greater concern. Their potential to charge excessive rates of interest guised as 'fee' or 'gratuity' or 'profit sharing' and the inequity that results there from (being 'the very essence of *riba*' Muhammad spoke of) has led practicing academics like El-Gamal to emphasise the appropriateness of Islamic banks' 'marking to market'.[61] This emphasis acknowledges that in a regulated financial market, interest is capped whereas profit making being unregulated, gives Islamic banks a blank cheque to charge uncapped fees on their financial products in the name of 'profit' that may in effect be unjustifiably high and inequitable.

In other words, it is not excessive interest we should be concerned about, but the excessive 'profit' presently being made by the Islamic finance industry. Adopting the definition and scope of application of *riba* preferred in this book, the principle of *riba* could be used to regulate commercial loans in such a way that whilst inequity is prevented, interest may be legitimately charged. This would be in line with the verse of the *Quran* that prohibits the taking of *riba* 'double and multiplied' as well as the sayings of Muhammad whilst at the same time allowing for bargains by mutual consent expressly permitted in *al-Nisa*: 29.

The soundness of the permissibility of charging interest in commercial lending transactions is strengthened by a consideration of the inverse scenario, that is, a prohibition on all interest bearing loans whatever the purpose. This would lead to great social inequity and inadvertent failure in Islam's objective of social justice resulting from a compulsion to lend money charitably (in the cause of God). How could it be decreed by God that the debtor may borrow at the loss of the creditor (through inflation, devaluation and illiquidity) so as to enable the debtor to profit? Hardly anyone would want to lend his money to another and suffer loss merely for the increase in other's wealth; it defies human nature. This is expressly acknowledged in the *Quran*, *al-Baqara*: 279, when it says pertaining to *riba*, 'you render not injustice nor shall you be rendered injustice', that is, the principle cuts both ways.

The wealthy would prefer to use their money in their own business, keep it for themselves (i.e. the opportunity cost of extending credit) or otherwise continue to give of it to charity as they please whilst desisting in extending loans commercially for the fear of *riba*. Needless to say, in both social and economic terms, this would be vastly detrimental to society because it would hinder availability of credit and, in turn, the circulation and redistribution of wealth.[62] In this sense, the *riba* prohibition dictates that whilst encouraging the giving of charity through interest free interpersonal loans, trade credit can be extended for an appropriate fee.

On this note, I refer to El-Gamal's explanation that, generally, one lends in Islam not to seek repayment at an increase but for purposes of giving charitably the time value of money (a sufficient counter value in any loan transaction) or usufruct lent whilst affording the poor debtor the retention of his dignity by allowing him or her to repay the amount borrowed as opposed to an outright donation made. Indeed, other writers on social justice and the current economic state of nations have openly acknowledged the humiliating character of charity to those who receive it owing to its top-down nature.[63] However, El-Gamal's explanation is inapplicable to commercial transactions (which include loans) because commercial loans are horizontal, taking place between individuals with freedom of choice and intending contractual legal relations at arm's length hence the dignity of both parties remains intact regardless of their economic status. Increased returns may be charged on commercial loans for why should one not in need be allowed the 'dignity of borrowing' if he does not need charity? Recall that the categories of those entitled to charity are expressly laid out in the *Quran* at *al-Tauba*: 60. Therefore, outside the eight categories, why is a debtor to be exempt from paying a counter value for the credit extended to him?

5.4 *Riba* and the common law doctrine of consideration

We have, so far, established that *riba* as expressed in the *Quran* and explained by Muhammad is a general principle requiring equity in all transactions. To ensure transactional equity, the *riba* principle applies through two respective rules depending on the nature of the transaction: (i) no consideration or gain may be drawn or elicited in non-commercial contexts, that non-commercial transactions are equitable as long as they do not draw a profit, gain or consideration; and (ii) commercial transactions may freely elicit gain or consideration but the bargain struck must be equitable in effect as demonstrated by Muhammad's saying (II) regarding the barter of dates. Therefore, while commercial transactions are unaffected by the first rule and may elicit consideration or make a profit, only consideration *effecting* an equitable bargain is legitimate otherwise the transaction is vitiated by the *riba* principle.[64]

Ultimately, however, it is the bargain that must be equitable, not the consideration. Consideration, whatever form or value it takes, is valid as long as the parties are mutually agreed and the bargain effected is equitable. What, then, is meant by a bargain being *equitable*? This is explained in subsection 5.4.1.

Riba can thus be said to pertain to the doctrine of consideration – but is not the Islamic law counterpart to the doctrine of consideration. Instead,

while *riba* affects whether consideration may be elicited, it is in essence a vitiating factor that *determines* whether the transaction is, in effect, equitable or not. Therefore, if the drawing of consideration effects an equitable bargain, the contract is valid at law. Otherwise, the *riba* principle kicks in to vitiate the transaction and the consideration elicited would automatically be nullified.

Under the common law, consideration has been described as follows: 'A valuable consideration, in the sense of the law, may consist either in some right, interest, profit, or benefit accruing to one party, or some forbearance, detriment, loss or responsibility, given, suffered or undertaken by the other'.[65] The doctrine of consideration provides that a promisee cannot enforce a promise unless he has given or promised to give something in exchange for the promise. Winn LJ in *D & C Builders v Rees*,[66] observed that an agreement is only binding if either made under seal or supported by consideration. To be a valid and enforceable contract, therefore, there must be a bargain between the parties not a promise to give gratuitously,[67] and consideration, whatever form it takes, is a strong indicator of the presence of a bargain.[68] In *Williams v Roffey*[69] the court explained that if:

> as a result of giving his promise, B obtains in practice a benefit, or obviates a disbenefit; and (v) B's promise is not given as a result of economic duress or fraud on the part of A; then (vi) the benefit to B is capable of being consideration for B's promise, so that the promise will be legally binding.

As McKendrick explains, as long as considerations is sufficient, albeit nominal,[70] the transaction becomes enforceable *unless* a further element of duress or fraud or other vitiating factor is present. Therefore, despite requiring only 'sufficient, not adequate consideration' a transaction, nonetheless, could be vitiated if it was concluded in an illicit manner indicating that the bargain is not equitable. So, comparable to the position under Islamic law, while consideration need not to be adequate under the common law, the transaction, nonetheless, must be equitable because, otherwise, it is caught by the appropriate vitiating factor that may render it unenforceable. This distinction is of further significance as we shall return to see in subsection 5.4.1.

The intention, in what follows, is to compare the two rules that give expression to the *riba* principle with their corresponding aspects under the doctrine of consideration under English common law. It is not intended to provide an overview of the doctrine of consideration, either under Islamic

law or under common law, since any good contract law text on either legal system provides that already. My contribution lies in the enquiry into *riba*'s relationship with consideration and in particular as to *riba*'s requirement of transactional equity vis-à-vis the common law and whether transactional equity is the basis of *eliciting* or *enforcing* consideration.

5.4.1 Equitable transaction versus adequate consideration

At first blush, the requirement that transactions must be equitable under Islamic law appears to be in sharp contrast with the requirement of adequate consideration under common law. A deeper consideration of the apparent, however, reveals that the two doctrines say the same thing in different terms. To reach this conclusion, let us commence with considering the apparent distinction that arises indirectly from the fact that *consideration under the common law pertains to the promise made*, not the contract sought to be enforced. As Professor Treitel explains, 'consideration being the *reciprocal benefit or forbearance on the part of each party in consideration for the other's promise*, is unconcerned with whether the seller (or the buyer for that matter) has made a *good* bargain'[71] (emphasis added). The common law position on consideration is, thus, that consideration need only be sufficient (something of value); it need not be adequate nor is it concerned with whether a good bargain is made.[72] Therefore, a £1 consideration for the sale of a business was deemed sufficient[73] as were three chocolate wrappers for gramophone records in the case of *Chappel & Co Ltd v The Nestle Co Ltd*.[74] The principle of *riba*, however, also requires that bargains be equitable and, therefore, that the *effect* of eliciting consideration as one element of contract formation must also be equitable. Yet, if one recalls the excerpt from *Williams v Roffey*,[75] above, the position under the common law is the same and was recently affirmed in the case of *Forde v Birmingham City Council*.[76]

Two issues immediately arise from the above distinctions, respectively: what does an equitable bargain entail; and, does 'equitable bargain' equate to 'adequate' consideration or 'good' bargain? The word bargain implies an agreement attained between two parties (often after negotiation of some sort). The Oxford Dictionary defines bargain as 'an agreement made between people saying what each will do for the other'. Bargains, therefore, are simply mutually agreed to transactions. Why then does a bargain have to be equitable if it is consented to? Simply because the equitable nature of the transaction acts as the litmus test of veracity of the consent given by the parties. Islamic law and common law possess principles towards this end. The principle of *riba* requires equitable transactions as indicated by Muhammad's sayings on *riba* and the application of common law vitiating factors (duress,

undue influence, unconscionability and inequality of bargaining power or other policy consideration) also indicate the requirement of equitable transaction, even if the requirement of 'sufficient' consideration has been satisfied. In *Antons Trawling v Smith*,[77] Baragwanath J held that:

> Where there is no element of duress or other policy factor suggesting that an agreement duly performed should not attract the consequences that each party must reasonably be taken to have expected. The importance of consideration is as a valuable signal that the parties intend to be bound by their agreement, rather than an end in itself. Where the parties who have already made such intention clear by entering legal relations have acted upon agreement to a variation, in the absence of policy reasons to the contrary, they should be bound by their agreement.

The 'equitable bargain' requirement simply underscores the concern, in all cases where vitiating factors apply to issues of consideration, that one party will exploit the vulnerability of the other. Consideration is, thus, one element of a valid contract and the existence of valid consideration does not guarantee the existence of a valid contract. To be a valid and enforceable contract, the transaction as a whole must be equitable, which is to say, must not be vitiated by any policy considerations or vitiating factors of the likes of duress or unconscionability.

As to whether 'equitable bargain' equates to requiring 'adequate' consideration or 'good' bargain, the Oxford Dictionary defines the word adequate as 'satisfactory or acceptable' and provides that the origin of the term is the Latin word *adaequare* which means to 'make equal to'.[78] English common law contract texts describe 'adequate' consideration as that which brings about a fair or good bargain.[79] A transaction need not comprise adequate consideration to be an equitable bargain: the equitable nature of a bargain is otherwise secured by operation of the vitiating factors (fraud, deceit, coercion, etc.) or by ensuring that the consideration is not, itself, unlawful, for example, stolen property. In a nutshell, therefore, equitable bargain does not equate to a 'good' bargain in terms of requiring 'adequate' consideration.

It is important to reiterate the fact that *riba* requires equitable *bargains* does not translate to a requirement that the consideration itself must be commensurate or adequate. Even where complete equanimity is required (in barter transactions) as in saying (I) of Muhammad, the target is preventing inequitable transactions, not requiring adequate consideration. Therefore, in the words of Professor Treitel, it is equally irrelevant under

Islamic law 'that the seller has made a good bargain'.[80] The focus of *riba* is that the transaction as a whole is of equitable effect to both parties and not whether the consideration was adequate or not. In all exchanges for cash or otherwise in non-barter transactions, as long as something of value has passed between the parties by their mutual agreement in equitable manner, then the law honours the agreement of the parties. This position is illustrated by Muhammad's saying (I) and (II). In saying (I) he concludes, 'if the species differ, sell as you wish provided payment is made on the spot'. Muhammad gives no direction as to the appropriate consideration or price but rather leaves it entirely to the parties. He requires only 'payment on the spot' which, in the context of sixth/seventh century ad, was necessary to prevent inequity being rendered through delay or absconding payment for the exchange. Similarly, in saying (II) Muhammad vitiates an otherwise perfectly valid barter transaction not because the consideration is not adequate, but due to the latent inequity of exchanging two portions of inferior quality dates for one portion of superior quality dates. This is confirmed by the fact that Muhammad then directs Bilal to sell his (low quality) dates at the highest market price and buy the (high quality) dates he wants at the lowest possible market price indicating there is no 'adequate' consideration requirement, only that the bargain be equitable which is satisfied by buying and selling through the market mechanism. Islamic law and common law, therefore, are aligned on the issues of consideration and equitable bargains.[81]

Moreover, the common law also distinguishes between cases where the consideration takes the form of a money payment for a service or product and cases where the consideration takes the form of non-monetary benefit. McKendrick explains that, 'where the promise is one to pay money for a service or a product (here used to encompass both goods and land) the law generally does not encounter any difficulty'. This is in direct agreement with Muhammad's saying (II) where he advises Bilal to sell his dates at market price instead of bartering them for high quality dates. McKendrick continues explaining that:

> the issue is more difficult where the alleged consideration takes a form other than a promise to pay a sum of money. Here we encounter the question whether it is for the courts or the parties to determine what constitutes sufficient consideration … The courts have generally adopted a liberal approach to the identification of consideration and cases can be found in which trifling or apparently insignificant acts have been held to constitute consideration.[82]

However, the conventional definition of consideration, adopted by Lush J in *Currie v Misa*,[83] as 'a valuable consideration, *in the sense of the law*', (emphasis added) implies that it is the court to determine what amounts to valuable consideration in a case, not the parties.

