as to prevent *riba* in the transaction.

We have already noted that, collectively, the Quranic verses on *riba* draw a distinction between commerce and *riba* on the one hand, and between charity (or *zakat*) and *riba*, on the other. In answer to question (2), therefore, this implies a similarity between charity and commerce. Charity implies giving and is the opposite of *riba* which is expressly described as 'taking others' wealth/substance'. Extended, in like fashion, to the contrast between commercial sale (*bay'*) and *riba*, *bay'* involves the exchange or giving of mutual benefit between contracting parties while *Riba* involves the taking or deriving of benefit from another without mutual consent.

Why, then, does the *Quran* use the term 'taking' in regard to *riba* practices in contrast to giving on the one hand and in contrast to trade (*bay'*) on the other? Taking indicates lack of consent or compulsion in acquiring something from another. Taking (*akhdh*), as used in the *Quran*, implies indirect thieving. Giving, on the other hand, indicates consent or a willingness of the giver and the exercise of choice in acceptance on the part of the recipient. Consent and choice are an integral part of contractual transactions, the two elements that legitimise the making of profit/gain. The lack of consent or compulsion thus deems any gain made illegitimate, be it under Islamic law or the English common law. One appreciates, therefore, that the *riba* prohibition pertains to the non-consensual or compelled taking from another/others.

Consistent with this line of thought is also the understanding that the sayings of the Prophet describe transactions that, then, were deemed the practice of *riba*. *Riba* is not today limited to those transactions depicted in the traditions of Muhammad; it is a much broader concept that was simply exemplified (then) by those *forms* of (inequitable/inefficient) transactions. *Riba* transactions today may validly take different forms from those of the barter transactions of seventh-century Arabia.

As for question (3), that is, if the intention was simply to prohibit any stipulated increase on loans, as many claim today, why is it that the *Quran* simply mentions *riba* with reference to future/credit obligations generally and even then, the risk of *riba* arising in such credit transactions is obviated by the direction to reduce the transaction to writing and take two witnesses thereto. Similarly, the sayings of Muhammad, which were always intended to clarify and explain the text of the *Quran*, indicate that *riba* has nothing particular to do with the act of lending because all explanations of *riba*'s application in Muhammad's sayings pertain to commercial-like exchanges with no reference to loans. Given the tone and intensity of the verses on *riba*, the *Quran* and the prophetic sayings would certainly have been clearer and more precise had the prohibition been one intended to pertain strictly to an *increase* charged on *loans*.[34] No such indication exists.

5.1.2 **Riba** *according to Muhammad*

Riba in the sayings of Muhammad fall under two categories: *riba al fadl* and *riba al nasia*.

The first category, *Riba al fadl*, has been translated by many as *riba* of increase, but given *riba* literally means increase, it does not make much sense. I prefer to use *riba* of excess.[35] It is derived from the saying (I) of Muhammad:

> Gold is to be paid for by gold, silver by silver, wheat by wheat, barley by barley, dates by dates, and salt by salt – like for like, equal for equal, payment being made on the spot. If the species differ, sell as you wish provided payment is made on the spot.[36]

Traditionally, this saying has been interpreted and applied as not only requiring equanimity in all homogenous exchanges but also prohibiting any increase arising from an exchange of money based on gold and silver being equated to money. The likening of gold and silver to money is dealt with in chapter 6 so suffice it to say here that money at Muhammad's time was in the currency form of dirhams and dinars, not in gold and silver as distinct and freely tradable commodities in their own right. Any tradition of that time speaks of money in terms of these two currencies, not in terms of gold and silver yet the saying (I) speaks specifically of gold and silver not of the currency forms.

