
1.1. Introduction.

Any legal system plays an important role in the principle underlying its legal doctrines. That the legal system operates in compliance with, or as a consequence of cultural order. In other words, any legal system is limited to a certain environment and subject to cultural influence. Culture and law operate in conjunction. Within the interaction between these spheres, multiple disciplines play, subsequently but equally another important contribution to any distinct legal system. Politics and economy are, among others, the major disciplines affecting that legal system including the law of contracts.

Cultural order in Anglo-Saxon systems built on the principle of liberty which emphasises the freedom of individual as one of the ultimate object to their national legal systems.¹ Hence, a weave of scholarly contribution began a long time go to implement the principle of individual freedom thorough different multidisciplinary institutions. Capitalism as a political and an economical idea emerged to serve the optimal object of liberalism system. On the application of this cultural order to its legal system, freedom of individual is an undisputed pillar to private/public laws including the law of contracts. Unsurprisingly, then, freedom of contract is the major principle of the doctrine of contract in English common law.

Islam takes a different stand. Its legal system, although conceptually shares the same values (liberty, justice, and equality) of most legal orders, it has its own interpretation through different multidisciplinary institutions. So the principle of permissibility instead of freedom of contract is the meaning of liberty. It is that individual is free to enter into a contract if that contract is not prohibited under Islamic law. Too politics and economy are limited, to some extent, to the same principle in order to serve both public and private interests and not only the interest of either. The law of contracts, is a question of what role does it play in allocating resource. In other words what is the normative justice of contract? Corrective or distributive justice?

Modern debate in the normative justice of contract theories divides into whether private law with it legal rules (contract law) should be based on right (corrective) or welfare distribution

with increasing support to the later. While the theory of justice in Common law contract emphasises the importance of exchange, Islamic law emphasises the importance of right (hagg) and rule (hukm). In reflecting the theory of justice, Islamic law of contract is focused on the subject, and issue relate to balance/discloser, of contract. This is to say, illegality, for example, of usury and uncertainty. The theory of justice then becomes about validity, based on moral (religious) values, rather than enforceability. To interpret this approach in commerce activities, it means “a faire distribution of wealth, greater support for the poor and needy, and less corruption and dishonesty”. The theory of justice in Islamic contracts constitutes a substantive (social) justice “through a correct distribution of legal entitlements”. Hence, Justice in Islamic contract is normally interpreted as a right.

The normative justice of Islamic contract, therefore, is distinctive. Illegality truncations such as usury fall in the zone of distributive function whereas defect is dealt by corrective measures. In other words social (moral) obligations (e.g. zakat or alms) are set to be distributed within the society. The function of these moral obligations is to prevent accumulation and exploitation because the very purpose of wealth is circulation. The defect of contract, on the other hand, would be solved through the contractual sanctions.

The problem of contract law arises when obligations are executed in the future. The fundamental nature of all future arrangements is incompleteness that attributable to problems of knowledge and interest. The source of contract failure to allocate recourses on a just base

4 Valentino Cattelan, ‘ From the Concept of hagg to the Prohibitions of riba, gharar and maysir in Islamic Finance’ (2009) 2 Int J. Monetary Economic and Finance 384
6 Valentino Cattelan, ‘ From the Concept of hagg to the Prohibitions of riba, gharar and maysir in Islamic Finance’ (2009) 2 Int J. Monetary Economic and Finance 384
7 The Qura’n 5:58 “…Allâh commands that you should render back the trusts to those to whom they are due; and that when you judge between men, you judge with justice…”
8 The Qura’n 51:19 “And in their properties there was the right of the Sà’il (the beggar who asks) and the Mahrûm (the poor who does not ask others)”
11 Randy E Barnett, ‘The Sound of Silence: Default Rules and Contractual Consent’(1992) 78 Virginia Law Review 821-911. In the Qura’n 31:34, there is also an indication to this notion ; ”Verily Allâh, with Him
is attributed to the impossibility of contract to be performed due to the defence or limited mechanism of contractual rules. Informational rules, mistake and fraud, fall within this defence mechanism which will be analysed extensively in this chapter.

An investigation of the role of Islamic contract law in allocation of resources on a just base is the task in this chapter. To do so, an analysis of the default rules in Islamic contract will be undertaken. Generally, distributional rules of risk fall into two paradigms. This is to say, illegality and uncertainty (information rules). This analysis will be taken within the broad framework of investment and in particular contract of sale as the latter is regarded as archetype of Islamic contract law.


It has been claimed that obligation is not a source of Islamic law of contracts. Rather a contract defines obligations between contracting parties. An eminent legal scholar described contract as ‘generator of obligations’ but, subsequently, Al Sanhuri, considered the subject matter (Mahall al-’aqd) to be a centre of contract law and not the obligation. In this sense, obligation in Islamic law might have been missing from Islamic legal literatures. But this is not, totally, true as the term obligation varies, linguistically, among Islamic jurists. So dayn (lit debt) was used to indicate obligation related to incorporeal property or fungible articles whereas ‘ayn’ (lit substance) is an obligation that refer to a specific item which indicates its individuality. To show how the contract subject and not obligation is the centre of contract is by quoting a well known legal principle that suggests an exchange of obligations (bay’ al-dayn bil-dayn) is not conforms to Islamic law. Although this principle concerns debt transaction, to avoid illegal activity riba (usury), nonetheless it provides an element to suggest that a contract is not based on obligation.

(Alone) is the knowledge of the Hour… No person knows what he will earn tomorrow, and no person knows in what land he will die. Verily, Allâh is All-Knower, All-Aware (of things)


13 Abd al-Razzaq al-Sanhu, Nazariyya t al-’aqd (Cairo, 1934), 63.

Literally, contract means tie or bind in Arabic language. Legally, there is an abstract definition that indicates a contract compromises a legal offer and acceptance in a way that affect the contract subject.\textsuperscript{15} Therefore, Islamic scholars have not distinguished between bilateral and unilateral agreements or pact and promise obligations. They are all called contracts.

Due to the lack of general theory of Islamic contract (‘aqd), there is no comprehensive definition of what does contract mean. Rather a sale of contract (‘aqd bay’) represents an archetype or a model to which other contractual arrangements should conform to. Therefore, as Schacht described, the sale of contract is the core of obligation under in Islamic law.\textsuperscript{16} Accordingly, law of contracts rather than a law of contract had developed, by Muslim jurists, under the doctrine of nominated contracts (al-‘uqd al-mu’ayyana).\textsuperscript{17}

The very nature of Islamic contracts law is Rida (consent). It is also the fundamental rule behind investment transactions. The origin of this principle is rooted in the Qur'anic guidance of Islamic law.\textsuperscript{18} Therefore, mutual consent allows the contracting parties to rescind or reinstate a contract for as long as they remain in the contract session.\textsuperscript{19} This option is terminated once the contract is concluded.\textsuperscript{20} However, most classical scholars are very strict on this point as they require a price and a delivery, as in an investment transaction, to be settled immediately after the conclusion of the contract. Also, they require contract form (sighah) to be the main element for the validity of the contract. At present, securities transactions cannot be carried out in the old fashioned way of mutual consent because the market and legal orders have implemented different rules to the mutual consent of the parties.