5.4.2 Raison d'être *behind* riba *and the doctrine of consideration*

Both Islamic law and the common law have protected contracting parties from inequity as a basis of determining enforceability of transactions. Under Islamic law, this is the function of *riba* as a vitiating factor with regard to consideration. Under the common law, this is the function of the various applicable vitiating factors.

Riba is currently *presumed* to be limited to the protection of *consumers* or *debtors* from the powerful merchants who occupied a dominant position in the (then) capitalist society. I say *presumed* because neither the *Quran* nor Muhammad mentions this; a deduction has been made from the context of revelation of the verses pertaining to *riba*, Muhammad's sayings and the capitalist reality of Makkah in the sixth/seventh century. However, even assuming this deduction is plausible, we also know that the *Quran* not once alludes to *riba* being a one-sided 'protection' principle and in Muhammad's saying (II), *riba* is experienced as a vitiating factor applicable regardless of the form of the transaction or the party on which it is imputed. It is the inequity of the transaction that *riba* catches and consequently vitiates the transaction unless the inequitable element is removed or remedied.

Lord Denning's judgement in *D & C Builders*, commonly used in illustration of consideration serving a protective purpose, indicates that the aim of the law is to protect both parties from *inequity*. It is equity in the case at hand that the court is really striving to attain, not the protection of either party. Denning explains, invoking the broad principle stated by Lord Cairns in *Hughes v Metropolitan Railway Co*.[84] that, 'parties who have entered into definite and distinct terms involving certain legal results … who otherwise might have enforced those rights will not be allowed to enforce them when it would be *inequitable* having regard to the dealing which have taken place within and between the parties' (emphasis added).

The equitable principle of estoppels is thus a general principle of the common law that is applied to different cases, and in protection (a shield) of either party, as appropriate. Lord Denning explains:

> This principle has been applied to cases where a creditor agrees to accept a lesser sum in discharge of a greater. So much so that we can now say

> that, when a debtor and a creditor enter into a course of negotiation, which leads the debtor to suppose that on the payment of a lesser sum the creditor will not enforce payment of the balance, and on the faith thereof the debtor pays the lesser sum and the creditor accepts it as satisfaction: then the creditor will not be allowed to enforce payment of the balance when it would be inequitable to do so … see *Central London Property Trust Ltd v High Trees House* [1947] 1 KB 130.

In applying this principle, however, we must note the qualification: The creditor is only barred from his legal right when it would be inequitable for him to insist upon them. When there has been true accord, under which the creditor voluntarily agrees to accept a lesser sum, and the debtor acts upon that accord by paying the lesser sum and the creditor accepts it, then it is inequitable for the creditor afterwards to insist on the balance.

In *D & C Builders*, equity between the parties just so happened to yield to judgement being pronounced in favour of the creditor, as Lord Denning explains:

> on the facts … it seems to me that there was no true accord. The debtor's wife held the creditor to ransom. The creditor was in need of money for his own commitments, and she knew it … She was making a threat to break the contract (by paying nothing) and she was doing it so as to compel the creditor to do what he was unwilling to do (to accept £300 in settlement of the £480 due to him): and she succeeded. In these circumstances there is no true accord so as to found a defence of accord and satisfaction: There is also no equity in the defendant to warrant any departure from the due course of law.

Lord Denning stresses the *equity* of the transaction as being the foundation upon which a contract becomes enforceable, including, for purposes of (accepting or foregoing) consideration.

Although the above referred to cases are on estoppel and not strictly relating to consideration, the value in their reference lies in that they illustrate the principle of estoppels in relation to contractual price or credit obligations in direct parallel with the principle behind *riba*. The principle is that any inequity in dealing between the parties will prevent or estop the inequitable party from exercising or enforcing their right/s in question (including eliciting consideration).

The principle behind *riba* and the doctrine of consideration are thus agreed on the fact that an equitable bargain is the *basis* for eliciting or

enforcing consideration because it is the equitable nature of a dealing that signifies attainment of 'true accord' per Lord Denning's dicta.

5.4.3 **Riba** *as a vitiating factor versus consideration as a distinct element of contract formation*

A possible distinction between *riba* and consideration is the effect of each on a contract. Consideration, unlike *riba*, is a distinct element of contract formation. Lack of, or insufficient, consideration is thus not strictly speaking a vitiating factor in that without sufficient consideration no contract would have been formed to be vitiated in the first place. *Riba*, on the other hand, is a vitiating factor that determines whether a bargain is equitable and thus whether consideration was legitimately elicited. Therefore, regardless of whether consideration exists and the consideration is deemed sufficient by the parties themselves (as was the case in Bilal's barter of dates) the transaction can still be vitiated by *riba* if inequitable. We noted in section 5.4.1 that the same position is true under the common law in reference to the role of vitiating factors.

5.5 *Riba*, consideration and intention to create legal relations

This chapter has defined *riba* as a vitiating factor pertaining to consideration that is based on the underlying principle requiring transactional equity. It has emphasised that a cornerstone of *riba*'*s* principle is that it draws a distinction between commercial and non-commercial transactions for purposes of application of the two rules giving expression to it, respectively. A commercial transaction is one characterised as a mutually consented to bargain or 'trade' and this characterisation *legitimises* the drawing of consideration.[85] In principle, it is the *intention* to 'trade' behind the transaction (regardless of form) that designates it as commercial or non-commercial. The commercial nature of a transaction, in turn, raises a rebuttable presumption that the transaction is equitable in effect and forms the basis of eliciting consideration. This answers question (5) that was posed at the end of section 5.1, that is, *what distinguishes a commercial agreement from a non-commercial agreement that deems a commercial agreement eligible to elicit consideration*?

However, being latent, the intention to 'trade' is generally inferred from the context and surrounding circumstances of the transaction that reveal whether the transaction was a mutual bargain. In the case of Bilal's barter of dates, for instance, Muhammad advised Bilal to sell his (low quality) dates at market price and buy the other (high quality) dates from the proceeds so as to obviate the vitiating effect of *riba* on the barter transaction. The resort to market mechanism or market forces of demand and supply is a

circumstantial factor that implies the *intention* to trade (as opposed to being a social exchange) and evidences the mutuality of the bargain which, in turn, legitimises the gain derived from another. The barter transaction, on the other hand, was described as being 'the very essence of *riba*' (as opposed to trade) even though it was carried out by the same parties with the same outcome. This can be rationalised as being the consequence of the lack of an objective determinant of the mutuality of the bargain that coloured the transaction as '*riba*'.

This relationship between consideration and the intention to 'trade' under the principle of *riba* prompts us to compare it with the common law relationship between consideration and the intention to create legal relations.

The general rule, under the English common law, is that a promise is not binding as a contract unless it is either made by deed or supported by some 'consideration'.[86] The common law also distinguishes between domestic or social agreements on the one hand and commercial contracts on the other for purposes of contractual force.[87] In domestic[88] and social[89] agreements, the courts presume against the parties having had an intention to create legal relations, whilst in commercial[90] agreements the courts presume that the parties did have an intention to create legal relations. The presumption is, in both contexts, rebuttable albeit not an easy one to rebut. The '*rationale behind the presumption under the common law derives mainly from public policy, rather than the parties' actual intention*', as explained by Lord Atkin in *Balfour v Balfour*[91] to avoid the 'floodgates' of cases that would otherwise be brought to court if social and domestic arrangements were held to result in legal relations (emphasis added). To put it bluntly, the presumption is a convenient criterion through which transactions are recognised as enforceable contracts or not, while limiting the number of cases brought to the courts for such determination. This is not to say, however, that the presumptions based on the nature of the transaction renders the actual intentions of the parties irrelevant; the parties' intentions are relevant for the purposes of rebutting the presumption the nature of the transaction raises. For instance, a husband can be his wife's tenant[92] and where a man, before marriage, promised his future wife to leave her a house if she married him, was able to enforce the promise though it was made informally and in affectionate terms.[93]

Consideration and the intention to create legal relations are, however, doctrinally distinct under the common law and, as explained by lord Atkin in *Balfour v Balfour* that, for instance, even if Mrs Balfour had succeeded in proving that she provided consideration for her husband's promise to pay her £30 a month, she would still have had to prove that she and her husband

intended to create legal relations. Similarly, Duke LJ in *Balfour v Balfour* explained that while a link between the doctrines of consideration and the intention to create legal relations exists, they remain two distinct doctrines both of which must be proved in establishing that a contract was formed between the parties. Therefore, a transaction formed with, or presumed to have, an intention to create legal relations is, nonetheless, unenforceable unless consideration is given in return of the promise. Alternatively, even though consideration passing from the promisee to the promisor is, generally, a strong indicator of an intention to create legal relations under the common law[94] it does not itself establish such an intention.[95] Both elements must exist for a transaction to be a contract enforceable at law.

The two doctrines, nonetheless, do overlap and it is sometimes difficult to discern whether the court's decision is one based on the absence of consideration or that of an intention to create legal intent as in *White v Bluet*. In this case, the court's language was one of absence of consideration having rendered the agreement unenforceable yet the court implied that the absence of consideration was a cause for unenforceability *because* it indicated an absence of an intention to create legal relations. Consideration, in such cases, becomes merely an indicator of an intention to create legal relations and the distinction between the two doctrines blurs. In such instances, the position under common law is similar to Islamic law in that consideration is not an independent doctrine or element of contract law but rather is attached to the intention to create legal relations as expressed by the *riba* principle.

As for the question, 'what distinguishes a commercial agreement from a non-commercial agreement that deems a commercial agreement eligible to elicit consideration?' The common law position can be explained by a two-fold answer: first, that mutuality exists in commercial agreements that does not in social or domestic agreements. This was stated in the case of *Simpkins v Pays*[96] where the house owner (defendant) refused to pay a share of a prize winning to the plaintiff (lodger in defendant's home) alleging that the agreement made between them was not intended to be legally binding. Again, this mutuality lies not in the form or setting of the transaction but rather the intention behind it. Sellers LJ in *Simpkins* held:

> It may well be there are many family associations where some sort of rough and ready thing is said which would not, on a proper estimate of circumstances, establish a contract which was contemplated to have legal consequences, but I do not so find here. I think that there was here a mutuality in the arrangement between the parties. It was not very formal, but certainly in effect, it was agreed.[97]

Legal commentary[98] on Seller J's reference to 'mutuality' in *Simpkins v Pays* notes that 'it [mutuality] refers to the presence of consideration rather than the presence of an intention to create legal relations'. This point is made as part of a wider argument to the effect that 'absence of consideration … provides a simpler and more realistic explanation of the special quality of domestic agreements' than does the intention to create legal relations. Second, that social and domestic agreements are not contracts precisely because they lack the ingredient of 'an intention to create legal relations'. Since only agreements with the requisite intention are valid contracts, and commercial contracts are deemed to possess this intention, commercial agreements are, as a general rule, deemed valid contracts whilst social domestic agreements are not.

What, then, if at all, is the difference between whether the parties intended to contract and/or whether they intend to create legal relations? Mance LJ explains this in the case of *Baird Textile Holdings Ltd v Marks & Spencer Plc*.[99] In fact, he seems to combine the concepts underlying *gharar* and *riba*, as we have discussed them in this book, as key components of forming a valid contract. He states:

> For a contract to come into existence, there must be both (a) and agreement on essentials with sufficient certainty to be enforceable and (b) an intention to create legal relations. Both requirements are usually judged objectively. Absence of the former may involve or be explained by the latter. But this is not always so. A sufficiently certain agreement may be reached but there may be either expressly or impliedly (in some family situations) no intention to create legal relations.
>
> An intention to create legal relations is normally presumed in the case of an express or apparent agreement satisfying the first requirement … If the parties would or might have acted as they did without any such contract, there is no necessity to imply any contract. It is merely putting the same point another way to say that no intention to make any contract will be inferred.

Note Mance LJ's order, that is, that intention to create legal relations may be presumed if certainty of terms is fulfilled, not the other way round.