A critical reading of the saying indicates that Muhammad was simply stipulating the requirement of equanimity in homogenous exchanges as underscored by the proviso, 'If the species differ, *sell* as you wish provided *payment* is made on the spot' (emphasis added). It is easy to appreciate that the uniformity required in the subject matter being exchanged (weight, measure and quality) and execution on spot basis,[37] was necessary to ensure (in that context) that equity was upheld between the exchanging parties and perhaps to encourage a money market economy given there would be no commercial advantage to be gained out of such exchanges. This is not surprising given the entire social fabric of Islam as a religion and way of life is woven upon the notion of justice and social welfare. One was, therefore, exempt from the above stipulated requirements if an item was exchanged for money which is then used to buy any other item, at a price agreed to between the parties, as explained in the following saying (II) of Muhammad:[38]

> Abu Said Al-Kudriy narrated that Bilal brought to the prophet some high quality dates and when the prophet asked him how the dates had

> been obtained, Bilal replied, 'I had some inferior dates so I sold two *sas* for one *sa*'.[39] On this the prophet said, 'Ah, the very essence of *riba*, the very essence of *riba*. Do not do so, but if you wish to buy, sell your dates in a separate transaction, then buy with the proceeds.'

Is the 'essence' Muhammad speaks of the barter (form) or the potential for inequity that arises from it? It cannot be the barter form of exchange because Muhammad does not prohibit bartering. Muhammad simply requires equanimity in the bartering of items. Bilal was free to buy and sell dates as he wished if he did so for cash. Saying (II), thus, affirms the fact that *riba* has little to do with form or loans particularly because whilst the transaction itself is one describable as 'trade' and (otherwise) lawful, Muhammad describes it as 'the very essence of *riba*'. It also indicates that Muhammad endorsed and encouraged the use of a market economy as far back as sixth century ad. Market transactions are deemed equitable in result as a consequence of the market forces of supply and demand coupled by the free consent of the parties that makes the transaction a bargain entitled to elicit consideration.[40]

It is apparent therefore that *riba al fadl* has little to do with everyday commercial loans and much to do with the encouragement towards engaging in equitable and efficient commercial transaction which the saying (I) of Muhammad exemplifies through an exchange of like for like, equal for equal or (alternatively) selling the commodity for cash at the best market price and thereafter buying (with the cash) any other commodity at market price. Note also that the sayings do not stipulate a 'fair' price or specific price at which the buying and selling ought to take place, and leaves such price to be determined by the parties in implied recognition of the inherent equity in mutual consent and the market forces of supply and demand/competition.

The meaning and implication of sayings (I) and (II) above may be better understood in light of their context: a barter economy. Oditah notes that, '[i]n a barter economy there may be no need for credit since goods, services, and facilities will be exchanged immediately for the bargained consideration. Such an economy necessarily assumes that performance and counter performance of contractual obligations will be simultaneous'.[41] A barter transaction is thus universally acknowledged not to involve credit and Muhammad's saying (I) merely states the obvious regarding the requirement of spot payment. It is the emphasis on 'like for like, equal for equal' that strikes at the heart of ensuring equitable exchanges in light of possible unequal bargaining power or lack of objective means of determining fairness of bartered items and measures. The saying was not intended to prohibit

credit transactions or increased returns in credit transactions – both of which Islam expressly permits, as we shall see below.

Riba al nasia, is the second category of *riba* and literally means *riba* of delay.[42] Technically, it has been interpreted as an increased charge that is elicited as a consequence of time extension for the repayment of a loan. Muslim scholars stress, therefore, that the prohibition of *riba* is not to be limited[43] to usury practiced in the pre-Muhammad societies (*Riba al jahiliyya*[44]) as illustrated in the *Quran*, *Ali-Imran*: 130: 'O you who believe, do not devour *riba*, double and redoubled, that you may prosper'. Rather, that *riba* pertains to all money lending transactions. Accordingly, *riba* entails a prohibition of usury, compound interest as well as any increased returns on money lent.

The prohibition against *riba al nasia* is also derived from the same saying (I) referred to above, that is, 'gold is to be paid for by gold … like for like, equal for equal, payment being made on the spot'. However, greater credence is given to another saying of Muhammad (III) that is frequently referred to: 'Every loan that attracts a benefit is *riba*'.[45] Though the authenticity of this saying is much in doubt, the ruling it implies is referred to by scholars as deriving from the saying (I) which they deem to be sufficient basis to grant them reliance on it. Consequently, Muslim scholars in the past have used this saying to justify the prohibition of any interest or increase charged on loans.