In investment, and generally commercial, transactions certain elements derive from the fundamental rule, i.e. mutual consent, that have been affirmed throughout Islamic legal history. These elements include capacity of the parties, legality of the subject matter of the

\textsuperscript{16} Joseph Schacht, An introduction to Islamic Law (Oxford : Clarendon Press, 1982)151
\textsuperscript{17} The application of nominated contract in securities market will be explained in the next chapter.
\textsuperscript{18} The Qur'an 4:29 “O you who have believed, do not consume one another's wealth unjustly but only [in lawful] business by mutual consent…”
\textsuperscript{19} Mahmoud A El- Gamal, Islamic Finance Law, Economics, and Practice (Cambridge: Cambridge University Press 2006)65
\textsuperscript{20} The option known as ‘khiyar al ‘Majis’ in Arabic. The Prophet said, "The buyer and the seller have the option to cancel or to confirm the deal, as long as they have not parted or till they part…) Narrated by Hakim bin Hizam, Sahih AL Bukhari, Volume 3, Book 34, Number 296
contract or generally the rules and conditions of the contract which are to some extent out of our concern.

Generally, investment is dealt, by the law, in a combination of property and contract rules which in turn result in the transfer of resources by means of property or service for the sake of profit.\textsuperscript{21} Therefore, the investment outcomes will be, legally, a transfer of property or attracting certain legal rights.\textsuperscript{22} Contract law facilities economic interactions and eventually regulate the conduct.\textsuperscript{23} The motivation of a contract in investment arrangements is, normally, the return that each party is looking for. The underpinning of contract is the allocation of future rights and obligations and thus, allocation of risks. It is therefore necessarily to shed light to the Islamic rule regarding the economic and social values for investment transactions. In brief Islamic economic values of contract are mainly concern with property rights of individuals and how it is distributed justly.\textsuperscript{24}

The theoretical nature of contracts entered into in Islamic banking and finance are in the category of exchange contracts (\textit{al-muwadat}), which are essentially trading-based. This is quite to the contrary with the activities in conventional banking and finance, which are mainly lending-based activities. When the contracts are exchange contracts, they necessarily entail the exchange of goods, services, or usufruct, for a consideration or price.

The most common forms of the contracts of exchange are either buying and selling (\textit{ai-bay'}) which involves the sale of goods, or leasing (\textit{al-ijarah}) which involves the sale of the usufruct (\textit{manfa'ah}). In both, the subject matter is the central focus of the legal effects accruing from the valid conclusion of the contracts. In Islamic jurisprudence, exchange contracts require more stringent fulfilment of the conditions of the subject object (\textit{shurut mahall al-'aqd}), particularly on the conditions of certainty, ascertain ability and proprietary value. This is because, exchange contracts involve the exchange of counter values, as opposed to the unilateral contracts of gratuity (\textit{al-tabarru'at}), which give one-sided benefit to the recipient.\textsuperscript{25}

\textsuperscript{21} Alistair Hudson, \textit{The Law on Investment Entities} (London: Sweet & Maxwell, 2000)32
\textsuperscript{22} Ibid.
\textsuperscript{24} There are other economic values underling Islamic law which are out of the scope of this section. These values are of equality, restriction of obligation, and Social justice. This shall be discussed throughout this research.
In brief, Vogel and Hayes classified major nominated contracts in three categories. First, mutually onerous contracts; sale (transfer of lawful, known and specific ownership for fixed price), *salam* or forward purchase (full and immediate payment for fungible goods to deliver at specific time in the future), *sarf* or currency exchange (must be immediate during the contract session), *istikna* or commissioned manufacture (a party purchases goods to be manufacture by another party. the goods must be described), ‘*urbun*’ or option contract (a non-refundable deposit in which buyer has a right to rescind the sale), *ijara* or lease and hire (sale of usufruct including lease of property and hire of a person), reward (for unknown work), settlement, offset, partition, and rescission. Second, gratuitous contracts; *ariya* or loan (either loan of fungibles or gift of usufruct of property), *daman* or guarantee (must be gratuitous), *kafala* or personal surety, and *sadaqa* or alms. Third; accessory contract; *wakala* or agency (can be compensated or gratuitous), *rahn* or pledge (binding upon delivery) *hawala* or assignment (assignment of debt in which reciprocal obligation must be identical), and *sharika* or partnership (partners agree; to share profit in percentage shares and lose is born proportionally to capital, to be mutually surety and agent at same time and to contribute credit, work, or capital, or a combination of all these.  

Fundamental risks attached to the last contract (partnership). All partnership contracts are revocable at will, lose falls only in capital, and profits cannot be fixed but rather they must be shared in percentage.

1.3. Function

Islamic Legal system allows individual a great autonomy over the management of their private exchanges. Consent of contracting parties is broadly what defines obligation and duties expect in what mandatory rules impose otherwise. Kronman stated three legitimate functions of contract law; defining right and duties established by an enforceable contract,  

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detecting whether or not a contract is legally binding, and indicating legal remedy of unexecuted breach.\textsuperscript{28} It has also been suggested, for regulatory purpose, that the function of contract should be an instrument of distributive justice to achieve a fair wealth distribution within the society.\textsuperscript{29} For examples, Islamic law prohibits usurious and gambling contracts. It does also emphasis on the distribution of risk, in investment arrangements, between contracting parties. All these examples (rules) indicate, to some extent, the function of contract rules as distributive of justice.

While libertarians based the function of contract on voluntary exchange and maximisation of wealth (taking advantage), Islamic contract is based on a restrained consent with distributional functions. Therefore, law detects legal rules in which Islamic contract should comply with to ensure the distribution of wealth. Beyond these legal rules, individuals are free to allocate resources at their will. Opponents to the function of redistribution in contract law based their rejection on liberty and argued that redistribution of wealth restricts liberty.\textsuperscript{30} However, contract law without distributional is more costly than any other alternatives and cannot detect which sort of advantage taking is allowed.\textsuperscript{31}

Schwartz and Scott summarised the arguments against their assumption that contract should be regulated by itself for the purpose of efficiency. It should be noted that their assumption was motivated by the notion of wealth maximisation. First, maximisation of profit is misguided as people lack the knowledge ‘systematic cognitive error’ of market behaviour and thus may not maximise their profit. Second, externalities e.g. a firm pollute the environment. Third, State should enhance fairness between contracting party. Forth, State should pursue distributional objectives.\textsuperscript{32}

Resources generally refer to as property. In Islamic law, the very purpose of resources is transferability.\textsuperscript{33} Investment thus goes under this function of mobilisation where properties

\textsuperscript{30} Fiedrich Hayek, The constitution of liberty (London: Routledge 1961)
\textsuperscript{33} Qur’an. 59:7 stated that "... in order that (Fai’ lit. Booty) it may not become a fortune used by the rich among you...” Although, this verse concerns what we may call today public spending and was related to booty surrounded without a fight. The allocation of this resource is left to the State judgment.
should transfer between individuals. The legal device of the transferability of properties is contract law, particularly contract of sale that dominate Islamic investment's zone.

Equality through fair exchange requires that any condition bear unequal obligation or goes against the requirement of contract obligation is invalid. Obeid explained the reason behind equality on contract:

“Allowing individuals to freely arrange the effects of their juridical acts according to their whims brings the risk of their committing abuses by perpetuating aleatory contracts […] This will have the effect of an imbalance of the benefits of the contracting parties, evidently going against the principles of equity and justice that the Koran […] and the Sunna of the Prophet have laid down for the contract to be concluded with concern for the perfect equilibrium of the reciprocal advantages.”