Recent case law indicates that the English common law is shifting in its focus pertaining to the intention to create legal relations in a manner that places the intention to create legal relations as a prerequisite for triggering the doctrine of consideration, rather than the other way round as per the status quo. A move in this direction would align the common law with Islamic law

because, as we have discussed above, it the commercial nature of a transaction (which possesses an intention to create legal relations) that legitimises the elicitation of consideration, not the other way round. This shift follows after the case of *Williams v Roffey Bros & Nicholls (Contractors) Ltd*,[100] which has made the doctrine of consideration much easier to satisfy, though not without much criticism.[101] In *Williams v Roffey*, Russell LJ stated that: 'the courts nowadays should be more ready to find [the existence of consideration] so as to reflect the intention of the parties'. *Antons Trawlings v Smith*[102] applied the reasoning in *Williams v Roffey* so as to hold that 'in on-going, arm's length commercial transactions where it is utterly fictional to describe what is being conceded as a gift, and which there ought to be a strong presumption that good commercial "consideration" underlie any seemingly detrimental modifications'. More recently, in *Chwee Kin Keong v Digilandmall.com Pte Ltd*,[103] Rajah JC took a step further in observing that: 'The time may have to come for the common law to shed the pretence of searching for consideration to uphold commercial contracts. The marrow of contractual relationships should be the parties' intention to create a legal relationship'. It must be noted that *Williams v Roffey* dealt primarily with consideration for variations of contract as opposed to consideration for contract. Thus, *Antons Trawlings* and *Chwee Kin Keong* may have gone slightly out on a limb in using *Williams v Roffey* in justifying a relaxed approach towards the requirement of consideration. Professor Coote[104] may be better justified in disagreeing with the approach in *Williams v Roffey* by opining that a better and more principled approach would be to dispense with the requirement of consideration for variations of contract, whilst recognising that a contract is still necessary. In other words, a contract requires consideration whilst the variation of an already valid contract ought not to require consideration. Ultimately, however, Coote and *Roffey* may be speaking the same language as it is not difficult to discover 'benefit' in varying a contract.

Conclusion

This chapter established that:

- The *Quran* explains *riba* as pertaining to illegitimate gain; illegitimate gain arises from any inequitable or unjust transaction.
- The *Quran* distinguishes between commercial and non-commercial transactions for purposes of applying the *riba* prohibition. This implies that the no consideration *riba* rule pertains only to non-commercial transactions.
- Accordingly, the sayings of Muhammad explain that all commercial transactions using money as a medium of exchange are free to elicit

profit/gain without triggering the vitiating element of *riba*. Barter transactions, though subject to market forces are not amenable to an objective measure of value and thus prone to inequity. Therefore, all barter transactions are subject to the requirement of equanimity in exchange.

- With specific regard to credit transactions, which includes loans, the 0% interest/gain rule applies only to non-commercial credit transactions.
- Commercial lending and finance falls within the ambit of trade/lawful endeavour for which increased return/profit may be charged. Interest may therefore be charged on commercial loans and finance transactions at the best market rate, as is the case with any other commercial transaction.
- The motivation and impetus for any non-commercial lending or exchange lies in it being an act of religious/charitable character in the cause of God.

The proposals and conclusions presented in this chapter have the potential of revolutionising Islamic finance, both economically and socially – by allowing for unprecedented growth unimpeded by pedantic restrictions of form over substance and simultaneously catering to social justice and equity. Consequently, the distinction of 'us versus them' for purposes of commercial arbitrage crumbles and the adoption and adaptation of financial structures and methods from other legal jurisdictions such as the common law (and conventional finance in general) becomes possible as long as the substance of legitimate gain through equitable transactions is adhered to.

6

THE NATURE OF DEBT AND THE LEGALITY OF ITS SALE

This chapter examines the nature of debt within Islamic law for purposes of ascertaining the legality of the sale of debt and the ensuing implications for sharia compliant securitisations. The task is complicated by the lack of clarity, even within one school of legal thought, pertaining to the definition and nature of debt and, consequently, as to the legality of the 'sale of debt' (receivables transaction). The significance of such ascertainment for sharia compliant securitisations cannot be overstated, as illustrated by the ENSEC Home Finance Pool 1 transaction – a securitisation that closed in May 2005. Whilst many thought it to be the first Middle East sharia compliant securitisation, scratching below the surface reveals the fact that it does not strictly qualify as such because of its fully cash collateralised obligations (i.e. no debt obligations were securitised). Therefore, whilst the cash collateralised obligations earned the transaction an AAA rating, it was not a securitisation in the traditional legal sense that entails the conversion of collateralised debt obligations (receivables) into tradable securities – the missing factor in the ENSEC transaction. The relevance of ENSEC's structure for purposes of this chapter lies in the fact that the transaction was structured as a fully cash-collateralised securitisation for purposes of evading the perceived sharia prohibition on the 'sale of debt' which, needless to say, severely curtails the use and development of securitisation structures in Islamic finance. The two main questions that arise in this respect are: why is the sale of debt prohibited under Islamic law; and what does the nature of debt have to do with such prohibition?

Islamic finance (in theory) drawing from Islamic law of contract and property restricts the sale of debt/receivables on two main grounds: First, debt is deemed non-proprietary on the basis of juristic likening of debt to money. Debt, on this basis, is deemed incapable of forming the subject

matter of a sale beyond the relationship of debtor and creditor,[1] just as is the case with money. Even the 'sale' between debtor and creditor is in essence simply a set-off arrangement and does not qualify as a proper sale contract. Even within the most progressive Islamic finance jurisdiction, Malaysia, the sale of debts/receivables to third parties is only valid if representative of an underlying proprietary asset. Further, the Islamic jurists' likening debt to money creates the effect whereby any increased return element of the securities trigger the *riba* prohibition and all receivables, including future streams of income, are characterised as purely personal rights – eliminating the viability of secondary markets. Second, given the intangible and/or future nature of debts/receivables, even if the receivable is asset-backed, the sale of receivable securities on the secondary market is perceived to trigger the prohibition of *gharar* (speculative uncertainty) and the legal maxim[2] that prohibits the 'sale of one deferred obligation with another' (*bay' al kali bi al kali*)[3] which is linked, again, to the issue of homogeneity and *riba*.

Therefore, the two fundamental reasons why the sale of debt is prohibited by Muslim jurists[4] are:

- the non-proprietary nature of debt as a result of likening debt to money; and
- the intangible and future nature of debt that is deemed alien to traditional conceptions of property.

To resolve the nature and legality of the state of debt in Islamic law, this chapter must therefore consider the following issues:

1. What is debt? How is it defined? Is debt money? And, what are the consequences, either way, of the sale of debt?
2. Is debt a personal or proprietary right? Is debt capable of being sold only if it is proprietary? And what are the consequences for Islamic finance securitisations, either way?
3. Must the sale of debt be asset-backed? If so, why and on what basis?
4. If Muhammad, and commercial practice, allow debt rights to be freely transferable to third parties via the contract of *hawalat al dayn* (transfer of debt) and, thus, impliedly granting debt proprietary nature, why are receivables (debt rights) not allowed to be freely traded on primary and secondary capital markets?
5. If the sale of debt is prohibited on the sole basis of it being likened to money (money being non-proprietary) how do we explain the fact that gold and silver are directly likeable to money yet they are proprietary

and freely tradable in nature; and why is debt not accorded the same allowance?

Before the above questions are addressed, it is important to note that the issue of sale of debt in Islamic law is *ijtihadic*[5] in nature – it is not spelt out in the *Quran* or by Muhammad but rather it is open to independent reasoning and determination. Therefore, different jurisdictions have reached different conclusions pertaining to the application of the sale of debt. The *ijtihadic* nature of this issue is of great significance because it allows for the drawing of fresh conclusions and evolution within the objectives of the sharia, rather than having to be rigid and restrictive. This is especially so given that the general principle operative with regard to commercial affairs is that of permissibility.[6] The permissibility of the sale of debt in Islamic finance can, therefore, be based on the opinions of one or several schools of jurisprudence[7] through a selective approach as long as the general objectives of the sharia in transactions are achieved whilst addressing the current social and economic challenges faced by Muslim societies.

6.1 The concept of debt

To consider the concept and application of the sale of debt in Islam, it is useful to commence with a consideration of the concept of debt. So, what is a debt and what does it comprise?

A debt is a liquidated money demand, as opposed to a claim for damages or other unliquidated money demands, and has thus been defined as a monetary obligation owed by one person to another.[8] Debts, commonly, are also referred to as receivables. A receivable is a single or periodic payment owed by one (debtor) and payable to another (creditor). Receivables include, but are not limited to, book debts and would cover assets as diverse as rents issuing from land or personal property, freights, bank loans and a simple debt for goods sold.[9]

In the context of this book, the term 'debt' is used to represent not only an amount borrowed but also an amount owed or due to another as a result of a credit transaction or deferred payment. Credit arises, mainly, out of either of three types of commercial transactions: a loan, sale or hire.[10] Whichever the transaction, the arising *obligation to repay* the loan or for the goods or services supplied (or to be supplied) is what gives rise to a debt which then subsists until settled.[11] Once settled, the debt ceases to exist.[12] Oditah points out that it is difficult to conceive of a situation where a debt or other obligation does not arise prior to its discharge. [13] Even where money is paid over the counter at the time of sale, there must be a moment in time

during which the purchaser is indebted to the vendor.[14] In most, if not all transactions, there is always a *scintilla temporis* during which one party is the creditor of the other.[15]

A critical point to make, however, is that the credit transaction, whichever kind it is, is distinct from the right to receive payment it gives rise to. In other words, a debt right is separate and distinct from the loan or sale or lease contract that creates it. The subject of enquiry for our purposes is, thus, the right to receive repayment and not the credit transactions giving rise to it. To illustrate the distinction, recall the distinction between the proprietary right of usufruct or lease and the underlying property that may be leased. An enquiry into the nature of leases and the legality of the sale of usufruct rights may be conducted independently of the underlying (varying) properties that may be leased. The same is true for our present enquiry regarding debt and the sale of debt rights. A major part of the analysis revolves around the determination whether, respectively, the debt and debt right and obligation arising are personal or proprietary in nature (section 6.4).

6.2 The relationship between debt and money under Islamic law

To resolve the status of debt effectively in Islamic law, we must resolve the relationship between debt and money. Muslim scholars persist in their likening of debt to money which, in turn, attracts to all debts the restrictive *riba* rules that they apply to restrict the exchange of homogenous items, that is, debt (money) for money. The significance of the comparison is at once apparent in view of the fact that money is not transferable because it is not proprietary under Islamic law, neither is debt. As we shall see in section 6.5.1, though debt is freely assignable to third parties under Islamic law, it is, nonetheless, denied proprietary character on the basis of the above comparison. This juristic position contradicts both the traditions of Muhammad and Islamic commercial practice that demonstrate debt's proprietary nature through its free assignability between contracting parties. For these reasons, debt's relationship to money under Islamic law must be addressed. Before I proceed to consider the relationship between debt and money, a word on drawing comparison in the Islamic *intellectual* tradition is fitting.[16] Drawing comparison has long been a means of intellectual enquiry and theoretical research employed both in philosophical aspects of cosmology as well as everyday matters of commerce and society. It is referred to as *tashbih* and the likening one thing to another is called *tamthil*. What is important, however, is that Islamic intellectualism has always operated on a qualitative (as opposed to literal) basis of drawing similarity or likeness. This is understood directly by the famous verse in the *Quran*, *al-Baqara*: 275 when

those who question the prohibition of *riba* in transactions say, 'verily, trade is like *riba*'; the response to which was, 'And Allah made lawful trade and prohibited *riba*'. Thus, on the basis of appearance (form), trading and the *riba* transactions prohibited were similar yet, the distinction being drawn by the *Quran* was qualitative – trade and *riba* transactions differed qualitatively in that one is, in effect, equitable and efficient (or at the very least less amenable to inequity and the ensuing market inefficiency) whilst the other is inequitable. In addressing the arguments pertaining to debt's similarity to money, I shall use this qualitative yardstick to determine its veracity.