5.2 The principle behind *riba* and its implications for Islamic finance

Ibn Rushd's central economic analysis of Muhammad's saying (I) pertaining to barter exchanges of the six specified commodities (which Ibn Rushd extended to all fungible commodities) hints at the principle behind *riba*. He says:

> It is thus apparent from the law that what is targeted by the prohibition of *riba* is the excessive inequity it entails. In this regard, equity in certain transactions is achieved through equality … thus, equity may be ensured through proportionality of value for goods that are not measured by weight and volume … As for fungible goods measured by volume or weight, equity requires equality, since they are relatively homogeneous and have similar benefits … justice in this case is achieved by equating volume or weight, since the benefits are very similar.[46]

Therefore, defined in light of the context in which the ruling was revealed,[47] the saying of Muhammad on *riba al fadl* (excess) points to an

underlying principle of equity and efficiency requiring a bargain made by mutual consent – the most efficient means of ensuring which is to sell one's item/s for money at market price. The principle of *riba* thus applies at two distinct levels:

1 Distinguishing market (commercial) transactions from non-market transactions, permitting the derivation of gain from the former and prohibiting gain from the latter;
2 In non-market transactions to prevent inequity in transactions by requiring that all contracts of homogenous exchange be conducted on like for like basis and, otherwise, for equal return at no benefit or consideration as of right.

It is crucial to note that in his saying (I), Muhammad did not disapprove of the gain made in the exchange of dates, but merely of the fact that superior dates were exchanged for inferior dates without (impliedly) an objective yardstick or regulating mechanism in place to ensure an equitable exchange. Muhammad expressed a preference for a sale of the dates at the best possible market price followed by the procuring of superior dates with the monetary proceeds thereof, this being the most equitable and efficient means to attain the (same) intended outcome.

The measurability of the items exchanged, which have no inherent or objective market value, and the absence of market forces regulation (demand and supply) seems to be the concern at the root of what Muhammad describes as 'the very essence of *riba*' in the specific context Muhammad was faced with.

The ensuing implications of this conclusion for Islamic finance are impressive on several levels. First, it negates the general theory that Islam prohibits interest on loans – money lending is a commercial transaction entailing an exchange in counter values and for which due consideration must be extended to the financier. Second, equity and efficiency in debt markets are satisfied through market competition and market regulation mechanisms. This is directly derived from Muhammad's saying (II) on dates.

Along the same vein, El-Gamal concludes that the twin objectives of equity and efficiency thus necessitate a marking-to-market approach in establishing trading ratios.[48] Accordingly, he points out that conventional finance plays a very important role for Islamic finance by determining the market interest rates for various borrowers based on credit worthiness and security provisions; that benchmarking the implicit interest rates in Islamic credit sales and lease-to-purchase transactions to conventional interest rates are, thus, quite appropriate.[49]

It has even been suggested that Islamic banks are well advised to abandon characterising their mark up in credit sales as 'profit' and list them as interest.[50] Why? Because the extent of 'profit' is potentially limitless whilst interest is capped by various contemporary anti-usury laws (in the US) and credit regulatory framework (in the UK) that protect those in need of credit against predatory lenders or otherwise illegitimate stipulations of gains on transactions. These conclusions negate any distinction between Islamic finance and conventional finance that the industry has strived to establish for arbitrage purposes.

5.2.1 **Riba:** ***the what or the how?***

The form *riba* takes was never meant to be defined or carved in stone because, as an understanding of the primary sources' text on *riba* reveals (see 5.1.1 and 5.1.2), *riba* is a public policy rule that presumes the legitimacy of gain making in commercial transactions and the inverse in non-commercial cases. The effect of such a presumption is that *riba* can render an otherwise valid commercial contract, deriving gain, invalid if such a transaction is inequitable. This is verified through Muhammad's saying (II). Unfortunately, as far back as recorded Islamic history takes us, Muslims have strived, out of their misunderstanding of the concept and principle behind *riba*, to define and confine it to certain forms and practices. The purpose of this was, of course, to make life and commerce easier for the merchant since what was once a broad-based public policy principle was pinned down to certain practices and eventually to *one* specific practice (lending money) that relieved people of the moral obligation to conduct themselves equitably in all commercial and personal interactions with others. *Riba* eventually became the *what* not the *how* and, with time, so narrow was the principle's ambit reduced and so devoid in substance that the very purpose it was intended to serve was neglected if not violated. This is the reality of the current definition and application of *riba*.

