

AN OVERVIEW OF CONTRACT UNDER ISLAMIC LAW, ITS CLASSIFICATIONS AND GENERAL PRINCIPLES

**CERTIFICATE IN ISLAMIC LAW
(ISLAMIC BANKING & FINANCE)**

HARUN M. HASHIM LAW CENTRE

INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

Outline

- Introduction
- Meanings and definitions of contract
- General principles of contract
- Conclusion

INTRODUCTION

- Contract is one of the branches of Islamic law that regulates our daily activities and prevents us from involving in activities that *Shari'ah* prohibits.
- It is divided into various classifications that are based on various considerations.
- Its general principles should be observed to ensure that our daily activities are carried out accordingly.

MEANINGS AND DEFINITIONS OF CONTRACT

- Root word/verb
- Arabic term for contract is '*aqd*' that is derived from the verb '*aqada*' that means to tie, put together, join, combine, fix, conclude, form, engage and contract.
- Literal meaning
- Tying up, putting thing together, joining, agreement, contract and the likes.

Definition

- Generally, it means an agreement between 2 parties whereby the consequences of contract were intended to be legally enforceable.
- Technically, it may be defined as an obligation, linking offer and acceptance, resulting in legal effects on the subject matter of the contract.

- General definition

- “It is every act which is undertaken with sincerity and firm determination regardless whether it emerges from a unilateral intention/commitment such as *waqf* and *wasiyyah* or from a mutual agreement among the contracting parties such as sale and hire.”

- Specific definition

- “The conjunction of an offer emanating from one of the two contracting parties with the acceptance of the other in the manner that effects the subject matter of the contract.”
(‘Abdul Karim Zaydan)

Types

- Unilateral contract means a contract or promise made by one party only, also known as one-sided contract. Normally involves transactions which are gratuitous in nature. No consent is required from the recipient party. Eg contract of *hibah* (gift), *wasiyyah* (will), *waqf* (endowment) etc.
- Bilateral contract involves a contract or promise made by 2 parties, also known as two-sided contract – most Islamic commercial transactions. Eg contract of exchange (sale) (*al-mu'awadat / al-buyu'*), contract of partnership (*al-shirkah*), contract of security (*al-tawthiqat*) etc.

Comparison

Unilateral Contract	Bilateral Contract
-Effected by one person	- Effected by two parties
-Does not require consent of recipient	- Consent is necessary
-Conditions of the essential elements (arkan) are more relaxed	- Strict conditions of the essential elements (arkan)

Authorities

- Al-Maidah (5): 1:
“O ye who believe! Fulfill the obligation.”
- Each of the contracting parties must perform what he is obliged to do under the contract.

Cont.

- Al-Baqarah (2): 282:
- “O you who believe! When you deal with each other in transactions involving future obligations in a fixed period, reduce them to writing, let a scribe wrote down as between the parties”.
- The Shariah encourages that the contract be reduced into writing for purpose of clarity and easy reference, particularly in the case of disputes arising from the contract. The Islamic contract must be properly formed and recorded in the presence of witnesses to ensure its enforcement is in accordance with a valid contract.

Cont.

- “Muslims are bound by their conditions except a condition which allows what is prohibited or prohibits what is lawful.” (Meaning of the *hadith*)
- Basis of contract = Shariah
- The aim behind that is to preserve stability of transactions and dealings among people, and to teach them to respect and keep their commitments and obligations.

CLASSIFICATIONS OF CONTRACT

- Sale-based contracts (*'uqud al-buyu'*) that include sale (*al-bay'*), cost-plus sale/ mark-up sale (*bay' al-murabahah*), forward sale (*bay' al-salam*), manufacturing sale (*bay' al-istisna'*), sale with deferred payment (*al-bay' bithaman ajil*), sale of debt (*bay' al-dayn*), sale of currency (*bay' al-sarf*) and sale and buy back (*bay' al-'inah*).
- Leased-based contract (*'aqd al-ijarah*) that cover leasing and hire.