6.2.1 Is debt money?

Money, both within the context of Islam and generally, forms part of one's wealth or tangible assets, especially in its origins of gold and silver. Money, today, at the very least, serves the function of being a measure of value, as did gold – or salt – once upon a time; its two other functions are: a store of value and a medium of exchange. There is nothing peculiar about money under Islamic law, neither is there a distinct definition special to Islam. Money is money, as is commonly defined and used, except in one specific aspect – money is not itself a commodity and has little value beyond its function as a medium of exchange, a measure of value and a store of value.[17]

A debt may be distinguished from money in that though it is representative of money owed, is not itself money. It is a claim or a right one has against another for money or things owed. It may be described as a *right* one possesses *in* another's assets equivalent to the value of his claim of money or kind owed. A debt claim is thus an asset to the claimant, and in that respect similar to money, but not the *same* as money. The apparent similarity between the two is that both are assets of the owner by virtue of their monetary value. However, if measurability in monetary value is what determines the similarity between money and an item of value, then most things on this planet could be likened to money because they are valued and valuable in monetary terms, just as a debt is. Monetary valuation of all commodities for purposes of encouraging equitable and efficient market exchange is, in fact, what Muhammad implied in his saying (II) regarding the exchange of dates by Bilal.[18]

The claim by most Muslim scholars[19] that debt is equivalent to money attracts all the restrictions pertaining to *riba* (either of no increased return or demanding equivalence in quantity and quality exchanged on spot basis).[20] These rules are derived from the saying of Muhammad (I) directing the exchange of homogenous items which have, in turn, been interpreted and extended to require their application to all sale of debt transactions. One version of this tradition provides:

> Gold is to be paid for by gold, silver by silver, wheat by wheat, barley by barley, dates by dates, salt by salt, like by like, payment being made hand to hand. If these types differ, then sell as you wish, if it is hand to hand.[21]

Before the different strands of arguments from the similarity (of debt and money) based on the above saying are addressed, consider that:

1 The saying does not restrict the sale (for money) of any of the items it refers to and it, therefore, cannot be used to restrict the sale of any other (non-mentioned) item in doing the same. What the saying does is to regulate the barter of such mentioned items based on equanimity only.
2 It follows from the saying, as commercial practice universally demonstrates, even gold and silver can be sold for money despite these two commodities being the two core universal metal currencies that symbolise money. If, therefore, gold and silver are proprietary in nature and freely transferable, the argument cannot stand that debt rights cannot be sold for money because of their monetary value. Further, Islamic commercial practice today seems to have embraced the trading of foreign exchange at a profit.

That said, the similarity could best be addressed by breaking it into (distinct) components of arguments establishing it, as follows:

1 At a conceptual level, debt is equivalent to money, thus a transaction of debt for money is equivalent to a transaction of money for money, attracting all the *riba* rules pertaining to the exchange of money for money (derived from Muhammad's saying on the exchange of 'gold for gold').
2 The *riba* rules pertaining to debt sales (as money) prohibit both an exchange at an increase or discount of the value of the debt as well as require any exchange to be executed on spot basis. Likewise, any indebtedness assigned to a third party should be done on the spot basis for cash of exact equivalent to the debt's worth, that is, at no gain to either side.
3 The sale of debt rights to third parties is prohibited since, debt being equivalent to money, Islam does not regard money as a proprietary commodity exchangeable beyond the contracting parties.

The first two components are linked hence are dealt with together. The last argument pertains to whether debt is proprietary or not and shall be deal with in section 6.5.

1 At a conceptual level, debt is equivalent to money, thus a transaction of debt for money is equivalent to a transaction of money for money, attracting all the *riba* rules pertaining to the exchange of money for money; and
2 The *riba* rules prohibit both an exchange at an increase or discount of the value of the debt itself as well as require any exchange to be executed on spot basis. Any indebtedness assigned to a third party should therefore be done on spot basis for cash of exact equivalent to the debt's worth.

There are two levels to this argument. First, that money and debt are equivalent in value and therefore a loan of £1,000 is worth £1,000 in cash. Second, that money and debt are conceptually equivalent and, therefore, a *right* to receive money is conceptually equivalent to money.

The first level of the argument is predicated on the limited concept of debt being loan credit, that is, arising from the loan of money by one to another. Not all debts, however, take the form of loan credit. Debts may also arise through trade credit transactions and it is a universal fact that trade credit is an obligation to pay another a specified amount in the future. As the well-known English saying goes, 'A bird in the hand is worth two in the bush', likewise, cash in hand (liquidity) is worth much more than the right to be paid the same amount in the future. This rule indicating the time value of money has long since governed credit transactions in Islam as is clearly illustrated by Muhammad in dealing with the Jews of Bani Nadhir upon asking them to leave Madina, to discount their debt rights for spot payment. Time has a monetary value and, thus, money and credit, even in the view and practice of Muhammad, are not equivalent in value. The similarity drawn is unsustainable.

Second, the argument, falsely, assumes a conceptual equivalency between debt and money. Debt and money are two distinct concepts. Money (paper currency), under Islamic law – as under all other legal systems – is used today mainly as a measure of value and a medium of exchange, within the prescribed boundaries of *riba* (inequity) and *gharar* (speculative uncertainty). Money can be used to buy whatever one wishes (provided it is *halal* (lawful)) at any price agreed upon. Debt, unlike money, is not a *measure of value* or a *medium of exchange*. The twin indicia of money forms the ratio that Muslim scholars derived from Muhammad's saying demanding reciprocity in the sale or exchange of currency metals (gold, silver) which they then extended to the exchange of all currency, by analogy. Given, therefore, that debt lacks this twin indicia, the *riba* rules do not apply to it because neither is debt money (conceptually) nor is it homogenous to money. The relied upon Hadith on *riba* provides 'where

the species differ, sell as you wish' and, thus, the creditor may sell his right/s to receive payment for cash as he wishes. This answers the third component of the similarity.

6.3 The relationship between debt and money under English law

6.3.1 Defining money

The legal definition of money under English law is physical money, that is, notes issued by the Bank of England and coins distributed by the mint, when transferred as currency, not as a curio or other commodity.[22] It does not include bank money or electronic money.[23] It has also been said that:

> the quality of money is to be attributable to all chattels which, issued by the authority of the law and denominated with reference to a unit of account, are meant to serve as a universal means of exchange in the state of issue.[24]

Money is a negotiable chattel and title even to stolen money is said to pass to a bona fide purchaser of value without notice.[25] In modern times, money has become a tradable commodity in its own right and the subject of intense trading on foreign exchange markets.[26]

6.3.2 Debt

The term debt implies not only an amount borrowed but also an amount owed or due to another as a result of a credit transaction or deferred payment. In this sense, debt stands for credit (i.e. a money obligation one owes to another). Accordingly, it has been said that 'from a commercial viewpoint all credit takes one of three forms: loans, sale or lease'.[27] I refer to Goode's definition of all three terms:

> A loan is a payment of money to the debtor, or to a third party at the debtor's request, by way of financial accommodation upon terms that the sum advanced, with any stipulated interest, is to be repaid by the debtor in due course.
>
> Sales credit is price deferment. Price deferment agreements involve sales on open account, instalment sale and hire purchase agreements, revolving charge accounts … as opposed to lease or hire at a rent.
>
> Finance leasing, that is, the leasing of equipment to a single lessee for all or most of its estimated working life, and without an option to purchase, at a rental which, instead of representing the use-value of the equipment intended to be leased … is calculated to ensure the

> return to the lessor of its capital outlay and desired return on capital … it is thus a finance tool by which legal title remains in the lessor but economic benefit of ownership belong to the lessee.[28]

Loans are, thus, only one facet of credit and the concept of credit accommodates the different treatment, at law, of debt, sale and lease transaction. Goode notes:

> The courts have always regarded price-deferment as essentially different from loan, so that legislation regulating the lending of money has never applied to instalment sales and hire purchase, finance charges under sale and hire purchase agreements have been immune from attack under usury legislation and the two types of financial accommodation have been subjected to entirely different common law rules.[29]

From the above it is clear that Islamic law of transaction is not peculiar or superior to the common law in the distinct rules and treatment applicable to loan or debt transactions. The common law recognise the commercial nature of debt transactions yet regulates them distinctly from sale or lease transactions. Further, a clear conceptual distinction is made between debt and money under the common law of England.[30]

6.3.3 Legal characteristics of physical money

It is frequently claimed in Islamic scholarship that Islamic finance today differs from, and is barred from various aspects of, conventional finance due to the fundamentally different nature and treatment of money under Islam. The ensuing outline self-evidently renders this claim inaccurate.

Physical money has five important characteristics under English law.

1. Its value in law is not its intrinsic value (of the paper or metal that represents it) but rather the unit of account in which the note or coin is designated. Thus, a £1 coin is of £1 value even though the metal that represents it is worthless. This is effectively demonstrated with notes where a £20 note is of equally negligible value as a £500 note yet one is worth £20 and the other £500.
2. It is not bought or exchanged; it is either borrowed or received by way of gift or in discharge of an obligation owed to the recipient.[31] Where notes or coins are bought or held as curios (not money), then they are ordinary commodities.

3 It is fully negotiable in that someone who receives notes or coins in good faith and for value, obtains good title even if his transferor stole the money or his title was otherwise defective.[32]
4 Unless otherwise agreed, a creditor is not obliged to accept anything other than money in discharge of the debt owed to him.
5 Money is a fungible, that is, any unit is legally interchangeable with any other unit or combination of units of the same denominated value. That when one borrows money, one becomes the absolute owner of the notes and coins borrowed and is under an obligation to restore, not the notes and coins, but their equivalent value. Thus, it is said, a creditor's right to be paid is purely a personal right in that the creditor does not *own* the money representing the debt but rather is *owed* money by the debtor.[33] The creditor does, however, *own* the *right* to be paid.

The above description confirms the conceptual similarity between money under Islamic law and the common law of England. Even if a difference did exist, there is nothing divine about Islam's current position on money. The currently held position was invented by human beings, like you and me, and it can equally be changed by human beings like you and me because, unlike other legal systems, Islamic law is not controlled by any country or people but belongs to the collective agreement of the community. Better yet, one Muslim community has the right to differ from another community on such non-ritual issues. On this basis, the Islamic practice of Saudi Arabia is starkly different from that of even Dubai, let alone Malaysia, and that of India distinct from that of Indonesia.

6.3.4 The distinction between physical money and intangible money

It is an accepted fact in today's world that though cash remains the overall dominant medium of payment, bank money or transfers represents by far the most important method of discharging money obligations in commercial transactions.[34] The question, then, is whether physical money is equivalent to intangible money (bank credit and credit notes)?

The answer is no. A clear distinction is drawn under the English common law between physical (notes and coins) and intangible (bank) money. This is expressed clearly by Lawson and Rudden:

> A debt is an abstract thing quite distinct from the money which will be the creditors if it is paid. For if X promises to pay Y £5, what belongs to Y is not the note which may possibly be at that moment in X's pocket, but a totally distinct thing, namely the contractual right to be paid

> the £5. Each of the two things, the note and the right to be paid the £5, can be objects of distinct transfers, for X can effectually and quite properly make A the owner of the note and Y can just as effectually and properly make B the owner of the right to be paid the £5.[35]

Intangible money is not the same as physical money in that it does not pass on delivery and otherwise lacks many of the legal characteristics of physical money, that is, it is not issued under state authority, it is not legal tender, it does not serve as a universal medium of exchange, and it is not negotiable. The same is said to be true of electronic money or digital cash.[36]

6.4 What is property?

The crux of the enquiry into the legality of the sale of debt revolves around the nature of debt under Islamic law, and specifically, as to whether debt rights are personal or proprietary. To determine this we must consider the concept of property and answer the questions: whether property is a right in a thing or the thing itself; what are the criteria that defines property; and what distinguishes a proprietary from a non-proprietary right? It is intended, by answering these three questions, to demonstrate that debt, in Islamic law and commercial practice, displays both the nature and criteria of property. Nonetheless, as will become clear in the discussion that follows, whether debt is personal or proprietary in nature has no impeding effect as to whether it may validly form the subject matter of a contract of sale. Non-proprietary rights have long since been capable of being sold (or leased) through contract, even before and at the time of Muhammad. Either way, therefore, debt rights being free of its misconceived similarity to money, may validly be sold as securities (at least) on the (primary) capital market under contract law. Under the common law, this is made clear in the observation of Rose LJ in *Re Bank of Credit and Commerce International (No. 8)*,[37] that 'Since a chargeback is incapable of vesting a proprietary interest, its effect is purely contractual'. Further, Lord Hoffman, on appeal at the House of Lords, in *Re BCCI (No. 8*),[38] distinguished between proprietary interest in the chargeback and proprietary interest in the deposits (debt). Though no proprietary interest subsisted in the chargeback, this did not preclude the subsistence of proprietary interest in the deposits (debt). We return to this in greater detail below.

Next, we commence with a consideration of property under the English common law given that the evolution of debt rights, from personal to proprietary, is already well established within the English common law.