A guest of profit or other economic incentives is the very existence objective for entering into a relational contract (long term). Hence, contracting parties would normally identify specific performance in imprecise terms to overcome the future risks. The inability of bargainers to regulate future risks paved the way to the establishment of provisions (standards) attached to contract for future performance. Accordingly relational contract has become a mechanism of control (fiduciary obligation) where an agent, for example, is only require to act in professional manner or, alternatively, by bounding agreement (protection against loss) for his principles. Another practical solution will be a combination of control and bounding agreement for optimising the cost of performance.

1.4. Theory of investment.

Literally, investment means quest of yield or harvest in Arabic. On the legal literature of Islamic studies investment used as gain, profit, and development interchangeably. Therefore, the term investment is hardly identified except in a broader definition. In a commercial

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34 What about some people who impose conditions which are not present in Allah's Book (Laws)? Whoever imposes conditions which are not in Allah's Book (Laws), his conditions will be invalid even if he imposed them a hundred times.” Narrated by 'Aisha, Sahih Bukhari, Volume 1, Book 8, Number 44.
context, we may try to define investment as a property being recruiting, based on Islamic principles, for the quest of a profit, development and protection in order to fulfil human’s duty as a vicegerent of God on this universe. Investment\textsuperscript{38} in Islam is regularly referred by Muslim scholars form Quran 11:61 which says: "... He (God) brought you forth from the earth and settled you therein..." In translating this verse, Ibn Kathir – a well known author of writing a commentary on the Holy Quran - indicated that humans are created, initially, from earth; to life on it and to construct it.\textsuperscript{39} Thus, investment is derived from a wider principle under Islamic teaching i.e. development. Therefore, someone can see why Muslim scholars require an investment transaction to be taken on productive activities that suppose to lead to development and fulfil the Islamic normative principles. Such a necessity has created controversy among Muslim scholars in modern market order.

Islamic philosophy on investment requires a combination of property and labour for the purpose of development. Thus profit is associated with a real effort for the validity of investment. The quest of profit under Islamic law may be more evident than any other religion in the world. The Prophet himself was a merchant and encouraged people to seek investment if they to fulfil the mission of human beings; that is as vicegerent (istikhlaf) of God. At the heart of investment philosophy is the allocation of resources, mentioned above on the introduction, as one of objective of Islamic law.\textsuperscript{40} It should be clear that the normative of law, economic, and investment, under Islamic, are overlap which need to be clarified in here. The normative of Islamic law is under what is called “necessities”\textsuperscript{41} whereas investment\textsuperscript{42} is derived from economic values. Thus the philosophy of investment in Islam is that investment is a quest profit which includes effort and mobility of resources that serves economic value. In other words private interest should lead to the interest of public not the other way around. However, private and public interests operate in a parallel spheres but when a conflict occur the latter prevails over the former. This is a profound principle which distinct Islamic law from Common law.

\textsuperscript{38} Also see Quran 67:15.
\textsuperscript{39} Al Haft al Demashqi (Ibn Kathir), Tafsir al Quran al 'Azim, ed . Sami al Salama,4 vols. (Dar Taybah le Ar'nsher wa Tawzi'a:Riyadh1999) edn 2, 331
\textsuperscript{40} Other objectives of investment are social and economic development, justice, and protection of property. For the latter, the Prophet said that “Whoever is killed while protecting his property then he is a martyr.” Narrated by ’Abdullah bin ’Amr bin Al-'As, Sahih Bukhari, Volume 3, Book 43, Number 660.
\textsuperscript{41} Principles or what it called Necessities ‘Daruriyyat’ are the preservation of property, life, lineage, faith and intellect. In the absence of clear reference in Islamic recourses, a legal opinion is given by scholars with these normative principles.
\textsuperscript{42} The only purpose for investment that will be discussed is the allocation of resources.
Therefore, private interest on the course of investment has to operate within the rules that impose on its performance. Investment is regulated by different social and economic principles. Under Islamic school of thought, investment regulations encompass morality, social and legal disciplines. This eclectic source of investment regulations creates difficulty for business and legal authority alike. It does also create confusion among academia as where lines should be drawn between these regulations and, indeed between private and public interests.

The zone of investment operation is restrained by economic sustainability, production generator and equality - more accurately risk sharing. In the contrary, speculation, uncertainty, and non-asset based investment regarded by modern scholars to be in non-compliance with the Islamic rules of investment. These prohibitions, also, encompass usury (riba), gambling (ghemar and misir) transactions where investment is undertaken by reckless and unnecessarily risk. Economically, these activities cause not just failure investment but also economic instability. Socially, however, it does, to some extent, not conform to the rules of investment which emphasise on the justice of resources allocation. In Islam, speculation transactions is regarded as money wasting and irrational action which may lead to a person being restrained form managing his wealth. This restrained rule applies to investment management such as fund management on financial market where it is advisable that an investor should choose an agent who is being known for his competence.

Morally, certain investment products are prohibited directly from the Islamic teaching with no clear justification given by Islamic legal authority. Collectively, these restrained rules are composed on the category of legal rules of investment which determine the scope of contract law. The application of investment contract in securities market will be consider in the next chapter.

1.5. Principles of risk distribution.

From Islamic perspective, the nature of risk is, traditionally; encompass two categories; illegality and information. The latter can be described as asymmetry (information) risks and

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43 Qur’an 15: 26 “But spend not wastefully (your wealth) in the manner of a spendthrift.”
44 Honest, expert, carful risk taker… etc. Qur’an 4:5 says “And give not unto the foolish your property which Allah has made a means of support for you…”
45 Generally, illegal products are pork, win, pornography and weapon. In capital markets such as in Malaysia and Islamic Dow Jones Shari’a screening norms a list of legal (halal) investment activities is provided.
the former is nature-based risk (illegal activities, e.g. usury). Informational risk in contract is regulated by certain conditions such as the identification of subject matter and the immediate distribution legal entitlements. In contrast, risk attached to nature-based activities is regulated by mandatory rules which impose legal sanctions on such activities. The risk in this category (illegality) will normally be invalidity and non enforceability. If damage may occurred will compensation will not be given.

1.6. Illegality

1.6.1. Gambling and uncertainty

Pure speculation is then a principle of risk in contract which goes against the function of distribution of risk. It is illegality is driven directly from the Qur’an. The reason behind this prohibition in financial arrangements, for example, is the purely inherited risks which dislocate resources unjustly and invoke enmity within the society. However, uncertainty of the subject matter of contract cannot be ruled out from gambling transactions. Indeed, gambling is quite often used with the principle of uncertainty or ghara. However for the purpose of this chapter, ghara will be discussed, below, in the section of informational rules. For the principle of gambling, we shall briefly explain what amount to gambling contract and how it operates in allocating risk.