It is noted, however, that a clear understanding of the relevant text in the primary sources indicates that the distinction drawn between trade and *riba* (despite claims of their apparent similarity) distinguishes *riba* as inequitable practices or transactions *resembling* commercial transactions in *form* yet lacking the *substance* of an equitable commercial transaction. The illegitimate (*riba*) transaction is distinguishable from the legitimate (trade/commerce) through the *effect*, that is, to question if the transaction is equitable.[51] This deduction follows directly from the fact that the *Quran* does not say Allah permits *profit* and prohibits *riba* – it says Allah permits *trade* and prohibits *riba*. The contrasting of *trade* with *riba* (a negation

of the comparison of *trade* to *riba*) is a clear indication that *riba* is any transaction much like trade in *form* but, in fact, different in *substance* and *effect*.

We, therefore, can deduce that, in the context of the *Quran*, *riba* is to commercial transactions what extramarital sex is to marital sex. The operational factor distinguishing the prohibited from the permitted lies not in form but rather in the context and substance of the action engaged in. *Riba* is any inequitable transaction – or one that is prone to inequity – in contrast to equitable transactions described as 'trade'. The benefit from *riba* transactions, in contrast to the benefit arising from commercial transactions, is thus akin to an illegitimate child born out of wedlock, in contrast to a child born from marriage. The prohibition against extra-marital sex (*zina*) is certainly not a prohibition against sexual intercourse or procreation in exactly the same fashion that the prohibition against *riba* is a not prohibition against deriving benefit or gain. This is the distinction the text of the *Quran* in *al-Baqara*: 275 alludes to. Further, *al-Baqara*: 276 states that Allah extinguishes *riba* and nurtures (causes to increase) acts of charity. If *riba* was interest, the translated text of the verse would read, 'Allah extinguishes interest' which makes little sense. *Al-Baqara*: 276 is better read as 'Allah extinguishes illegitimate gains and nurtures acts of charity'.

The significance of this distinction cannot be overstated, for just as profit/gain is the result of legitimate commercial engagements, devouring others wealth unjustly was the result of *riba* engagements. The mislaid equation of interest to *riba* arises from not paying attention to the above drawn distinction and, seen in this fresh light, the distinction has grave implication for the sharia arbitrage practices of Islamic finance today that resemble sale and lease transactions but are really guises for debt financing that consequently escape the more stringent debt regulatory compliance requirements and are effectively less equitable (and less economically efficient) compared to conventional finance transactions. In any case, though still prevalent, sharia arbitrage transactions that mimic conventional finance with few synthetic changes to ensure 'sharia compliance', like the *Murabaha*[52] (or *tawarruq*[53]) transactions, are gradually being denounced by Muslims.[54]

5.2.2 Principles of Islamic law on matters of commerce vis-à-vis rituals

It is useful to remember that earlier Muslim scholars and jurists sought equity and efficiency in commercial and social matters by adopting Roman or other legal forms much like Muhammad did by adopting the