Property, generally, falls under two categories: real property (land) and personal property (personalty).[39] Both categories of property comprise of *proprietary rights*. Real property comprises all land rights (and proprietary rights attached to the land) while personal property comprises all residual proprietary rights after real property (land and items that form part of the land) have been subtracted. Not surprisingly, therefore, personalty is described as being residual in nature, a characteristic that is said to contribute to its formless nature[40] since personalty, unlike land, is capable of expansion both in respect of recognition of novel kinds of property and quantity and can be multiplied indefinitely in number.[41] It is on this basis that the English common law came to recognise debts, company shares and various forms of intellectual property rights all of which evolved from a status of mere *personal* rights in a thing to *proprietary* rights.[42]

The non-expanding nature of real property/land is widely acknowledged, as by Bernard Rudden for instance, when he says, 'In very general terms, then, all systems limit, or at least greatly restrict, the creation of real rights: "fancies" are for contract, not property'.[43] Many systems enact as a basic rule the proposition that 'no real rights can be created other than those provided for in this Code or other legislation'.[44]

The 'fancies' that Rudden speaks of are the non-proprietary rights one has in a thing that can nonetheless be transferred through contract. This is what we indicated would be the position of debt under Islamic law in the case that debt continues to be denied a proprietary nature of rights. Hence, whilst deemed personal, debt may still form the subject matter of a contract for purposes of transfer between contracting parties without the ability to transfer to or affect the rights of a third party. More importantly, Rudden's statement regarding the restricted category of property rights refers to the real property (land), not personal property rights that may change and/or expand with time and context. His meaning is a reflection of judicial statements expressing the same distinction.[45] A few instances are:

> [T]here are certain known incidents to property and its enjoyment; among others certain burthens … recognised by the law … but it must not therefore be supposed that interests of a novel kind can be devised.[46]
>
> It is a well-settled principle of law that new modes of holding and enjoying real property cannot be created.[47]
>
> New and unusual burdens cannot be imposed on land. It strikes our ears strangely to hear a right of services from an individual called a right of property as distinguished from contract.[48]

Therefore, the fundamental distinction between land and personalty is that land rights are fixed whereas personalty is expanding.[49] Accordingly, debt achieved recognition as one of many forms of intangible property as a result of legal evolution that saw debt shift from being a pure personal right to personal property rights. This is also true of debts under Islamic law, as we consider later in this chapter. Note, however, that even the position of the law pertaining to land is relative – the judicial pronouncements are not indicative of an absolute position of crystallised rights for as Gray and Gray explain:

> Property is socially constructed[50] … and it is even possible, that in large historic processes of evolutionary development, some kinds of claim affecting land can actually alter their status, moving backward or forwards across this threshold of proprietary character.[51]

Hegel expressed this relativity thus, 'the march of mental development is the long and hard struggle to free a feudal content from its sensuous and immediate form'.[52]

6.4.1 Distinguishing personal from proprietary rights

It is intended, in distinguishing between proprietary and personal rights, to highlight the criteria that define property rights as opposed to personal rights. The distinction hinges on the understanding that just as *property* is divided into real (land) and personalty, *rights* are also divisible into either proprietary or personal in nature. Property rights, whether real or personal in nature, are proprietary nature and can be dealt with accordingly. Personal rights, on the other hand, are non-proprietary and cannot be dealt with except through contracts as between the contracting parties. There is, therefore, a clear distinction between personal *property* (property other than land) and personal *rights* (non-property rights *in* a thing).

Gray and Gray point out that conventional wisdom dictates that in order to enjoy a proprietary as distinct from merely personal character, (land) rights must be capable of third party impact.[53] This characterisation is of course not limited to land (real) property but is equally indicative of personal property. According to Bridge, 'the touch stone of a property right is its universality: it can be asserted against the world at large and not, for example, only against another individual such as a contracting partner'.[54] These twin indicia of property, assignability of benefit and enforceability of burden, are deeply embedded in one of the classic statement of English property law.[55]

In *National Provincial Bank Ltd v Ainsworth*, Lord Wilberforce, in the course of his judgement, identified the essential characteristics of a property right as follows:

> Before a right or an interest can be admitted into the category of property, or of a right affecting property, it must be definable, identifiable by third parties, capable in its nature of assumption by third parties, and have some degree of permanence or stability.[56]

Note that Lord Wilberforce speaks of *rights* or *interests*, not things, being *admitted* into the category of property (having previously been merely personal rights or interests). He points out a threefold criterion of property rights: identifiable by third parties, ability of assumption by third parties, and *some* degree of permanence. This threefold criteria in *Ainsworth* was applied in the recent case of *Mubarak v Mubarik*[57] as to whether the 'right or interest the wife had under the discretionary trust … as property at all'. Holman J held that her right or interest did not have any degree of permanence or stability and was not capable of assumption by third parties. Two of the three requirements set out in *Ainsworth* thus stood as unfulfilled, denying the right or interest in question, proprietary character.

English common law, not too long ago, considered debt to be a right of mere personal nature (that could not be traded in though it could be contractually assigned). Through the Courts of Chancery and the principles of equity, debt rights were granted proprietary status and thus they took the character of proprietary rights (assignability to as well as enforceability against third parties). Debt rights thus took on the character of being rights *ad rem* (against the world) as opposed to rights *in personam* (against an individual).

The common law was resistant to the notion that intangible things (aka chose in action), the best example of which is debt, could be transferred.[58] This resistance stemmed from the notion, as Muslims are currently operating under, that debts and similar things such as intellectual property (IP) rights and company shares were intangible and thus personal rights (as opposed to personal property) whereas property was mainly thought of in terms of tangibility (or permanence in form). The transfer of what was perceived as personal obligations, to third parties or the permitting of third parties to interfere in personal rights was seen as contrary to public policy. This deficiency in the law of property was left to equity to repair through enforcement in the courts of Equity and, eventually, by permitting the bringing of a debt claim by the assignor in the name of the assignee, the

assignability of debt became accepted. With this acceptance emerged the recognition of debt as property just as any other tangible item, like a car or a computer.[59] The only distinction between a debt and a car for instance is that a debt comprises solely of a right to payment, and thus, once paid it ceases to exist. This, however, is where Lord Wilberforces' third criterion assumes significance because what is required is a *degree* of permanence. The degree of permanence of a debt is thus relatively shorter than that of a car but it, nonetheless, possesses a degree of permanence. It is further important to point out that, as far as assignability being a criterion of property, there stands absolutely no difference between a building and a debt because in both instances what is assigned is the *right* in the thing and *not* the *thing* itself. Therefore, the resistance in the common law towards the acceptance of debt as property stemmed not from the peculiarity of assigning intangible rights (which is what assignment entails) but from the peculiarity of recognising an intangible as property given that hitherto, property was tangible in form.

A major distinction between property and personal (non-property) rights is, therefore, that property rights can be assigned to third parties while non-property rights are purely personal rights that, though capable of passing in contract, are not amenable to third party assignment and are incapable of otherwise affecting third parties. Accordingly, debt rights, under Islamic law, are also proprietary. To illustrate the distinction between proprietary rights and personal rights, Gray and Gray explain that 'an informal dinner party invitation – being an occasion of ill-defined content and uncertain duration – is neither *transferable* to others nor apt to endure through a change of ownership of the freehold estate in the land'[60] (emphasis added).

However, Gray and Gray also point out that, contrary to what *Ainsworth*[61] indicates, proprietary quality, as is now widely acknowledged,[62] does not necessitate transferability or alienability. That, while it is often an important incident of proprietary entitlement, transferability is far from being an indispensable index of proprietary character.[63] He adds that the snare of market psychology has led to the crude belief of the property lawyer that if something is property one can buy and sell it. He notes, therefore, that the misconception that proprietary rights are those that can be bought and sold is prevalent. *Property need not be capable of sale and non-proprietary rights have always been the subject of contractual exchange between private parties.* According to Gray and Gray, it is the binding impact on third parties that is the threshold criterion of proprietary rights and, on this basis, what begins as a personal contractual relationship may evolve into a proprietary relationship. Nonetheless, the general perception and application of proprietary

rights has it that a debtor's duty to pay the creditor creates a valuable property because of its exchange value (transferability). If a debt (receivable) could not be transferred (assigned) it would be no more than a contractual expectancy of the creditor's and, as such, non-proprietary.[64] The same line of thought was expressed in the judgement of the Australia High Court in the case *Dorman v Rodgers*[65] where a Dr Dorman claimed an appeal 'as of right' under S35 (3)(b) of the Judiciary Act 1903 (Cth) from a final judgement of the full Court of a State Supreme Court 'in any proceedings in which the matter in issue amounts to or is of the value of $20,000 or upwards or which involve directly or indirectly a claim, demand or question to or respecting any property or any civil right amounting to or of the value of $20,000 or upwards'. Dr Dorman relied on the second limb of the above provision in appeal against a decision to strike his name off the register of practitioners as a result of being convicted of 44 charges under the Health Insurance Act 1973 (briefly, of making dishonest claims for payment for medical services between February 1975 and 1 October 1977).[66] Gibbs CJ, in *Dorman*, relied on the judgement of the same court in *Clyne v N.S.W. Bar Association*[67] that no appeal lay as of right from an order striking the name of the appellant off the roll of barristers. The court in *Clyne* held that: 'There is no property that can be said to be involved, and no civil right capable of being valued'.[68]

Gibbs CJ observed 'that decision governs the present case, and in my opinion it was correct'. He explained that what was valuable was the person's own earning capacity, which is something '*personal*' to him (emphasis added). 'The right to practice is of course not transmittable.'

The judgement of Murphy J in *Dorman* discusses the concept of property and describes various rights falling within the category of property.[69] He observes that:

> *In legal usage property is not the land or thing, but is in the land or thing.* Throughout the history of the common law the concept of property has been used to recognise the legitimacy of claims and to secure them by bringing them within the scope of legal remedies.[70] (emphasis added)
>
> They might first be formulated as social claims with no legal recognition. As they became accepted by reason of social or political changes they are tentatively and then more surely recognised as property. The limits of property are the interfaces between accepted and unaccepted social claims. The great case of *Ashby v White* established that the right to vote in elections for parliament was property and its denial a deprivation, remediable by an action for damages. …

> It is not an essential characteristic of property that it be transferable. The right to vote in *Ashby v White* [1790] Eng R 55 and in *Amalgamated Society of Engineers v Smith* [1913] HCA 44 was not transferable. Numerous other property rights are non-transferable, for example licences of various kinds.[71]

Murphy J's observations resonate with Gray and Gray's observations made earlier in this section as well as those referred to in the next section. Nonetheless, he goes on to hold that Dr Dorman's 'appeal is hopeless' and that it should be dismissed. His decision appears to be based more on considerations of public policy given Dr Dorman's 44 convictions rather than on the conclusion that his right to practice was non-proprietary.

Note, however, Gray and Gray's warning against the 'vice of circuity'.[72] He thus explains that rights are not enforced against third parties because they are proprietary but that they are proprietary precisely because they are so enforceable. Hence, 'proprietary character is not the basis upon which that protection is given, but is simply a term descriptive of the effect of that protection'.

6.4.2 Property: a right or a thing?

Austin long since hinted at the answer to this question in explaining that, 'The *right* of property, is resolvable into two elements: First, the power of using indefinitely the subject of the right … secondly, the power of excluding others'.[73] Gray and Gray explain, in other words, that 'property … connotes, ultimately, a deep instinctive, self-affirming sense of belonging, control and domain'.[74] Accordingly, Gray and Gray explain that 'property is not a thing but a power relationship … It is the condition of a thing "being *proper* to me"[75] … It is a relationship of social and legal legitimacy existing between a person and a valued resource' (whether tangible or intangible).

Therefore, Gray adds, 'once property is defined as a relationship of socially approved control,[76] it becomes infinitely more accurate to say that one has property *in* a thing than to declare that *something* is one's property' (emphasis added). He emphasises that in legal usage property is not the land or thing, but is (a right) *in* the land or thing;[77] that is, property is the right we have in things and not the things we think we have.[78] They point to a 'mistaken reification of property' and explains that much of our false thinking about property stems from the residual perception that 'property' is itself a thing or a resource rather than a legally endorsed concentration of power over things and resources.[79] They cite C.B. Macpherson as the one who drew attention to the way in which, in the transition from the pre-capitalist world

to the world of the exchange economy, the distinction between a right to a thing (i.e. the legal relation) and the thing itself, became blurred. That, 'the thing itself became, in common parlance, the property'.[80] It is in this light that Gray and Gray state, definitively, that at the heart of the phenomena of property lies the semantic reality that *'property' is not a thing, but rather the condition of being 'proper' to a particular person* (e.g. 'that book/car/house/ is *proper* to me').[81] He explains that in archaic English, the word '*proper*' served to indicate relationships of proprietary significance[82] (emphasis added).