The normative justice in contractual arrangements requires identification of legal obligations and awareness of all risks associate to them. Obied surmised the issues of gambling and uncertainty by asserting that any transaction comprises an element of uncertainty relating to the subject matter, its price, or delay for delivery of the subject matter. Kamali on other hand, stated that uncertainty is used in the sense of risk and hazard which attributed to the ignorance of the subject matter; its availability and existence, therefore, uncertainty, Kamali

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46:5:90 “O you who believe! Intoxicants (all kinds of alcoholic drinks), and gambling, and Al-Ansâb (Animals that are sacrificed (slaughtered) on An-Nusub and for the idols), and Al-Azlâm (arrows for seeking luck or decision) are an abomination of Shaitan’s (Satan) handiwork. So avoid (strictly all) that (abomination) in order that you may be successful”.


concluded, is a contract where its consequences are unknown and hidden to contracting parties.\textsuperscript{49}

Ibn Juzay, a classical Muslim jurist, stated what constitutes uncertainty in contract as follow: "(1) Difficulty in performing delivery of the subject matter; (2) Lack of sufficient knowledge (\textit{jahl}) regarding the type of the price or the subject matter; (3) Lack of sufficient knowledge regarding the characteristics of the price or of the subject matter; (4) Lack of sufficient knowledge with regard to the quantum of the price or the quantity of the subject matter; (5) Lack of sufficient knowledge with regard to the date of future performance; (6) Two sales in one transaction (\textit{bay'atan fi bay'atin}), (7) The sale of what is not expected to revive; (8) \textit{Bay'}\textit{ al-hasah}, which is a type of sale whose outcome is determined by the throwing of a stone; (9) \textit{Bay'}\textit{ al-mundbadhah}, which is a sale performed by the vendor throwing a cloth at the buyer and concluding the sale transaction without giving the buyer the opportunity to properly examine the object of the sale; (10) \textit{Bay'}\textit{ al-mulamasah}, where the bargain is concluded by touching the object of the sale without examining it".\textsuperscript{50}

Although Muslim scholars are not in a full agreement as to what extent of uncertainty and gambling a contract should not constitute, the importance, here, is to explore the inherited risk in private contracts and indeed in the legal rule of contract as an instrument of risk allocation. Ibn Taymiyya argued that the lack of knowledge in exchanges restricts the contractual freedom and create an obstacle to people welfare which lead to gambling that fall against the theory of justice.\textsuperscript{51}

In the final analysis, uncertainty and gambling which allocate properties either insufficiently or randomly will eventually disequilibrium in the setting of legal entitlements and unconsciousness to contract obligations.\textsuperscript{52} Therefore, there is a need for discretional rules to redistributed or rebalance the unequal risks legal.

\textsuperscript{49} Mohammad Kamali, ' Uncertainty and Risk-Taking (\textit{Gharar}) in Islamic Law ',\textit{IIUM Law Journal} (1999) 7(2)pp199-216
\textsuperscript{52} Valentino Cattelan, ' From the Concept of \textit{hagg} to the Prohibitions of \textit{riba}, \textit{gharar} and \textit{maysir} in Islamic Finance' (2009) 2 \textit{Int J. Monetary Economic and Finance} 384
1.6.2. Usury.

Perhaps the most controversial issue in Islamic financial industry is usurious transactions which are common in modern economy. Different legal authorities including Qur'an$^{53}$ and Sunna$^{54}$ invalidate such contract with strong abandonment. Usury is one of the few illegal contract that has been rarely questioned among Muslim scholars.

Literally, Riba or usury means increase and "wrongful devouring of property".$^{55}$ Usury applies to loan contract (riba al-jahiliyya), increase of return for an extension given to a borrower who is unable to pay his debt when due.$^{56}$ It does, importantly, apply to exchange contracts where delay (riba al-nasi'a) or excess (rib al-fadl) of certain obligations is seen as inequitable.$^{57}$ Usury of delay is normally a delay of obligation either with or without inequality or identity of the type of obligation whereas usury of excess is inequality of a single type of obligation with or without delay.$^{58}$

Saleh explained the issue of usury as the following:

"An unlawful gain derived from the quantitative inequality of the counter value in any transaction purporting to effect the exchange of two or one species[…] which belong to the same genus, and are governed by the same efficient cause. Deferred completion of exchange of such species, or even of species which belong to different genera but are govern by the

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$^{53}$ The Qur'an 3:130 "…Eat not Ribâ (usury) doubled and multiplied…"

$^{54}$ Allah's Apostle said, "The bartering of gold for silver is Riba, (usury), except if it is from hand to hand and equal in amount, and wheat grain for wheat grain is usury except if it is form hand to hand and equal in amount, and dates for dates is usury except if it is from hand to hand and equal in amount, and barley for barley is usury except if it is from hand to hand and equal in amount." Narrated by 'Umar bin Al-Khattab Sahih Bukhari Volume 3, Book 34, Number 344


$^{57}$ Valentino Cattelan, ' From the Concept of hagg to the Prohibitions of riba, gharar and maysir in Islamic Finance' (2009) 2 Int J. Monetary Economic and Finance 384

same (efficient cause) is also *riba*, whether or not the deferment is accompanied by an increase in any one of the exchanged counter value.\(^{59}\)

The argument of injustice in usurious transactions is stated as an assertion of an unbalance distribution of legal entitlements which stem either form actual inequality or delay from quantitative perspective.\(^{60}\) In turn justice in private contracts requires protection of weaker party from unequal barraging power and risk distribution between both parties. The normative objective in usurious contract is then a pursue of social justice by preventing monopoly and exploitation.\(^{61}\)

El-Gamal, a leading economic scholar, provided another explanation of the prohibition of usury. He rejected the common justification of usury i.e. exploitation and moral justice and argued that the usury is mainly based on rational efficiency (fair compensation).\(^{62}\) El-Gamal used *murabah* (sale plus mark up) and *ijarah* (fixed rate of return as rent in the lease) contracts to support his argument and asserted that the implied interest in these transactions invalidate the moral justice (prevention of exploitation) behind usurious contracts.\(^{63}\) He concluded by saying the injustice in usury is not 'asymmetric relation' but rather an economic, hence, usury lends its self to injustice.\(^{64}\) Therefore, equality of counter values, in case the subject matter is fungibles, identifies as equity and, in turn, equity/quality is acquired through efficiency of exchange based on proportionality of monetary values.\(^{65}\) The prohibition of usury (delay and excess) which incurs misallocation of risk between contracting parties reduces efficiency as unjust price minimize allocative efficiency.

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\(^{59}\) Nabil A. Saleh, *Unlawful gain and legitimate profit in Islamic law: riba, gharar and Islamic banking* (Cambridge: Cambridge University Press, 1986) 12, 13

\(^{60}\) Allah's Apostle said, "Do not sell gold for gold unless equivalent in weight, and do not sell less amount for greater amount or vice versa; and do not sell silver for silver unless equivalent in weight, and do not sell less amount for greater amount or vice versa and do not sell gold or silver that is not present at the moment of exchange for gold or silver that is present". Narrated by Abu Said Al-Khudri, *Sahih Bukhari*, Volume 3, Book 34, Number 385. See also Valentino Cattelan, ‘From the Concept of *hagg* to the Prohibitions of *riba*, *gharar* and *maysir* in Islamic Finance’ (2009) 2 Int. J. Monetary Economic and Finance 384


\(^{64}\) Ibid 64, p3

\(^{65}\) Valentino Cattelan, ‘From the Concept of *hagg* to the Prohibitions of *riba*, *gharar* and *maysir* in Islamic Finance’ (2009) 2 Int. J. Monetary Economic and Finance 384
Usury as a source of justice failure in contractual arrangements stems from the imbalance of risk allocation and therefore reiterates illegal. In applying the principle of right (haqq) to usury contracts, a substance (social) justice requires legal entailments to be redistributed.