practices of the Jewish and Christian communities around him. It is only several centuries after the demise of Muhammad that jurists began feeling obliged to work under the heavy burden of 'sacred' history and the unreasonable admiration of the presumed timeless 'wisdom' of their predecessors.[55] It is this book's proposal that, as Al-Misri suggests, all distinctions pertaining to whether stipulated increases are termed 'fee' or interest and whether finance transactions are structured as loans or 'sale and buy back' be secondary to the primary concern of whether the transaction is equitable and efficient. The works of El-Gamal,[56] Dr Saleem,[57] and Abdul Ghafoor[58] all point toward this conclusion but stop short of its explicit expression. El-Gamal, apologetically concedes after rigorous analysis that adherence to religion has, historically, been ensured through adherence to forms, equally in the area of ritual and transaction. However, Islam is much more than a religion with set rules to follow. Islam is a way of life (*din*). This way of life has several spheres, ritual worship being only one sphere because, in essence, all of life is worship and thus all of life must be lived embodying the spirit of Islam. The domain of ritual worship in Islam has always required a degree of adherence to set forms that ensure a measure of continuity of practice through time. Outside the domain of ritual worship, human action was, and remains, entirely free of set forms and is governed by our free will and individual accountability yet regulated by customary practices and legal principles very similar to the (democratic ideal of) individual liberties counterbalanced by political governance and social justice. The principles governing the two distinct domains are best summarised by the prominent Maliki jurist, Ibn Taymiyya:[59]

> The acts and deeds of individuals are of two types: *ibadat* (devotional acts) whereby their religiousness is improved and *'adat* (transactions) which they need in their worldly matters. An inductive survey of sources of the sharia establishes that devotional acts are sanctioned by express injunctions of the sharia. Thus what is not commanded cannot be made obligatory. As for transactions, the principles governing them would be permissibility and absence of prohibition. So nothing can be prohibited unless it is proscribed by Allah and His messenger.

Therefore, adherence in the domain of commercial/non-ritual matters is more a matter of upholding the spirit and essence of Islam (justice and social welfare) because neither the *Quran* nor the Prophet laid down set forms or detailed laws (of transactions or actions). The primary sources hint at

the intended socio-economic outcome to be attained, but do not mention the prescribed form to be adhered to. We have chained, out of our own doing, ourselves to the forms we created and insist on adhering to them. Religious canon has no part in such insistence. Indeed, for a spirituality founded on the very basis of forbidding an attachment to forms (to prevent the mischief of idolatry) it is only natural that Islam would require the same (detachment to form) in every other facet of life. The Islamic finance industry and jurisdictions will not hear of this because it pulls the rug from under their feet and denies them the sharia arbitrage opportunities derived from the distinctions they have established between 'Islamic' and conventional finance. Ultimately, however, the charade must end sometime and it is herein shown using the *Quran*, prophetic traditions, scholastic reasoning and Islamic economic writings of recent past and present times that it is not interest that Islam prohibits, rather it is inequity and inefficiency that is the target of the prohibition. We see that interest and marking to market can, in fact, be means of ensuring equity and efficiency in the financial market much like the Prophet's advice to sell at the highest price possible and buy at the lowest price possible was at his time. From this vantage point, the future for Islamic finance is as wide and as indeterminable as we choose to create it. By implication, the complexity of structures that have inhibited the take-off of any genuine sharia compliant securitisation to date, or any other financial structure for that matter, need no longer persist to be so. If the question then posed is on how are we, now, to ensure equity and efficiency, the answer is replete in the established market and customary practices prevalent today. It will be recalled that the Prophet freely adopted the practices of the Christians and the Jews of his time to fill in any lacunae that the *Quran* was silent on or not in direct conflict with. Likewise, it is open to us today, as it was open to the jurists who adopted from the Roman and other more advanced civilisations of their time, to adopt practices, institutions and laws that serve the spirit of Islam.

It will be remembered that the *Quran* is a text of guidance not only to a given people, but to the entirety of Humanity – it does not distinguish a people from another and speaks readily to all those who believe regardless of their religion or creed. In fact, there is nothing like 'Islamic' finance. There is only *one* finance because the contractual principles indicated in the *Quran* and the authentic sayings of Muhammad, are the very same that underpin the common law contractual and commercial framework. This is demonstrated herein by establishing that every concept discussed under Islamic finance throughout the ages exists today in a more complex, advanced and refined form under the common law. The rationale behind such principles