- Equity-based contracts (*'uqud al-sharikah*) that comprise of partnership (*al-sharikah*) and profit sharing (*al-mudarabah*).
- Security-based contracts (*'uqud al-tawthiqah*) that consist of guarantee (*al-kafalah*), transfer of debt (*al-hiwalah*) and mortgage (*al-rahn*).
- Safekeeping-based contract (*'aqd al-wadi'ah*).

GENERAL PRINCIPLES OF CONTRACT

- Permissibility is a general rule
- Contract must be based on mutual consent
- Contract must be free from any elements of *ikrah* (duress/coercion)
- Contract must be free from element of *riba*
- Contract must be free from *gharar* (uncertainty)
- Contract must be free from *tadlis/taghrir* (fraud), *ghalat* (mistake) and *ghabn* (deception)
- Contract must be free from prohibited commodities/activities

(i) Permissibility

- Everything that is not prohibited by the text i.e. *al-Qur'an* and *hadith* is considered lawful and permissible provided that it does not violate any established principles of the *Shari'ah* such as principles of justice and equity.
- “The originality/general rule of contract and its relevant principles are permissibility provided that there is no restriction of law and they are not contrary to the Islamic law injunctions.” (Legal maxim)

- “The originality in Islamic law of transactions is permissibility unless there is a prohibition.”
(Legal maxim)
- Ibn Taymiyyah says, “As for transactions, the principle governing them would be permissibility and absence of prohibition. So, nothing can be prohibited unless it is prescribed by Allah and His Messenger.”

(ii) Mutual Consent

- The contract entered into by the contracting parties must be free from any form of threat, duress and coercion. This is to ensure that the contract is concluded on the basis of mutual consent.
- “O you who believe! Eat not up your property among yourselves unjustly except it be a trade amongst you, by mutual consent. And do not kill yourselves (nor kill one another). Surely, Allah is Most Merciful to you”.(surah al-Nisa’, 4:29)
- “The property of a Muslim is not licit for others to enjoy unless by his consent.” (Meaning of the *hadith*)
- “Verily the sale is based on mutual consent.” (Meaning of the *hadith*)

(iii) *Ikrah*

- *Ikrah* connotes “to compel a person without right, by fear to do a thing without his consent.” (*Majallah*, article 948)
- It is of two types i.e. *ikrah mulji*’ and *ikrah ghayr mulji*’.
- *Ikrah mulji*’ refers to “threat which is caused by a hard blow that leads to destruction of life, loss of a limb or one of them and *ikrah ghayr mulji*’ connotes “threat which is caused by a blow or imprisonment that leads to grief and pain.”

Conditions of *Ikrah*

- i) A person exercising duress must be capable of implementing his threat.
- ii) The threat must be realistic, in the sense that it is reasonable to expect it will be carried out.
- iii) The threat must be one of serious injury to the person threatened
- iv) The threat must be immediate according to the view of majority of Muslim jurists.
- v) The threat must be unlawful or for unlawful purpose. Thus, it is not duress if a court orders the compulsory sale of a debtor's property with imprisonment as the penalty of non-compliance.

Effects of *Ikrah*

- Jumhur – contract whether subject to cancellation such as sale and hire or not subject to cancellation such as marriage and divorce becomes null and void if duress affects the disposition of person since duress eliminates the consent that is the basis for dispositions.
- Hanafis – contract subject to cancellation
 - i) majority of Hanafis – contract becomes voidable. If the duress is removed and the person subject to duress insists on the contract and satisfies with it, the contract becomes valid,
 - ii) some Hanafis including Zufar – contract becomes suspended that is subject to ratification of person subject to duress.
- Hanafis – contract not subject to cancellation – the contract is valid because duress for this type of contract is equated to the joke.

(iv) Riba

- *Riba* literally means *al-ziyadah* (increase) or *al-nama'* (growth, expansion or augmentation).
- *Riba*:
 - every excess in return of which no reward or equivalent counter-value is paid
 - A predetermined excess or surplus over and above the loan received by the creditor conditionally in relation to a specified period
- Its legal definition depends on whether it is *riba al-jahiliyyah*, *al-nasi'ah* or *al-fadl*.