1.7. Informational rules

This section is primarily concern with the defects of a contract that can arise when allocating resources between contracting parties. Imperfect information in exchange transactions leads to an imperfect allocation of resources and therefore a failure of justice. On the other hand, market failure is a consequence of contractual failure. The defects of a contract reflect the unequal access to information between parties and thus their liberty undermines. In investment transactions the lack of information can significantly affect both the outcome of the contract (i.e. profit) and impose risk that a party is unwilling to take. The objective of informational rules in contract law is usually significant at the stage of contract formation. It also extends for the duration of the course of the contract where obligations are deferred. In this section we shall explain the rule of information in Islamic contract. The purpose of this section is to see how informational rules operate in the allocation of risk.

The informational rules in contract law determine the validity of consent. In turn consent reflects intention (niyya); an idea that the entire Islamic law is based on. Intention should therefore be expressed for a legal action to be taken. The expression must reveal the intention of a legal person in a definite manner. The validity of an unclear expression will be determined by the presence of intention at the time in which that legal action was taken. The determination of real intention is thus objective. Expression, on the other hand, has to be freely made without any impediments. If the expression contradicts intention solely or as a consequence of a fraud or a mistake then consent as a contract requirement is vitiated. Hence the validity of the contract is in dispute. In other words, it is irrelevant under Islamic law whether the consent was influenced by deceit or by a mistake; rather because consent has been affected there is subsequently no contract. In such an analysis the concepts of fraud and mistake, under the doctrine of the law of contracts did not need to be developed according to the point of view of Islamic scholars.
There is neither a general theory of the information required for a contract nor a theory for contract. What can be found are scattered legal texts that indicate that a contract has to be fully disclosed. It was reported that if a lack of information in a contract of sale is illegal. Consequently, the sale is voidable due to the failure of improper flow of information where a consumer is facing a very great risk of being a gambler and thus losing his resource (i.e. money). In a sample partnership transaction the number of contracting parties is limited and access to information could be obtained. Yet information failure in Islamic contracts would always occur from either fiduciary or deferred obligations.

Islamic law of contract responded to this failure in a defensive or cautious way by requesting a set of legal rules via ex ante (identification of obligations) and post (stipulations) allocation of risk. However, in the modern market order, contractual complexity and other social interactions have made defensive mechanisms largely impractical and render the contract powerless in maintaining justice between parties. Therefore, a need for a transformation of the rules of information must develop if Islamic contracts law and contract law in general are ever to keep their autonomy.

The normative theory of justice in contract law as a part of private legal order has partly been affected by the integrity of its informational rules. In Islamic law fraud is measured by damage. So if a contract lacks informational requirements, yet no harm is found, a sanction will not be taken. The justification for the possibility of the lack of a legal sanction is the lack of a casual connection between farad and damage.

In Islamic contracts law the moral considerations of justice, equity, and balance in the transactions led scholars to adopt an objective theory that differs from the subjective Western

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66 “The Prophet forbade two kinds of sales i.e. Al-Limais and An-Nibadh (the former is a kind of sale in which the deal is completed if the buyer touches a thing, without seeing or checking it properly and the latter is a kind of a sale in which the deal is completed when the seller throws a thing towards the buyer giving him no opportunity to see, touch or check it). Narrated by Abu Huraira, Sahih Bukhari, Volume 1, Book 8, Number 364. There is, also, another hadith (Prophetic deed) that reported “Allah's Apostle forbade the selling by Munabadha, i.e. to sell one's garment by casting it to the buyer not allowing him to examine or see it. Similarly he forbade the selling by Mulamasa. Mulamasa is to buy a garment, for example, by merely touching it, not looking at it.” Narrated by Abu Said, Sahih Bukhari, Volume 3, Book 34, Number 354


theory. Islamic jurists studied the impediments to consent in contract law only on the basis of duress. Therefore, unlike subjective Western theory, fraud and mistake had not been considered except in a subsidiary discussion in Islamic classical study. To justify such an analysis by Islamic scholars is to understand how contract law is understood by Islamic jurists; it is the necessity of causal connection. The defects of consent are treated objectively in which optional clauses are given to contracting parties so that they can withdraw from their obligations. These protective rules are meant to provide both parties with the awareness of their actions and to safeguard their will and consent.

There are three categories affecting the consent of the contracting parties: duress (ikrah), fraud (tadlis), and mistake (ghalat). The first category is out of the scope of this section. However, Islamic scholars generally regard duress as a defect affecting consent and therefore the validity of the contract. Only the principle of the invalidity of contract has been discussed comprehensively by Islamic scholars. Duress renders the contract to be non-binding and automatically non-existent. However, the Maliki school viewed duress to violate, but not eliminate, the consent and thus the contract is suspended unless the affected party approves it. On the other hand, fraud and mistake are not binding on the affected party unless he/she approves it.

The informational paradigm under Islamic contracts law is based on two normative frameworks: misrepresentation (ghabn) and exploitation (istighlal). Subsequently, fraud is determined by misrepresentation and mistake is bound up with exploitation. The effect on the contract is to make it voidable when a mistake has occurred, and null in the case of fraud if associated with damage. Remedy for these failures are restitution and compensation.

But before we explain the doctrines of fraud and mistake as failure associated with a contract we should start with an explanatory instrument that developed (by Islamic scholars) our understanding of informational rules. This instrument is known as the doctrine of option (Khyiar) which plays a remedial role if a defect in a contract arises.

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70 For example, a buyer has the option (Khyiar) to withdraw from the contract if the item was not inspected by him at the formation of the contract.

71 In Islamic legal texts fraud (tadlis or khilaba), lesion or misrepresentation (ghabn), gross misrepresentation (ghabn fahish), deception (shushsh), imbalance (gharar), and trickery (taghrir) are used interchangeably as to mean fraud.
1.7.1. Role of optional clauses. (corrective measures)

Under Islamic law a unilateral legal right is given to a party in a contract of sale to recover any loss that may occur. This legal right allows the party (victim) to revoke or ratify the contract and thus determine its validity. The contract is valid, theoretically, subject to the use of option. In other words, the validity of the contract is suspended until and unless the use of option is dismissed by whoever has the right of option. The doctrine of option (corrective measures) then supposes to deal with any fault associated with the contract, be it fraud, mistake or duress. It is irrelevant, under Islamic contracts law, as to whether fault is classified as misrepresentation or fraud. The idea is as simple as this: whatever goes wrong options will deal with it. As such the nature of the information rule under Islamic contracts law is derived largely from the doctrine of option and the subject of the contract. Under English common law, the doctrine of option may be understood as implied terms as option is a precondition associated with the contract. The idea of optional clauses in a commercial sale may developed from prophetic tradition.\textsuperscript{72}

There are six main options known under Islamic contracts law that are usually associated with a contract of sale.\textsuperscript{73} Options may be classified as option by mutual consent and option by law. It is also possible to categorise options into conventional and legal categories. However, it would be appropriate in this small section to give a description of the options in no particular order.

\textit{Option of acceptance or contract session (KHIYAR AL-MAJLIS)} occurs during the formation of a contract and allows both parties to either accept or reject an offer. The period of this option lasts until the separation of the contracting parties. The argument, however, is whether or not this option may last after the conclusion of the contract. It seems that this option will not be enforced after the contract has been made. It should be noted that the option of acceptance does not apply to unilateral contracts such as endowments or gifts.