Accordingly, a creditor owns the *right* to payment for the debts he has claim to against other people and may deal with them (rights) the same way he would his computer or company shares.

The same is true of Islamic conceptions of property even at the time of Muhammad. First, the word property in Arabic, though often assumed to be *mal*, actually originates from the word *haqq* which means 'right' or 'what is proper' or 'appropriate' or 'proprietary'.[83] When one says in Arabic that something 'is mine' or 'my property' or 'my *right*' one says in Quranic terminology (with which we are here concerned) '*haqq-i*'. Second, as we discuss in section 6.5.1, a debt is the *right* to receive payment that subsists *in* a fund, thing or person until such payment is made. This fact is confirmed by the ability of a debtor (or creditor) to assign one's debt obligations (or rights) to another person and so extinguish his or her obligation or right towards payment, as we shall discuss in section 6.5.2.

6.5 Debt vis-à-vis property under Islamic law

A debt is agreed by the sharia scholars to be a *right* of the creditor and the *obligation* of the debtor.[84] The creditor has the right to repayment of the amount owing and the debtor has the obligation of repayment of the amount owed, between the creditor and debtor, respectively. The right or obligation is, therefore, not to the thing itself (debt or credit) but rather subsists *in* the debt as a *right or obligation to repayment* between the parties that gave rise to the credit contract. To this point, Islamic law and the common law is agreed.[85] However, sharia scholars, generally, insist that the right of the creditor and the obligation of the debtor to payment is a purely personal right, hence, only capable of transfer between the contracting parties and incapable of passing through contract to third parties. In support of such characterisation, Muslim jurists refer to the distinct terminology used: *ain* pertaining to property and *dayn* pertaining to debt. They argue, therefore, that debt cannot be property; and property cannot be debt, leaving us at an apparent deadlock as far as deeming debt rights proprietary is concerned.

6.5.1 Is Debt property?

In section 6.2.1 above we concluded that gold and silver are directly representative of money (in value and kind) yet perfectly proprietary, and, therefore, debt, too, can be proprietary whilst representative of money (in value). The question then is: are debt rights freely tradeable?[86] The answer is indicated in the tradition of Muhammad and the commercial practice of his time: that debt rights are not only transferable to third parties, they are also tradable for cash at a mark-up or discount evidenced by the tradition of Banu Nadhir in which Muhammad advised the Jewish community leaving Madina to discount their debt rights for spot cash. The same tradition also underscores the fact that debt is not homogenous to money because Muhammad allowed the exchange of debt rights for money and the rules of equanimity in Muhammad's saying on *riba* does not apply in the case of sale of debt for cash as he allowed debts to be discounted.

The Fiqh Academy of the Organisation of the Islamic Conference, under its decision number 5 of 1998, gave support to the conclusion that financial rights are freely tradable proprietary rights that may be evidenced on paper and sold on the capital market as bonds (securities) on the condition that interpersonal debts and cash form only a limited proportion thereof. In the referred to decision the Fiqh Academy ruled that:[87]

- 'Any collection of assets can be represented in a written note or bond; and
- This bond or note can be sold at any market price provided that the composition of the group of assets represented by the security consists of a majority of physical assets and financial rights with only a minority being *cash and interpersonal debts*'.[88]

Pertaining to the distinction drawn between debt rights (*dayn*) and property (*ain*), we already noted that the terminology for property is *haqq* which means one's *right*. A debt (*dayn*) is a right *haqq*: it is a right to payment, of a sum of money or money's worth, by another. In any case, the concept of property under Islamic law is elastic and has evolved at different times based on the values and objectives of the society. Thus, at one time, under Islamic law, slaves and women were socially approved as property and were regularly bought and sold (or even leased or loaned) but are now no longer deemed property. It is universally accepted that all people are sovereign individuals in their own right with the ability to own property as opposed to being owned as property. Pertinent to note, in this respect, is that there is no express statement in the *Quran* or made by Muhammad that prohibited

women and slaves from being deemed property. Rather, their status as sovereign individuals is an implication drawn from Muhammad's (and eventually, society at large) treatment and manner towards them. The same can be applied to debt rights transitioning from personal to proprietary. The *Quran* and traditions of Muhammad need not contain an express statement as to their being property. It suffices that this is implied in the treatment accorded to debt rights by Muhammad and that there is no express negation of debt rights being proprietary.

The argument that debt has always been considered distinct from property, therefore, does not mean debt is not property. Islamic law terms (and treats) lease of usufruct (*ijara*) distinctly from *ain* (property). In fact, seldom, if ever, are lease rights referred to as my 'property' but rather merely as rights of proprietary nature. It is the underlying property, upon which the lease right subsists, that is deemed *ain* (property), in the traditional sense, whilst the leased usufruct being simply rights. Lease or usufruct rights in property were once also personal in nature. Eventually, social evolution led to such rights being granted proprietary status via customary practice (even before the time of Muhammad) to facilitate commercial and social welfare. Moreover, the property subject to lease rights may differ and change from time to time or society to society as long as it does not embody something the *Quran* and tradition of Muhammad expressly prohibited.

It is also possible that the distinct terminology of *ain* and *dayn* arises much like the common law distinction between real property and personal property. *Ain* was before and is usually used to denote real property as opposed to personal property (tangible or intangible). For instance, one would not term a bag of grains *ain*, even though it is definitely saleable and proprietary in nature (saleability and proprietary nature being distinct characteristics). The same applies to debt and, thus, the argument distinguishing *dayn* from *ain* does not stand.

6.5.2 Transferability of debt under Islamic law and the contextual evolution of property rights

In section 6.4 it was noted that a fundamental criterion of property rights is transferability to third parties. Transferability of rights to third parties signifies, through effect beyond contracting parties, the admissibility of a right into the category of property rights, as indicated by Lord Wilberforce in the case of *National Provincial Bank Ltd v Ainsworth*.[89] In section 6.4.2 Gray and Gray cautioned against the 'vice of circuity',[90] that rights are not enforced against third parties because they are proprietary but that they are proprietary precisely because they are so enforced. Hence, 'proprietary

character is not the basis upon which that protection is given, but is simply a term descriptive of the effect of that protection'. Transferability of a right, therefore, crystallises its character, for instance, debt rights or lease rights that were once personal, as proprietary.

It is of great significance, therefore, that under Islamic law the transfer of debt to third parties (*hawalat al dayn*) is a universally accepted concept with broad commercial application. It commenced as a social, and later commercial, practice of transferring debt *obligations* to third parties, even before the time of Muhammad. Legally, *hawalat al dayn* has been defined as, 'the shifting or assignment of debt from the liability of the original debtor to the liability of another person'.[91] Essentially, it is described as the substitution of one obligor for another with the agreement (consent) of the creditor.[92] Such transfer is similar to the concept of novation of debt under the English common law since,[93] in contrast to an assignment, *hawala* envisages the transfer of the debt obligation of the debtor to a third party and such transfer requires the consent of the creditor. The requirement of the creditor's consent, however, does not negate the assignability of debt rights since the position under discussion is that of the practice in sixth- and seventh-century AD Arabia and parallels the initial position under the common law as Chitty confirms:

> Contractual rights, being things in action as opposed to things in possession were not assignable at common law without the consent of both parties. This rule seems to have been based initially on the difficulty of conceiving of the transfer of an intangible, at any rate one of such personal nature, and later on the desire to avoid maintenance, viz. officious intermeddling in litigation.[94]
>
> Everybody has a right to choose with whom he will contract … consequently, the burden of the contract cannot in principle be transferred without the consent of the other party, so as to discharge the original contractor. [95] As Sir R. Collins M.R. said in *Tolhurst v Associated Cement Manufacturers Ltd*:[96]
>
> Neither at law nor in equity could the burden of a contract be shifted off the shoulders of a contractor on those of another without the consent of the contractee.

Therefore, Chitty adds, the requirement of consent as a prerequisite of the discharge of the original contractor from his obligation means, 'as a general rule the assignee of the benefit of a contract involving mutual rights and obligations does not acquire the assignor's contractual obligations'.[97]

Muhammad expressly affirmed and encouraged the transferability of debt obligations (for purposes of legality under Islamic law) for purposes of facilitating the repayment of debt within the society generally. The sayings of Muhammad, used to establish the transferability of debt, are all a slight variation of the following narration by Abu Hurayra on what Muhammad said:

> To evade and defer (payment of a loan) on the part of a person who is rich, is tyranny. If a loan is transferred to a rich person, he should be pursued for its repayment.

From the saying/s of Muhammad, Muslims inferred both that debt obligations may be transferred, that such transfer completely discharges the transferor from liability and therefore it is the transferee that is to be pursued for the repayment of the debt obligation. To this inference the sharia scholars added two more: that the consent of all three parties (creditor, debtor and transferee) are required for the transfer and the creditor should accept the transfer as long as the transferee is solvent (this being in line with the underlying purpose of *hawala*, that is, facilitating the repayment of debt obligations).

It is important to add that the concept of *hawala*, as earlier mentioned, existed even before the birth and message of Muhammad and, thus, it cannot be classified as an 'Islamic' law or textual creation other than by incorporation. It is common knowledge that Muhammad did not create an entirely new way of life for his people nor did he stipulate each and everything they could or could not do. Rather, especially in the domain of human affairs (as opposed to faith), the principle of permissibility remains the general rule and Muhammad simply incorporated the practices he found among his people that did not conflict with the overarching principle of justice, equality and social welfare. He changed or replaced only those practices that conflicted with these principles. This process confirms both the evolutionary nature of commercial practice in the history of Islam and the evolutionary nature of debt as a social and commercial concept. In fact, the concept and negotiability of debt as we now know it to be permissible under Islamic law is not how it originally was at conception, nor as it was at the time of Muhammad. With passage of time, both before and after the sixth and seventh century ad, the concept, use and negotiability of debt evolved to facilitate both commercial practice and socio-economic welfare. Muhammad's acknowledgement and encouragement of debt transfers certifies both the imperative value of credit and a well-functioning credit

repayment system in a society. Taken in this light, one easily appreciates the tradition of Banu Nadhir, in which Muhammad advised Banu Nadhir upon their emigration from Madina to discount their debts due in the future for spot payment. The discounting of debt established, as far back as seventh-century Arabia, the credit value of time as well as the value of liquidity (spot cash).

The sale of receivables and the full-fledged proprietary nature of debt is, thus, simply the continuing evolution of debt rights from what they were then to what they have now become. The discounting of debt rights and their transferability to third parties at that time marked the foundations of modern commercial and financial practices that other civilisations embraced and built upon. It's about time we picked up where we wandered off on this evolutionary trail.

6.6 Future (debt) contracts under Islamic law and practice

Contrary to claims, consequent to the similarity of debt and money, Islam recognises and provides for, in the express text of the *Quran*, future credit contracts. The exact words used are significant: '*idha tadayantum bi dayn liajallin musamma, fa'qutubuhu*' ('when you incur indebtedness for a fixed future period of time, reduce it to writing'). The manner in which indebtedness is incurred is not specified, and, therefore, this could be through any credit transactions: loan, sale or lease. The complete translation of the above verse[98] provides a detailed procedure for future credit transactions comparable to contracts by deed under section 1 of the Law of Property (Miscellaneous Provisions), Act 1989. It states:

> O ye who believe! When ye incur indebtedness with each other, in transactions involving future obligations for a fixed period of time, reduce them to writing. Let a scribe write down faithfully as between the parties: let not the scribe refuse to write as Allah has taught him. So let him write and let him who incurs the liability dictate, but let him fear his Lord, and not diminish aught of what he owes. If the party liable is mentally deficient, or weak, or unable himself to dictate, let his guardian dictate faithfully, and get two witnesses, out of your own men; and if there are not two men, then a man and two women, such as ye are content with as witnesses, so that if one of them errs, the other can remind her. The witnesses should not decline when they are called on (for evidence). Disdain not to reduce to writing (your contract) for a future period, whether it be small or big: that is more just in the sight of Allah and more upright as evidence, and least amenable to your

> engaging in *riba* among yourselves. Except, if it be a transaction which ye carry out on the spot, frequently among yourselves, then there is no blame on you if ye reduce it not to writing. But take witness whenever you enter into a commercial contract; and let neither scribe nor witness suffer harm. If ye do (such harm), it would be wickedness in you. So fear Allah, and Allah teaches you, and Allah is well acquainted with all things.
>
> If ye are on a journey, and cannot find a scribe, a pledge with possession (may serve the purpose). And if one of you deposits a thing on trust with another, let the trustee (faithfully) discharge his trust, and let him Fear his Lord conceal not evidence; for whoever conceals it – his heart is tainted with sin. And Allah knows all that ye do.