Illegality of *Riba*

- *Al-Qur'an*
- 1st. Stage

“And that which you give in *riba*, in order that it may increase from other people's property, has no increase with Allah; but that which you give in *zakah* seeking Allah's countenance, then those, they shall have manifold increase.” (*surah al-Rum*, 30:39)

compare *riba* with *zakat* and charity

praising *zakat* and charity but not *riba*

- 2nd Stage

“For the wrong-doing of the Jews, We made unlawful for them certain good foods which had been lawful for them and for their hindering many from Allah’s way. ** And their taking of *riba* though they were forbidden from taking it and their devouring of men’s substance wrongfully. And We have prepared for disbelievers among them a painful torment.” (*surah al-Nisa*, 4:160-161)

- ### associating the practice of *riba* with the Jews
- ### consider the practice as depriving (*zulm*)

- 3rd. Stage

“O you who believe! Devour not *riba*, doubled and multiplied.” (*surah ali ‘Imran*, 3:130)

- ### prohibiting charging double and multiple *riba*

- 4th. Stage

“Whereas Allah has permitted sale and forbidden *riba*.” (*surah al-Baqarah*, 2:275)



- ### conclusively prohibiting all forms of *riba*

- *hadith*
- “The Prophet s.a.w forbade accepting and giving *riba*.”
- “The Prophet s.a.w. cursed a person who accepted *riba*, its payer, its two witnesses and its writer.”
- “Gold is to be paid for gold, raw and coined, silver and silver, raw and coined (with equal weight), wheat by wheat by equal measure, barley by barley with equal measure, dates by dates with equal measure, salt with salt with equal measure; if anyone gives more or asks more, he has dealt in usury. But there is no harm in selling gold for silver and silver (with gold), with unequal weight, payment being made on the spot.”
 - Six commodities – (medium of currency) - gold, silver, (staple foods) - wheat, barley, dates & salt

Interpretation of the *hadith*

- Money1 + Money1 (gold & gold) = 2 conditions
 - i) Equality (same measurement)
 - ii) Hand to hand (spot transaction)
- Food1 + Food1 (wheat & wheat) = 2 conditions
 - i) Equality
 - ii) Hand to hand
- Money1 + Money2 (gold & silver) = 1 condition (Hand to hand)
- Food1 + Food2 (wheat & barley) = 1 condition (Hand to hand)
- Money + Food = No condition (free trading)
- Others + Others = No condition

Extension of Six Commodities

- i) Zahiris – They are not subject to extension by way of analogy because analogy is not recognised to be a source of determining law.
- ii) Jumhur – They are subject to extension to all other commodities that are deemed to possess the same characteristic but '*illah* (effective cause) for extension is subject to juristic views.
- iii) Shafi'is – '*illah* for gold and silver is because they are currency (*thamaniyyah*), and for wheat, barley, dates and salt as they are foodstuffs that are used to sustain the body whether as principal nourishment, spices, fruits or medicine.

- Malikis - *'illah* for gold and silver is because they are currency (*thamaniyyah*), and for wheat, barley, dates and salt as they are foodstuffs that can be stored for a reasonable time without perishing.
- Hanafis – *'illah* is because the exchanged commodities belong to the same genus and they changed hand by way of weight or measure.
- Hanbalis – a) First view - *'illah* for gold and silver is because they belong to the same genus and they change hand by way of weight and *'illah* for wheat, barley, dates and salt as they belong to the same genus and they change hand by way of measure, b) Second view - *'illah* for gold and silver because they are currency (*thamaniyyah*), and for wheat, barley, dates and salt as they are foodstuffs c) Third view - *'illah* for wheat, barley, dates and salt is because they are foodstuffs that are weighable or measurable.

- *Ijma'*
- *Riba* is forbidden in *Islam*.
- **Wisdoms**
- appropriation of property of another person without consideration
- preventing people from working
- discouraging people from helping the others
- preventing exploitation of the poor by the rich
- blessing from Allah.

Types of *Riba*

- *Riba al-Jahiliyyah*
- “A manifestation by the lender asking the borrower at maturity date either he will settle the debt or increase it.”