\textsuperscript{72} The Prophet said, "No deal is settled and finalized unless the buyer and the seller separate, except if the deal is optional (whereby the validity of the bargain depends on the stipulations agreed upon)." Narrated by Ibn 'Umar, \textit{Sahih Bukhari}, Volume 3, Book 34, Number 326

\textsuperscript{73} Noel J. Coulson. \textit{Commercial Law in the Gulf States, the Islamic Legal Tradition} (London: Graham & Trotman, 1984) 57
Option of condition or stipulation (KHIYAR AL-SHART) allows both parties to include a condition in the contract which gives them a right either to ratify or cancel the sale. This option cannot be associated with a future event as the latter will encompass uncertainty and thus be void. It is only a suspended condition for a certain period of time. It is therefore the contractor’s will (desire) which determines whether or not the option is used. This option may also be stipulated in favour of a third party e.g. an agent.

Option of designation (KHIYAR AL-TA ‘YIN) is in fact similar to the option of condition. The option of designation was developed by the Hanafi and Maliki schools in the case when the subject matter of the contract was undefined at the point of inception of the contract so as to allow a party to reserve the option to validate the contract. This option was available for a fixed period of time. Thus the party has an option to either ratify or cancel the contract. Hanabli and Shafi’i believe this condition does not conform to Islamic principles as the subject matter of the contract has to be identified properly at the inception of the contract.

Option of defect (KHIYAR AL-‘AYB) is a legal right which allows a buyer in a sale to rescind the contract if a defect is to be found after the transfer of property. This also applies to hiring property where the party has to return the subject with no defect to the owner. The importance of this option is that it does not have to be stipulated at the inception of the contract but rather shall be regarded as a condition of avoidance (of the contract). The option of description (KHIYAR ALWASF) is quite similar to the option of defect and therefore will not be discussed.

Option of inspection (KHIYAR AL-RU’YA) is also, a legal right that occurs either in the absence of the subject matter of the contract or the physical absence of the contracting parties at the inception of the contract. Thus a buyer in a contract of sale is given a right to ratify or cancel the contract upon his possession of the property. So upon the delivery of the subject matter, the buyer will have the right to inspect and thus hold or return the property if it does not meet his expectation. The option of inspection is also helpful if there has been a mistake in the contract where the intention of the contracting parties has not been disclosed.
1.7.2. Fraud (gharar).

In Arabic, *tadlis* means fraud. It causes misrepresentation or lesion (ghabn) and leads to a contractual imbalance (gharar) between the contracting parties. In legal parlance, lesion means a disadvantage suffered by a party of a contract where the price of the subject matter of the contract is paid at an excessive value, more than its real or just value. Lesion on its own is meaningless unless it is associated with fraud. Within the same token *tadli*, as a legal term, means a dishonest and deliberate action leading the contracting party to commit a mistake thereby convincing him to enter into a contract. Under Islamic law *tadlis* tends to be more descriptive as it means, in a contract of sale for example, a false statement about the subject matter of the contract has been made to the buyer. From this definition, *tadlis* is similar to cheating, yet the latter regularly occurs after the formation of the contract or during the course of a contract, e.g. a change in the function of the property when it is delivered, whereas *tadlis*, often, occurs at the inception of the contract. *Tadlis* shall also be distinguished from what Roman law called *Dolus bonus* or permissible deceit in which merchants praise their products to convince costumers. Permissible deceit is not prohibited if it is compliant with the merchant’s customs and does not deceive due to ambiguity.

Fraud as a defect of a contract has never been discussed as in the west. In principle, Islamic scholars associate fraud with its consequence when judging it as a defect. The consequence should indicate *ghabn* or lesion on one of the parties’ concerned otherwise fraud simply has no effect. The relation between cause and effect in determining the validity of the contract means that fraud and *ghabn* cannot be performed unilaterally. In other words “for an act to be annulled on account of fraud, the fraud must have caused *ghabn*, and for an act to be annulled on account of *ghabn*, the *ghabn* must have been caused by fraud”. It should be noted that *ghabn* and *tadlis* vary as the former tends to include deliberate deception whereas the latter may be motivated by intention or by accidental misrepresentation. Within the

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74 Originally, the doctrine of lesion can be traced to Roman law. It means wound or injury. Lesion affects the consent of a party in a contract and if it is excessive the party can rescind from his obligation. There is no clear cut meaning of this terminology under English common law.


concept of *ghabn* a distinction is made between whether or not it is excessive; an element which has an importance on the validity of the contract for some legal scholars. In this sense fraud and misrepresentation are interrelated. Fraud constitutes two elements: exploitation caused by dishonesty or inducement.

However, fraud must be associated with misrepresentation otherwise the contract will be voidable but not void. So whether or not the contract is motivated by *tadlis* is not a question under Islamic law unless *ghabn* occurs.\(^78\)

Fraud, if it is known, has no particular effect on classical Islamic scholars’ discussion.\(^79\)

However, the doctrine of fraud is drawn from Islamic legal sources under the context of trade. The *Qura’n* indicates that trade is permitted when it is conducted in good faith. Hence, any defect in the goods sold must be declared by the seller. The concept of fraud has its origin in deception. In this sense fraud covers a wide scope. It is clear that intention represents one part of the problem and damage represents the other part. In the case of fraud the contract has already been concluded, unlike in the doctrine of mistake, so fraud regarding the subject matter is generally discovered after the formation of the contract. The effect of such fraud renders the contract voidable and gives rise to the option clauses. In the case of a contract of sale, the defrauded party (i.e. the buyer) can rescind the contract or use the doctrine of options. The latter doctrine represents another element of the origin of the doctrine of fraud. In the final analysis of this doctrine of options any contract of sale requires a duty of disclosure to be declared at the inception of the contract. If the duty has not been fulfilled the exploited party will be given right of rescission from the contract as a legal remedy.

The conceptual analysis of the doctrine of fraud among Muslim scholars varies. The debate is between whether fraud should be treated as a specific option with its own legal principles and whether it should be associated with the doctrine of options. Proponents of the latter argue that there should be no distinction between the option of fraud and the doctrine of

\(^{78}\) The originality of fraud may be from this hadith; “A person came to the Prophet and told him that he was always betrayed in purchasing. The Prophet told him to say at the time of buying, “No cheating” Narrated by Abdullah bin Umar, *Sahih Bukhari*, volume 3, Book 34, Number 328

\(^{79}\) Nabil A. Saleh, *Unlawful gain and legitimate profit in Islamic law : riba, gharar and Islamic banking* (Cambridge : Cambridge University Press, 1986)116
options as there is no substantial difference to justify such isolation. The opponents, the majority, counter such an argument by treating the option of fraud uniquely under the shadow of the contract of sale and beyond the boundary of the doctrine of options. This inconsistent systemic approach to the concept of fraud may find its origin in linguistic ambiguity and misconception.

Fraud can be perpetrated via different means. It can also be perpetrated by a third party. Therefore, we shall categorise fraud as: fraudulent acts, fraudulent statements, failure of disclosure, and fraud by a third party.