of Islamic finance, thus, can be served better and more comprehensively under the common law. Likewise, in matters of debt finance, we need not bother with any demarcation between 'Islamic' and conventional for the twin objectives of equity and efficiency are nowhere better served and catered for today than under the common law. The objection may be raised that the common law is not perfect; it has its flaws. The response to that is, certainly, no human system is or can be perfect. The beauty of the common law, as Islamic law, however, is that it possesses an efficient and balanced mechanism dedicated to the constant review and improvement of its laws, regulations and processes, a discussion of which is beyond the scope of this book. The point being that if something is wrong with the system, why not fix it instead of trying to build an entirely new system just for purposes of distinction, yet remaining effectively more inefficient and inequitable. That is akin to setting out to reinvent the wheel just because one does not deem it 'Islamic'. The wiser option is to perfect the existing wheel in accordance with the universal principles of Islam hence attaining one's goal faster. In the latter option, one finds equity and efficiency of outcome and in the former, unnecessary hardship and inefficiency afflicted.

5.3 Social justice and implications of the redefinition for Islamic finance

The argument often put forward against interest in commercial lending is that the prohibition of *riba* pertains to the making of money out of money without effort or counter value in exchange. Others argue that making money out of money is prohibited regardless of the value it brings or adds. This indicates a misunderstanding of both *riba* and commercial banking on two levels:

- Commercial endeavour of banks and financial institutions is evidenced in the setting up and rendering services of credit provision to those who choose to borrow complete with premises, professional advisors, managers, machinery and secure safekeeping for money kept available for additional borrowing. What difference, if at all, is there between a bank offering money lending services and a realtor offering properties for rent? Or a car dealer offering a fleet of cars for hire? Is the effort not mainly in the start-up costs with a diminishing portion (over time) going toward the maintenance of the items to be lent, rented or hired? This is especially so in light of the discredited notion of loan-credit being likened to money and the acknowledgement of credit rights being proprietary, as is discussed in chapter 6.

- It is agreed that any contract (for goods or services) must be a mutually consented to bargain. This is a principle derived from the saying of Muhammad (II) pertaining to the barter of dates. In this regard, a money lending contract for an increased return is a mutually consented to bargain whereby the borrower gains credit to use for his own purposes (often) for profitable gain or an increased return whilst the lender gains the increased return on his money in compensation for the loss of liquidity and the risk of losing his principle (in case of default) in addition to suffering the twin effects of inflation and devaluation over time.

Nonetheless, the proposal that interest is not prohibited in commercial loans is still countered with the concern that the creditors will charge 'excessive' rates of returns that is prohibited by the *Quran* in *Ali-Imran*: 130 ' … devour not *riba* double and redoubled'. This concern is however allayed once one appreciates the counter intuitive notion that the characterisation of interest as 'excessive' makes little economic sense since the definition of excessive is subjective and is unlikely to materialise in the regulated financial context we exist in today.[60] Reality establishes that 'excessive' rates of interest are not the norm in commercial lending practice. If interest rates of a certain bank are excessive, one has the choice not to borrow money from that bank at such 'excessive' rates just as one has the choice not to choose to eat in an expensive restaurant. One cannot say that the charging of exorbitant prices for a cup of coffee and toast in a five star restaurant means that such a transaction is unlawful and the coffee and toast must be given to the customer for free. That is ludicrous. The transaction is like any other commercial transaction and one may choose to participate in it or not depending on his needs or means. The same goes for commercial loan transactions. The concern of 'excessive' interest rates, thus, is best dealt with through the very same element required in any transaction, that is, a mutually consented decision between the parties involved to strike a bargain. The parties are free to negotiate a rate that compensates the lender for the opportunity, cost of lending, inflation, devaluation and the risk of default as well as a reasonable gain for the bargain struck, and interest rate guidelines or benchmarks may be developed at a national or international level. Moreover, in line with Muhammad's recommendation, market forces of supply (of money) and demand (for credit) already acts as a natural regulatory mechanism that prevents the charging of exorbitant interest rates.

It is, in fact, the potential of unregulated Islamic banks that structure loans and finance in the form of sale and leases or buy-backs that is of