- *Riba al-Nasi'ah (Riba al-Duyun)*

- Literally, *nasi'ah* means to postpone
- Can occur in a situation, eg in loan transactions, because of delay in repayment
- “A predetermined excess or surplus over and above the loan received by the creditor conditionally in relation to a specified period.”
- Interest charges for bank loans are *riba al-nasi'ah* because they are charged in relation to the time given for repayment of loan and delay in exchange of currencies amounts to *riba al-nasi'ah* as currency exchange must be on cash/spot.

- When a loan payment is postponed to a later date but with the penalty in the form of an increase over the principal loan.
- Eg, debtor A borrows 5,000 loan and when he cannot pay on time, he must pay double to receive credit extension. He now owes the creditor RM10,000. In the event where debtor A is unable to pay the loan plus extension sum, he requests for a further delay which would require him to pay RM20,000 in total. Hence the loan is double and quadrupled over some period of time until he is able to pay.
- The practice of 'continued redoubling' over the capital is highlighted in the Quran – al-Baqarah (2):130.

- *Riba al-Fadl*

- Exchange of transactions
- “An excess charged in exchange or sale things homogenous in nature or similar of the same species.”
- Based on hadith
- 2 main categories:
 - (1) medium of currency; gold and silver
 - (2) staple foods: wheat, barley, dates and salt

###operation of al-Qiyas – extension of commodities

Effects of *Ribawi* Transactions

- Hanbalis – Loan is ipso facto a complete nullity simply because *riba* is forbidden
- Malikis and Shafi'is – Loan is considered null and void on the ground that the contract is vitiated in essence as the mutual agreement of the parties to enter into a transaction is not recognised by the law.
- Hanafis – Loan remains a valid gratuitous loan transaction on the basis of the doctrine of severance whereby the *ribawi* condition is removed from the agreement.

Resolution of SAC

- “*Riba* is one of the main criteria causing securities of listed companies to be excluded from the SAC approved list. It is resolved that securities of a company whose operations and main activity are based on *riba* are not *halal*. Examples are merchant banks, commercial banks and finance companies.”

(v) *Gharar*

- *Gharar* literally means deceit or fraud (*khida'*), uncertainty, danger or risk, and peril or hazard (*khatar*).
- It is legally referred to uncertainty on the ultimate outcome of a contract which may lead to dispute and disagreement among the contracting parties.
- It also refers to the sale of probable item whose existence or characteristics are not certain.
- “The Prophet s.‘a.w. prohibits *gharar* transaction.”
(Meaning of the *hadith*)

- “Do not buy fish which is still in the water, for it involves uncertainty (*gharar*).” (Meaning of the *hadith*)
- Imam Malik while explaining the abovementioned authority says, “One kind of uncertain transactions is selling what is in the wombs of female animals because it is not known whether or not it will come out, and if it does come out, it is not known whether it will be beautiful or ugly, normal or disabled, male or female.”

Factors of Gharar

Gharar in Contract

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graph TD; A[Gharar in Contract] --- B[No ownership<br/>Incomplete ownership]; A --- C[Non-possession of<br/>the object]; A --- D[Insertion of<br/>ambiguous stipulations]
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No ownership
Incomplete
ownership

Non-
possession of
the object

Insertion of
ambiguous
stipulations

Presumption of *Gharar*

- The contracting parties are unaware whether such an event will take place or not.
- The subject matter is not within the knowledge of the contracting parties.
- The existence of subject matter is uncertain.
- The acquisition of subject matter is doubtful.
- The quantum of subject matter is unknown.

Exceptions to Principles of *Gharar*

- *Gharar* will not affect the validity of the contract in the following situations:
- The uncertainty is slight/trivial – tolerable by the parties.
- The uncertainty is in gratuitous contract.
- There is public need for the transactions such as *bay' al-salam* (forward sale contract), *al-istisna'* (manufacture contract). This is based on the Islamic principles, “satisfying people’s need and removal of hardship will always take priority”.

Examples of *Gharar* Transaction

- Uncertainty transactions include to sell a thing which one's does not have in one's possession nor expects to bring it under one's control such as sale of fishes in the river, birds in the sky or runaway animals and to buy something (a conventional insurance) where there is uncertainty as to whether the item bought can be obtained or not. The item bought (insurance) will only be claimed if an accident or disaster strikes the buyer, but an accident or disaster may or may not happen. Therefore, it is uncertain whether the item bought by the buyer will materialise.