1.7.2.1. Fraudulent act.

The first fraud is a fraudulent act (tadlis fa’li) which has can apply in three situations. The first situation, based on a Prophetic hadiath, known as a mussarat sale, is seen by Islamic scholars as being a result of actual fraudulent manoeuvres. However, if the sale is not associated with actual loss on the buyer’s side, yet fraud has taken place, the contract is valid for the seller. On the other hand, the buyer has an option either to cancel or ratify the contract. The argument in this sale focuses on the effect of this contract. The Hanfie school considers that the sale is valid and compensation will be given to the buyer if he loses excessively. They base their argument on the fact that there is no defect inherent in the subject matter of the sale which fraud meant to hide thus restitution is the only remedy. This argument is countered by the majority of Islamic scholars who argue that, in a few cases, fraud in the absence of ghabn may annul the sale. Although the Hanafie school was somehow pragmatic on this point to the extent that it allowed the parties an equal bargaining power in the transfer of property, nonetheless they neglected the fact that the seller was deceiving the buyer by intention. In any event, the buyer can rely on the option of defect (khayar al a’yab) to void the contract.

80 Noel J. Coulson. Commercial Law in the Gulf States, the Islamic Legal Tradition (London : Graham & Trotman, 1984)72

81 Nabil A. Saleh, Unlawful gain and legitimate profit in Islamic law : riba, gharar and Islamic banking (Cambridge : Cambridge University Press, 1986) 61

82 The Prophet says “Do not tie up the udders of the she-camel and sheep … if one among you buys…he has two options after milking it: either to retain it or to return it with a measure of dates” Narrated by Abu Huraira, Sahih Bukhari, 34:64. Tasriah( p tasriyat) is an act of binding the teats of a cow, to give the appearance of a productive milk- yield, in which a false impression is given.
The second situation of a fraudulent act is known as concealed deception (Ghushsh al – Khafi). This is an active fraud in which a seller attempts to mix or add a substance to the subject matter so as to defraud the buyer. A typical example is the diluting of milk with water. However, the difference between tasriah and concealed deception lies in a difference of motivation. The former is an active fraud to defraud the buyer but the latter is meant to provide an impression that the subject matter is free of defect. Although such an action may amount to fraud, it is unlikely that the contract will be void. Instead compensation may be given to the buyer if he loses considerably.

The third situation is beautician fraud (tadlis al-Mashatah\(^{83}\)). It is a contract in which the subject matter has been customised for the purpose of deception. This fraud occurs in a marriage contract and in a contract of sale. A notable situation for such a fraud is the sale of a slave where a cosmetic improvement took place so as to defraud the buyer into believing that the slave is healthy and strong. This is an action which is considered a fraud. The argument was whether or not the alteration was deliberate. If it was, then it has been found to be a fraud in the majority of opinions.\(^{84}\)

By examining the situations of these fraudulent acts, it seems that there are certain conditions for actionable fraud. First, it has to be significant and has to cause damage (Darar). Second, it has to be known to one party and acted upon. Third, the other party has to be ignorant of the fraud. The fraud itself must reach such a degree that it would deceive any ordinary person.\(^{85}\) Had a fraudulent act been determined then the defrauded party would be able to use the option of fraud (a majority view) or restitution (Hanfi view) to recover his damage.

1.7.2.2.  Fraudulent statement.

The second fraud is a fraudulent statement (tadlis qawli) that is entirely based on a misrepresentation given by the seller. Classical Islamic scholars associated this fraud with lies. The option of fraud (khiyar al-tadlis) applies only to fraudulent acts as fraudulent

\(^{83}\) This term is, exclusively, found in Shi’ah school.

\(^{84}\) Ibn Qudama, al-Mughni 3ed (Cairo: 1367 AH), IV, 142-3. Ibn Qudama considered beautician as fraud regardless of intention or deliberate motivation.

\(^{85}\) Noel J. Coulson, Commercial Law in the Gulf States, the Islamic Legal Tradition (London : Graham & Trotman, 1984) 70-71
statements are not subject to any distinctive option under Islamic law.\textsuperscript{86} As such the contract is valid but gives rise to a remedy by the virtue of options. To clarify this point, the doctrine of option is always available in the presence of fraud but in the case of misrepresentation, the mislead party will not use the option of fraud but rather the option of defect. Two situations are subject to fraudulent statements.

The first situation is a misrepresentation called forestalling the market (\textit{bay’ al-Mustarsal}\textsuperscript{87}) in which trading caravans are met on their way to the market. Local traders buy, from the trading caravans, goods below their market value and take advantage (exploit) of the travellers’ ignorance of the real value of their products. It was reported that the Prophet criticised this behaviour calling it cheating and gave the trading travellers a right to restitution\textsuperscript{88}. Thus, a contract may be rendered void if it is accompanied by too great an inequality in price (i.e. there exists a significant loss for the trading travellers) and \textit{ghabn}. \textit{Ghabn} in this context should be seen in line with exploitation and an unfair contract as the Prophet did not associate forestalling the market with neither any particular option nor any specific remedy. It was just stated that the trading travellers can rescind in the case of an unfair contract. From another angle, the reason for this revocation was based on the practice of the local traders who used to buy goods from travellers and hoard them to monopolise the market. In the final analysis, therefore, the option of fraud (\textit{Khiyar al-Tadlis}) does not apply to misrepresentation except at the \textit{Hanbli} School. However, the buyer in any event has an option to return to the seller if the latter does not disclose the original price that he has paid. It should be born in mind that, under Islamic contracts law, fraud does not solely invalidate consent and the contract unless \textit{ghabn} is associated with it.

The argument then would be to what extent \textit{ghabn} is considered to render the contract void. \textit{Ibn Abidin} stated that \textit{ghabn} is not considered unless the price is in excess by one third of the value of the subject matter.\textsuperscript{89} The \textit{Hanbli} School on the other hand, allows any gross disproportion between the value of the subject matter and the price paid by the buyer to trigger the doctrine of option (i.e. fraud). Nevertheless, fraud must result in an imbalance

\textsuperscript{86} This is the opinion of the majority. However, \textit{Hanbali} states that any fraudulent statements associated with non-disclosure, \textit{de facto} fraud which affects the validity of the contract.

\textsuperscript{87} Literally, it means meeting the riders and was developed by the \textit{Hanbli} and \textit{Maliki} schools.

\textsuperscript{88} Noel J. Coulson. \textit{Commercial Law in the Gulf States, the Islamic Legal Tradition} (London : Graham & Trotman, 1984) 72

between the contracting parties for the option of fraud to be used, the Shafi School insisted. It should be noted that the opinions of the Shafi and Hanbli schools are exception when the option of fraud is applied to misrepresentation. Thus for the option of fraud to be performed, two conditions have to be met. First, a deception has to exist in an exchange contract and in which a warranty is given. Second, such a deception must constitute a condition.\(^90\)

The second situation of fraudulent statements is trust sale\(^91\) in which a contractor has to disclose a lack of knowledge of the market (not the cost) price of the subject matter. To ensure the confidence of the co-contractor the contractor has a duty to disclose the market price and honour the trust relationship.\(^92\) However, lack of ignorance (on the contractor’s side), lack of ghabn, and a bargaining (or haggling) sale (Mukayasa) disallowed the right of rescission.