The sophistication of the provisions of the above text of the *Quran* is astounding even by modern standards. Together, the two verses provide for:

- future credit agreements,
- the requirements of writing and witnesses of the agreement,
- conditions excepting the requirement of writing (i.e. spot transactions and customary transactions),
- an alternative to the requirement of reducing the contract to writing in absence of scribes to write (i.e. a pledge with possession),
- the concept of trust and its ensuing requirement of utmost good faith.

In appreciating the term *dayn* (debt) as credit extended, one also appreciates that the *Quran* does not distinguish between loan (*qardh*), sale (*bay'*) or lease (*ijara*) credit transactions, requiring only that transactions be contractual,[99] by mutual consent[100] and equitable[101] (not for *riba* and unjust enrichment). Credit is, by implication of the Quranic references, independent of the underlying transaction that gives rise to it. It is a universal fact that extending credit earns the creditor a time value for which he or she may charge a profit. This time value is expressly affirmed in Muhammad's tradition pertaining to discounting the debts of Banu Nadhir. Given, therefore, that all credit within a commercial context may be extended at a profit or discount, requiring only caution against inequity, one can equally deduce by extension that credit rights may be transferred or exchanged for profit or discount without restriction as long as everyone adhere to the principle of contractual fairness.

6.6.1 Future (debt) contracts and **gharar**

We noted earlier that one of the reasons the sale of debt to third parties is prohibited is because debt rights are intangible and future in nature which creates the perception that sale of debt transactions are risky (*gharar*) transactions. This is an indirect objection that, though not denying the proprietary nature of debt in principle, attempts to do so on the basis of *gharar*.[102] As discussed in chapter 4, *gharar* is a vitiating factor that threatens the validity of a commercial contract it taints. Two points must however be recalled

First, the fact that any contract for sale or transfer of a thing is open (or even prone) to being tainted by *gharar* does not mean that that the thing itself cannot be the subject of a contractual exchange or assignment. For instance, selling birds in the air, or carrots in the ground or products yet to come into existence are all prohibited as *gharar* contracts because the subject matter is deemed too uncertain to comprise a legally binding contract. Nonetheless, this does not mean that birds, carrots or future products cannot be the subject of contractual exchange. In fact, two of the most popular and oft-used contracts in Islamic commerce, both historically and today, involve contractual exchanges pertaining to subject matters not yet in existence: *bay al-salam* (pre-payment transactions) and *bay al Istisna'a* (commission to manufacture).[103] The fact that both these contracts are widely acknowledged to contain excessive *gharar* did not, and still does not, negate either the validity of the contracts or the transferability of the contractual subject matter. Contractual mechanisms were simply created to minimise the *gharar* whilst allowing the contracts to serve the social needs of the time, both then and now. The key point to note, thus, is that social need for a transaction or a practice greatly facilitates the permissibility of the transaction or practice in question because the benefit to society to be created through satisfaction of a social need outweighs any other consideration of perceived harm that would otherwise deem it impermissible. This is especially so in non-ritual matters with no religious prescriptions, as is the case with commercial transactions, and can be easily understood if appreciated in light of Islam's overarching concern with social justice. Thus, Muhammad is reported to have said that my people will never agree upon an error.

The fact that debt transactions, be they sale or transfer, may be speculative or uncertain does not negate the validity of the contract. The social and commercial evolution since the seventh century AD and the apparent social need for debt or receivable transactions is a major factor in facilitating the permissibility of receivable transactions. In any case, we have already established above that the patent endorsement by Muhammad of the transferability of debts grants debt rights proprietary status. This book

is only putting forth an already acknowledged position by Muhammad himself.

Second, not all *gharar* is of vitiating effect; only *gharar* of excessive degree is vitiating and, even then, only if incurable in nature.[104] In other words, *gharar* is an evidential concept which acts as a vitiating factor to protect against inequity that may arise from uncertainty of contractual terms. Considering therefore that, as with any other relatively novel mode of transaction, time and prevalence of sale of debt transaction is giving rise to mechanisms that are reducing their speculative nature for purposes of contractual equity. The *gharar* element in sale of debt transactions can be regulated, should it be deemed excessive (like *bay al-salam*'s case), and the *gharar* is certainly not incurable as to deny the transaction legal effect.

Applying the above to Islamic finance securitisations would allow for the sale of securitised receivables on the capital markets for purposes of creating liquidity and generating finance as part of the evolution of commercial practices and transactions.

6.6.2 Deferred 'sale of debt' transactions

The general Islamic jurisprudential (*fiqh*) rulings regarding the sale of debt prohibit the sale of receivables on credit (deferred payment) basis because of the legal maxim[105] that prohibits the 'sale of one deferred obligation with another' (*bay' al kali bi al kali*).[106] It is likely that this maxim was derived from the Hadith pertaining to exchanges of homogenous items as we discussed and addressed in 6.2 and 6.5 above. The maxim is wider in scope of application than the Hadith on homogeneity so as to prohibit, for instance, a contract to buy 10 kg of dates at a total price of £100, both delivery of the subject matter and payment to be made at a deferred date. A current example would be a contract to purchase property with deferred delivery of vacant possession on credit. The prohibition arises because the transaction is deemed to be one of credit[107] (deferred payment) for another deferred obligation (delivery of possession or subject matter). To make the transaction lawful, one of the parties must deliver their side of the bargain, be it the subject matter or the price. In all such contracts, the amount owed is a debt until payment is made which then converts the subject matter into property and cures the contract of its nullifying character. The question, therefore, given the sale of securitised assets evidenced by a note as security (*shahadat al-dayn*) on the primary market creates an obligation to repay a borrowed amount (debt) at a later date (deferred payment), is whether this is prohibited under the above maxim? The answer is, no. Such sale of debt obligation is permitted by the Islamic jurisprudence on the basis that the

sale entails the sale of property rights (securities/notes) on credit (much like usufruct can be sold for deferred payment) and therefore though it is a credit (debt) transaction, it is not a sale of one debt obligation for another as only one side of the contractual equation is comprised of debt.[108] So far so good. A complication arises with further sale of such debt obligations (the securitised asset) to third parties, that is, any subsequent sale on the secondary market. This is currently prohibited, by a majority of the jurisprudential schools, however the debt arises and regardless of whether the payment is made on the spot or on a deferred basis,[109] again, on the basis of the maxim prohibiting the sale of debt for debt. The securities (notes), once sold, are representative of an obligation to receive future payment (debt) and any subsequent sale transactions of such securities (whether on cash or credit basis) are deemed to be caught by the above maxim (prohibition). It is only the Maliki school that allows such sales of debt to third parties for spot payment and as long as the debt object is not food and does not involve prohibited *riba* of delay (*al nasia*).

Thus, we find that the *fiqh* ruling goes beyond the scope of the maxim prohibiting the sale of debt for debt (just as we noted that the maxim goes beyond the scope of Muhammad's saying) in that it even prohibits the sale of debt (securities) for cash in hand simply because such sale is to third parties. The prohibition seems to pertain more to the issue of credit sales being erroneously thought to taint the contract with excessive *gharar* (making it a *gharar* contract) which was addressed in section 6.6.1 above. There is no reason why the same transaction attracts different legal outcomes merely based on whether the transaction is between primary contractual parties, or extends to a third party. This is especially so when one realises that it was already concluded that debt or receivables are proprietary rights and, thus, any securities purchase on the secondary market is a fresh contract between the security (asset) holder and a buyer of that asset. Once the security is sold, the previous party drops out of the equation and the buyer assumes his position in almost bearer bond fashion. No implications of *gharar* or 'credit for credit' exist in the transactions even at the secondary market level. Further, the *fiqh* ruling must be contextualised to appreciate that twenty-first-century financial and economic markets are far advanced in sophistication to overcome risks involved in credit transactions as opposed to seventh-century Arabia.

6.7 The common law attitude to sale of future debts

Marathon Electrical Manufacturing Corp v Mashreqbank PSC is the key case discussing the distinction between future and existing receivables and succinctly summarises the common law position and attitude towards future

debts.[110] In *Marathon*, Mance J held that English law treated as existing debts not only those which had been earned by the promisee, whether or not presently payable, but also those which were unearned. In so holding, he quotes Oditah at length as follows:

> The attitude of English law to existing and future indebtedness is described by Mr Moss's junior, Dr Oditah in Legal Aspects of Receivables Financing (1st edn, 1991, pp. 1–8, 29, 135) as follows:
>
>> English Law draws an arbitrary distinction between existing and future receivables on the one hand, and future receivables and other contingent liabilities, on the other. All contractual rights are vested from the moment when the contract is made, even though they may not be presently enforceable, whether because the promisee must first perform his own part of the bargain, or because some condition independent of the will of either party (such as the elapsing of time) has to be satisfied. The result is that English law treats as existing debts not only those which have been earned by the promisee, whether or not presently payable, but also those which are unearned. The basis for the inclusion of unearned rights to payment in the category of existing receivables even where the contract is wholly executory is that they grow out of a present obligation. So it is that for a long time the courts have treated as existing or present receivables a legal right to be paid only at a future date if it depends upon an existing contract on the repudiation of which an action could be brought for an anticipatory breach. The contract is the tree, the future debts which may arise, the fruits. The unearned debts are potential and hence existing. But in so lumping earned (even though not presently payable) debts and unearned, albeit potential, debts, as existing debts, the common law has, in a somewhat extravagant fashion, destroyed the vital distinction between rights *in esse* and rights *in potentia*. Thus, a right to interest under a fixed-term loan, future rent from existing leases, sums payable under an existing construction contract, royalties payable under an existing copyright, freight payable under a signed bill of lading, and sums payable for goods or services not yet delivered or rendered, are all present receivables. Uncertainty as to the amount payable is immaterial. Similarly the fact that under some of these contracts nothing may be earned because the right is conditional on counter-

> performance is not considered important . . . The hardship and inconvenience engendered by this rule is mitigated by two factors. The first is a generous interpretation of 'existing receivables'. As we have already seen, English law treats as existing, not only earned receivables whether or not presently payable, and whether or not ascertained, but also unearned receivables expected under existing contracts. Many contractual relationships are of a long-term nature, and individual contracts are usually implemented within a pre-existing framework. Whether the existence of the framework alone is sufficient to stamp the expected receivables with the badge of existing property is unclear.[111]

He concluded, that:

> Whether one is considering an assignment of the benefit of the right to receive payments under a credit or, as here, an assignment of the actual proceeds as and when collected under a credit, the facility to assign is one which has obvious commercial benefit to the beneficiary. The facts of the present case illustrate how it may assist a beneficiary to continue and to finance his business generally as well as, quite possibly, the very business the subject of the letter of credit.

It can be readily appreciated that, given the permissive approach of the common law towards existing receivables as extending to future receivables flowing from present obligations, the adoption of the common law position in Islamic finance transactions will be greatly facilitative of successfully structured securitisation transactions. This is because the common law position allows the avoidance of triggering both the vitiating factor of *gharar* (given the ensuing conceptual certainty gained from adopting the common law position on existing receivables); and maxim prohibiting sale of debt for debt because any receivable flowing from a current obligation is deemed to be an existing (as opposed to future) receivable.