Resolution of SAC

- “The existence of *gharar* in the main activities of a company can cause the company’s securities listed in the Kuala Lumpur Stock Exchange to be excluded from the list of securities approved by the SAC. It is resolved that securities with *gharar* features are not *halal*. Company activities categorised as *gharar* include conventional insurance activities.”

(vi) *Tadlis, Ghalat and Ghabn*

- *Tadlis* or *taghrir* means to cheat that is commonly known as fraud. Fraud occurs wherever a party knowingly makes a false representation of the past or present material fact with the intention of causing the other party to enter into contract and other party justifiably relies on the representation and suffers damages.
- It is prohibited to be practised on the basis of the *hadith*, “He who cheats us is not one of us.”

- It is divided into three types, i) *tadlis fi'li* (actual fraud), ii) *tadlis qawli* (verbal fraud) and iii) *tadlis bi kitman al-haqiqah* (hiding truth fraud)
- i) *tadlis fi'li* (actual fraud)
- It refers to asserting something regarding the subject matter of contract in order to give a picture which is not real such as the practice of *tariyyah* where the teats of cow or she-goat have been tied up for sometime in order to give the prospective buyer an unduly optimistic impression of the animal's normal milk yield, painting old car with new colour and changing registration number with the latest one.

- Jumhur – the victim has right of option whether to rescind or continue with the contract without any request for compensation or to return the subject matter to the offeror.
- • Hanafis – the victim has no right to cancel the contract but is allowed to claim compensation.

- ii) *tadlis qawli* (verbal fraud)
- It is a lie issued by one of the contracting parties to lead the other to conclude the contract as where the seller says to the buyer, “This thing is the best one,” although it is not so.
- It does not effect the contract unless it is accompanied by grave cheating. In such a case, the victim has right to cancel the contract in order to preclude damage from him.

- iii) *tadlis bi kitman al-haqiqah* (hiding truth fraud) means “to hide the defect of any of the subject matter of the contract”.
- Examples include to plaster the body of the car that involved in the accident with cement and to cover the defect of the house with the wall papers.
- All Muslim jurists agree that the victim has right of option of the basis of the *hadith*, “When you buy something, you may say, “there is no fraud.”

- *Ghalat* denotes “a false or inexact representation of reality.”
- It is divided into i) mistake to the subject matter, ii) mistake to the value of subject matter, iii) mistake to intended description, iv) mistake in person and v) mistake of law.
- i) **Mistake to the subject matter** refers to mistake by one of the contracting parties thinks that the subject matter is from a certain genus but it is not so. For example he buys a piece of jewelry which is supposed to be gold or diamond but it is copper or glass.

- There is no contract on such transaction simply because the supposed subject matter has not be properly ascertained and does not exist.
- ii) **Mistake to the value of subject matter** exists when a person buys a car of specific brand and year but the car is of different brand and year.
- The contract is void due to the non-existence of actual subject matter and provided that the difference is excessive.

- iii) **Mistake to intended description** happens in a situation where the subject matter of contract is deemed to be as it is described by one of the contracting parties but it appears from the evidence or implication different from the stipulated description as for example the sale is for a black cloth but it turns out to be grey or brown, and the sale of gold purported to be of 22 carats but it turned out to be 18 carats.
- The contract is not binding for the buyer. He has an option whether to rescind or continue the contract because false description leads to impediment of consent.

- iv) **Mistake in person** occurs where a person concluded a contract for a famous doctor to treat him but he turns out to be not.
- The contract is not binding on such person because knowledge that one is contracting with a particular person is part of the purpose of contract in Islamic law.
- v) **Mistake of law** arises where the contracting parties do not know the law applicable to the contract.
- Generally the contract is valid as Islamic law considers ignorance of the legal rule is not an excuse unless such ignorance is due to lack of knowledge or legally valid reason. If such ignorance happens, the contract and its effect is void and the ignorant person is given the right of option.

- *Ghabn* means decrease that refers to being one of the subject matter not equivalent to the other.
- It is divided into two, i) *ghabn yasir* (trivial deception) and ii) *ghabn fahish* (great deception).
- i) *ghabn yasir* refers to trivial deception in a price that is within the expectation of the experts such as 10% or where the person buying a pen for RM100 but it is estimated by the experts to be actually RM95.
- A victim of trivial deception has no right to rescind the contract because of difficulty to avoid it. It occurs often in practice and people are commonly ready to forgive it.

- ii) *ghabn fahish* refers to an excessive deception in the value of goods when a party charges a price for an article which is exorbitantly greater than the valuation of appraiser or the market value.
- “It is to be deceived in respect of goods to the extent of a half a tenth, in respect of animals to the extent of one-tenth and in respect of real property to the extent of one-fifth, or to any greater amount.” (*Majallah*, article 164).
- Hanafis – the grave deception does not effect the validity of contract unless there is fraud in it. This rule however does not apply to the sale of orphanage property, *waqf* property and *bayt al-mal* property.

- Hanbalis – the grave deception effects the validity of contract that is entered into on the basis of *talaqqi rukban* (meeting riders out of town), *najash* (increasing the price of an item which is offered for sale not for buying it but for cheating other buyers) and *mustarsal* (ignorance of person on the price but he depends on the trustworthiness of the seller).
- Malikis - the grave deception effects the contract that is entered into on the basis of *najash* only and the victim has right of option.
- Shāfi'is – the grave deception has no effect to the validity of the contract whether it is accompanied with fraud or otherwise. This is because deception occurs only when the victim is neglect. If he asks the expert, the deception will not occur.

(vii) Prohibited Commodities/Activities

- Prohibited commodities refer to “the commodities that are clearly prohibited by the *Shari‘ah* and *Shari‘ah* prohibits the Muslim to own and use them” and prohibited activities connote “activities that are clearly prohibited by the *Shari‘ah* and *Shari‘ah* prohibits the Muslim to get involve in them.”
- Prohibited commodities include liquor and any form of alcoholic drinks and beverages, carcass and any non-slaughtered animals, bloods, pigs, pork, dogs and the likes.

- Prohibited activities cover interest based financing operations, conventional pawn broking, conventional insurance, production and distribution of alcohol as well as those having business premises where alcohol is served, production and distribution of pornographic materials, pig farming, pork production and production of other pig by-products, prostitution, businesses whose the primary motive is entertainment (music, cinema), production and distribution of idols, statues, and materials for worshipping other than Allah Almighty and other activities, which are against the teachings of Islam to finance businesses related to tobacco and defense/weapons production.

Resolution of SAC

- One of the criteria to consider a particular company's securities fall outside the list of Shariah-approved securities is that the main activity of a company is the production and sale of goods and services that are prohibited in Islam, including:
 - i) processing, producing and marketing alcoholic drinks;
 - ii) supplying non-halal meat like pork, etc.;
 - iii) providing immoral services like prostitution, pubs, discos, etc.

- Such activities also include gambling that refers to “i) getting something or profit too easily without working for it or ii) activities which involve betting whereby the winner will take all the bets and the loser will lose his bet.”
- “O you who believe! Intoxicants, gamblings, idolatrous practices and the dividing of the future are abomination of Satan’s handiwork. So avoid it in order that you may be successful ** Satan wants only to excite hatred between you with intoxicants and gambling and hinder you from the remembrance of Allah and from prayers. So will you not then abstain?” (*surat al-Maidah*, 5:90-91)

Resolution of SAC

- “Gambling is one of the main criteria causing a listed company’s securities to be excluded from the list of securities approved by the SAC. It is resolved that the securities of a company carrying on gambling activities are not permissible. The activities include casinos and gaming.”

CONCLUSION

- Contract is classified into various classifications that include sale-based contracts, leased-based contract, equity-based contracts, security-based contracts and the likes.
- To have a *Shari'ah* compliant contract, all its general principles such as the contract must be free from any element of duress, *riba*, uncertainty, fraud, mistake and the likes should be adhered to strictly.
- Without observing the general principles of contract, the contract should be considered as null and void.