6.8 The 'asset-backed' requirement under Islamic law

The most progressive jurisdiction within Islamic finance practice, Malaysia, recognises debt as proprietary only in so far as it represents an underlying asset. Further, it has also been said that for an intangible right like debt to be tradable as a security (i.e. financial asset) it must involve 'the funding of trade in, or the production of, real assets'.[112] The argument therefore implicitly calls for all such financial assets and intangible rights to be 'asset backed' and be

traded for purposes of funding the production of real property. The double layer requirement insinuates the invalidity of intangible rights as assets in their own standing. The asset-backed requirement is said to be necessary so as to avoid *riba*.[113] The intended implication of this 'asset-backed' requirement is to prevent the exchange of one money obligation for another (as considered in 6.6.2 above) because in the absence of the asset backing, debts are considered money that attract the *riba* prohibition – essentially taking us back to square one. Three issues here: first, we can agree with the explanation that the asset-backed requirement is intended to prevent *riba*, however, we concluded, in chapter 5 above, that *riba* does not mean interest or increased return in commercial context; second, we concluded that the similarity between debt and money is misconceived and inapplicable; and third, we have already demonstrated that debt rights are proprietary on the basis of the tradition of Banu Nadhir, the traditions allowing their unrestricted assignment to third parties, the ruling of the Fiqh Academy of the OIC allowing the sale of financial rights as bonds at any price, and the contextual evolution of property rights as per the maxim: *whatever is known among the business community as their custom is considered to be like what is enjoined upon them*.[114]

Accordingly, 'asset-backing' should no longer be required for the sale of debts just as is the case for leases rights or foreign exchange transactions. After all, Islamic legal theory recognises intangible property rights such as intellectual property rights, which cannot be said to be dependent on the 'backing' of real assets. One's intellectual property in a book or piece of literature or idea is quite independent of the physicality of the book and is inherently of more value than the collection of papers in the book. Intellectual property rights may be sold independently from the book just as a right to payment of a sum or sums may be sold independently from the actual, tangible money one is owed.[115] It is universally accepted that Islam permits the ownership of usufruct in a physical item (e.g. house, building, car, aeroplanes, etc.) which subsists separately and independently from the physical property – evidenced not only by the distinction between ownership of the house (real property) and ownership of lease rights in the house but also by the prevalent practices of sub-leasing and the grant of licenses to property.[116] It is, in fact, the characterisation of usufruct as a saleable thing that has caused the popularity of sale and lease-back *sukuk* structures.

Therefore, just as share ownership and trading is accepted and practiced by Muslims engaged in commerce and financial investments (including within sharia-governed nations), likewise, is the case of debt trading. Each successive seller sells not the physical money owed but the right to receive payment of that amount.

6.9 Judicial support in acknowledging the proprietary nature of debt

The Chancery court, through maxims and equitable principles, helped convert personal interests into proprietary interests and extended proprietary interests held by one person to several individuals through the equitable concept of trust and beneficial ownership. This was no doubt facilitated by the desire to relieve hardship and create equitable outcomes in commercial dealings in accordance with the principles of Equity. The significance of the judiciary's role in the transition of debt rights to property role assumes even greater magnitude when we consider how difficult it was and still is to create new proprietary rights where none existed before, even under an uncodified systems like the Common law.[117] We noted several judicial comments to this effect in section 6.2.

The validity of a bank taking an effective charge over its own customer's credit balance, for instance, permitted by the courts of equity, demonstrates how a determined jurist (Lord Hoffmann) can surmount apparently insurmountable conceptual problems in order to arrive at what is perceived to be a sensible commercial result.[118] Lord Hoffman had to expand the concept of proprietary interest to embrace chargebacks.[119] In doing so, however, Lord Hoffman drew a distinction between a lien which is a right to possession and the proprietary interest the bank has in the customers' deposits (debt). His reasoning was not without critics but the importance of the judgement lies in the fact that the House of Lords was willing to reach a decision that was commercially sensible rather than compliant with policy.[120] It is this sensible approach that has always driven England to its position as a global commercial and financial centre. Neither was Lord Hoffman blind to the sense of injustice such an approach imparted on to the depositors. He observed:

> If the depositors had been third parties in economic reality as well as in law, I imagine that it would not have been thought particularly unfair that the liquidators had chosen to exercise their undoubted choice of remedies and to proceed against the primary borrowers rather than resort to the third party security which they held. But the separate personality of depositor and borrower was an essential element in the structure which the parties chose to adopt for their borrowings and it cannot be ignored now that BCCI has become insolvent'.[121]

Lord Hoffmann, thus, ended the decade-long uncertainty over the legality of chargebacks that was deemed 'conceptually impossible' by Millett J in the earlier case of *Re Charge Card Services*.[122] In doing so, the House of

Lords reversed the decision of the Court of Appeal in line with the decision in *Re Charge Card Services* that a chargeback by a bank over a customer's deposit was invalid. In delivering his judgement, Lord Hoffman observed that chargebacks over customer's deposits, in most cases, would be as good as securities over proprietary interests. This, of course, indicates that Lord Hoffman acknowledged the non-proprietary nature of deposits (bank credit) that do not extend to third parties. Nonetheless, Lord Hoffmann rejected the reasoning in *Re Charge Card Services* that such chargebacks were 'conceptually impossible' and added that there is no reason to prevent banks and their customers from creating charges over their deposits if, for reasons of their own, they want to do so. That, where there is no threat to legal consistency and no public policy objection, the courts should be very slow to declare a practice of the commercial community 'conceptually impossible'. Clearly, this was a decision that favoured commercial reality over conceptual compliance.

Lord Hoffman's approach, in principle, is aligned with Islamic commercial legal principles. The principle of permissibility deems everything permissible unless expressly prohibited and applies equally to commercial, contract and property law issues. Lord Hoffman's dictum implies the application of this principle of permissibility. He uses legal inconsistency and public policy objections as a yardstick of determining whether a commercial practice should be prohibited and in the absence of both he permitted the practice of chargebacks between primary contractual parties. In chapters 4 and 5 we mentioned repeatedly that the yardstick in Islamic law of contract and commerce is whether the transaction is equitable between the parties and often this is a question of public policy. The issue of public policy also applies directly through the question of whether the transaction serves *maslaha* (social welfare). The role of the judiciary through equity in the transformation of personal interests to proprietary interests in England offers a great example for possible emulation by Muslim jurists in attaining the same on acknowledgement the status of debt and permitting its sale.

That such flexibility is resorted to and applied by sharia scholars (albeit selectively) is clear in numerous instances including the fact that Islamic finance structures are increasingly using the special purpose vehicle (SPV) structure. Traditionally, Islamic contract law indicates that only human beings qualify as legal entities and contractual parties yet sharia scholars and commercial practice have embraced the use of SPVs as legal entities in the structuring of financial transactions with no fuss at all. Of course, it is pragmatic to have done so as the SPV structure adds much to the efficiency of the structure as well as the equity created through using a trust mechanism.

The question to highlight, however, is why the selective approval and disapproval of novel concepts? And on what criteria is such approval and disapproval done? Preferably, such approval should be strictly based on the general principle stressed throughout this book, that is, that of permissibility unless prohibited by a clear text of the *Quran* or tradition of Muhammad. The arbitrary approval of what appears to be alien or 'non-Islamic' concepts and practices will otherwise continue to disrupt efforts towards legal and social development. It also perpetuates the legal, structural and regulatory uncertainty that currently characterises Islamic finance deals.

Conclusion

It is pertinent to mention in closing that it is a fallacy to claim that the current position on debt and its status is 'Islamic'. The *Quran* takes no stand on the issue, recognising it as a contractual transaction, and, moreover, Islam is a faith that draws expression from those who practice it. The time for revelation has come to pass, yet we must work to give the eternal principles of Islam life in our daily lives by being true to their spirit without inhibiting the natural evolution of human society in all its spheres. Time is ripe for Islamic contract and legal theory to break new ground in extending Islamic principles to current commercial practice, indeed, that is the only way Islam can continue to co-exist in a diverse world of cultures and religions. It did exactly that at the time of Muhammad, how can we now claim otherwise?

7

SECURITISATION

It was suggested in chapters 2 and 3 that sharia compliant securitisation structures are promising because they offer a sophisticated yet simple solution to the liquidity in Muslim-majority economies as well as pave the way for an organised and sustainable secondary Islamic capital market.[1] Moreover, though apparently a novel concept within Islamic finance, a securitisation structure utilises traditional contractual forms and structures already familiar to Islamic law of contract. This makes it an excellent capital raising and liquidity mopping structure. This is due to securitisation being a technique that allows the packaging and marketing of (otherwise) non-marketable assets.[2] Accordingly, it is said that:

> illiquidity in the Islamic financial sector is exacerbated by the absence of an organised secondary market for Islamic investments[3] … one means of obtaining liquidity is through the securitisation of both short term and long term Islamic financial contracts. Securitisation in turn requires the establishment of *a sharia approved liquid secondary market*[4] for these securitised instruments.[5]

That said, we proceed to define securitisation and outline the more popular type of securitisations applied in today's global economy, its benefits, drawbacks as well as some of the important, if not problematic, issues that arise in structuring securitisations.

7.1 Defining and outlining securitisation

Securitisation, in broad terms, is the conversion of (illiquid) assets into securities to be traded on the securities market so as to create liquidity and/or raise funds. It may be explained as a method of finance whereby a lender,[6] instead of lending money to a company to finance its general business, buys

assets from that company which it then converts into securities and sells on the capital market. Hence, instead of the lender looking to the company's profits as a whole to repay that lending, it agrees (by virtue of the sale) to look solely at the assets that it bought and later sold as securities for repayment. Securitisation can also be defined as a means of raising finance secured on the back of identifiable and predictable cash flows derived from a particular set of assets. Almost any assets that generate a predictable income stream can be securitised. Alternatively, a 'whole business securitisation' describes a securitisation where the cash flows derive from the entire range of operating revenues generated by a whole business (or a segregated part of a larger business). These have been used by a wide variety of businesses (in the UK) to raise finance, that is, Welcome Break, Road Chef, Westminster Healthcare, London City Airport, the Tussauds Group and many pub companies. There is no formula that determines whether a business is suitable for securitisation. However, in whole business securitisations to date, the businesses in question produced stable, predictable cash flows. The key to the suitability of a business for securitisation is thus the stability of the cash flows.[7]

Securitisation is therefore a method of raising funds and creating liquidity through the sale of tradable securities that represent an asset or an interest in an asset. In theory, therefore, securitisation relies on the transfer of title to facilitate the access to financing and it is this passing of ownership instead of borrowing money (i.e. title finance) that makes securitisation a viable financial structure in Islamic law which is perceived as prohibiting the dealing in interest that arises in debt or loan financing. Islamic finance requires therefore that the sale of the asset to be genuine, and only then can one sell securities (backed by the assets) on the capital market. In conventional finance, however, the actual sale tends to be of the security (coupons) with the sale of the asset to the SPV being mostly a function of satisfying legal form rather than economic substance.[8] This raises the issue of characterisation of the transaction depending on whether a 'true sale'[9] has occurred.[10] The 'true sale' issue, is considered in greater detail in the next chapter, and is among the more important issues to be considered in enhancing the viability of securitisation in Islamic finance in light of the current 'asset-backed' requirement.[11]

7.2 Securitisation of receivables

The securitisation of receivables is the most common type of securitisation. It ensures a continuous flow of income to cover the periodic payments on the securitised assets and usually entails the purchasing of a leased asset, a mortgaged property, unsecured commercial loans or credit card payment systems which are then securitised and sold on the capital market. It

therefore employs the concept of title finance to raise funds through the capital market.[12]

The structure is generally as follows:[13]

- The owner of the receivables (originator) sells the receivables to the special purpose vehicle (SPV) that is often an 'orphan' and/or owned by a charitable trustee so as not to be a subsidiary of the originator (to ensure bankruptcy remoteness as explained in section 7.7 below)
- The purchaser or SPV borrows money, which is called the 'funding loan',[14] to finance the purchase price of the receivables and repays the borrowing out of the proceeds of the subsequent sale of the receivables.
- The purchaser authorises the originator to collect the receivables on its behalf and to remit the proceeds to the SPV.
- The purchaser SPV grants security over the receivables and its other assets to the lenders to secure the funding loan.

In order to ensure the receivables are sufficient to repay the lenders on time, 'credit enhancement' may be arranged. This is where a third party gives a guarantee to the SPV, or the originator agrees to make a subordinated[15] loan to the SPV to finance part of the purchase price of the receivables (and is repayable after the funding loan is repaid). In this case, the SPV repays the originator's subordinated loan after repaying the funding loan (i.e. if there is a surplus of receivables), and this may be done at a very high rate of interest depending on how profitable the securitisation is.

Summarily, receivables securitisation is used as a method of funding various receivables including mortgage debts, leases, loans or any steady stream of receivables income whereby securities representing interests in these receivables are sold. The basic technique requires the rights over the receivables[16] to be transferred from the originator to the special purpose vehicle (SPV or Issuer). The SPV then issues bonds and incorporates into the securitisation structure certain credit enhancing features.[17]

7.3 Requirements of a securitised transaction

A securitised transaction would generally need to fulfil the following requirements.[18]

Credit: If the funding loan is to be rated highly by a rating agency, the receivables must be sufficient to cover the funding loan made to the purchaser to finance the purchasing price. Any shortfalls or mismatches must be covered by guarantees or other credit enhancement, or by finance of part of the purchase price by a subordinated loan.