1.7.2.3. Failure of disclosure.

The third fraud is a failure of disclosure. This has been developed, by all major Islamic schools, by analogy with a fraudulent act i.e. Mussarrat sale. It occurs by non-disclosure of the defect of the sale subject. It is called a fraud with defect (tadlis bi al-‘Ayb). In general silence is not an offence but rather, in this case, may amount to negligence\(^93\). There is a distinction between silence as an expression of consent and silence as concealment. The first silence concerns personal liberty and is thus preserved. The second silence relates to good faith in a transaction and may amount to a liability. Islamic law applies the doctrine of failure of disclosure to two situations.

The first situation is a fraud with defect in a bargaining (musāwamah\(^94\)) sale. It involves a non-disclosure of the subject of the contract to the buyer, but whose defect is known by the

\(^90\) Ibn Nujaym, *al-Bahr al- Ra’ig*, VI,145

\(^91\) Hanabli and Maiki developed the concept of misrepresentation in line with the trust sale. Ibn Hanbal himself defined the party in a trust sale as ‘he who does not have the advantage in bargaining’.

\(^92\) This was based on a Prophetic hadith which says “deceit of a thing on trust is a sin”. See S.E. Rayner, *the Theory of Contracts in Islamic Law, A comparative Analysis with Particular Reference to the Modern Legislations in Kuwait, Bahrain, and the United Arab Emirates* (London: Graham & Trotman, 1991) 229

\(^93\) Islamic scholars stated that “no statement is to be attributed to a silent person”

\(^94\) Musawamah is a sale at an agreed price (the seller does not disclose his cost to the buyer).
seller. Therefore fraud with defect is an implied condition which requires the seller to disclose any defect in the subject matter. Thus the intention not to disclose a defect is a fraud that constitutes "tadlis (Maliki school) or a deception (Hanbli and Shafi schools), and is therefore forbidden (Hanfi school). However the validity of the contract is subject to the options of fraud and defect. Again, deception without fraud may not invalidate the contract.

The second situation occurs as a betrayal of trust-ship relations (between a fiduciary and a beneficiary); an essential principle under the philosophy of Islamic law. Trust sales (bay’al-Amana) are based on the sellers (agent) honesty in disclosing the original price of the subject matter. Failure to do so will allow the buyer to rescind the contract, some scholars argued, or to receive a compensation for the loss. The remedy of compensation is arguably an exception to the general rule on the remedy of misrepresentation. The reason is that damage has to be associated with information failure. However, in my opinion, in trust sales it seems that fraud is not the legal basis for the remedy, but rather the original price that the buyer has to pay is the legal basis for the remedy. To support this opinion, in the fraudulent statements mentioned above the legal basis for a remedy is when a fiduciary deceives the beneficiary by declaring a false price of the trust sale. Both situations render the contract to be voidable and the affected party has the right of fraud option.

1.7.2.4. The rule of third party.

The fourth fraud is the rule of third party which will be discussed in brief. Islamic law does acknowledge the fact that consent may not only be vitiated by contracting parties. Three situations apply to the fraud by a third party.

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95 The Prophet is reported to say “it is illegal for a Muslim to sell to his brother … without disclosing its defect (if the seller knows)” Ibn Majjah

96 The two options juxtapose as, in certain incidents the subject is not obtainable, the option of defect may not arise.

97 Murabaha: sale at a disclosed mark-up over the cost incurred by the seller. wadi’ah: sale at a price below cost. Tawila: sale at purchase price without addition or discount.

98 It is called khiyar al tadlis.
First of all, a deception (gharar) carried out by a third party in a commercial transaction amounts to fraud. An example is given of a case where a tradesman has two sons in which one of them lacks authority. When the latter deals with buyers or other traders, then there is a fraud by a third party which gives rise to a rescission.

The second situation is called an al- Najsh sale. The Hanbali School allows a buyer in such a sale the right of rescission or revocation regardless of whether or not the seller acted in collusion with the third party. The reason is that the buyer is innocent and should be protected. This however, is not the view of the Shafi’i and Maliki schools as they see collusion as a condition for the right of option.

The third situation of fraud by a third party occurs in an agency contract. In theory an agent acts in the interest of a principle. Thus, any fraud presupposes that both parties (principle and agent) are acting in collusion to defraud an innocent party which provides the latter a right to rescind from any legal relationship.

Islamic schools, to conclude, recognize fraud as affecting consent by adopting an objective approach rather than a coherent theory. The reason for such an approach can be attributed to the eclectic philosophy of the nature of fraud. Hence, the recognition of this doctrine varies among Islamic schools from full adherence, relatively speaking, to reluctant acknowledgment. No matter how fraud is structured or conducted, the question will always be what damage has a fraudulent activity caused. The differences between fraudulent activities overlap, with no clear distinction, between action, statement, and non disclosure. It is also irrelevant whether fraud is caused by contracting parties or by a stranger as long as resources are being misallocated. But how, and to what extent, misallocation shall be taken into account seems to represent a challenge for the integrity of Islamic contracts law. The lack of Islamic courts participation in the development of Islamic contracts law is essential to such a result. The rule of informational failure under Islamic contract can easily be described as fuzzy because it encompass’ fraud and mistake- discussed in the following section- without distinction.

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99 The tradesman should have disclosed this fact.

100 Is a trickery sale in which a third party, with no intention to buy, acting with a seller to deceive a buyer or the buyer acting in collusion with competitors to deceive the seller.
1.7.3. Mistake (ghal’at).

Mistake, what is called *ghal’at*\(^{101}\) in Arabic, is regarded as an informational failure in contract law. In fact, mistake is one of the difficult issues in which contract law has to make a balance between certainty in transactions and the protection of a party who has entered, by mistake, into a contract against his intention. Mistake is both limited and vague principle as it constitutes an incoherent doctrine. The reasons for such abandon are attributed to several factors. First, the majority of Islamic schools require mutual consent (offer and acceptance) to be concluded in the contract session- which would minimise the mistake. Otherwise the contract may not be valid. Second, the development of the doctrine of options, as a defensive mechanism, was seen to encounter contract failure. Third, fraud, to some extent, especially on the subject of the contract, is viewed interchangeably with mistake. Fourth, an identification of the subject of the contract and the contracting parties interact with the rules of legal prohibitions, were prerequisites for the validity of the contract had made mistake an unnecessary doctrine. Fifth, at the level of jurisprudence, the role of Islamic courts in the development of the law of contracts was, to some extent insignificant.

However, Islamic schools are in agreement that mistake renders a contract voidable only if it was clear and unsurprising.\(^{102}\) So if the mistake is accidental, it does not vitiate consent. The justification given is that when a mistake by a seller is clear there is no surprise, for a buyer, the contract is voidable as in this case there is no trouble in the certainty of the transactions and more importantly the liberty of the party should be protected. Mistake in Islamic contracts law relies on the interdependence between the concepts of misrepresentation and fraud as discussed above. It also extends to the doctrine of options which essentially works as an instrument to explain the concept of mistake.

The doctrine of mistake is scattered among Islamic legal texts with no genuine framework. However, Islamic scholars in assessing mistake look for two different concepts: mistake as to meaning (*ghalat ma’na*) and mistake as to desire (*fawat al-wasf al-marghub fih*). The distinction between these concepts is based on the use of the subject matter of the contract not on the material of the subject matter. It is the quality of the subject matter of the contract that a party bears in mind when he enters into the contract. Thus, the mistake represents a failure

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101 In Islamic legal literature mistake and ignorance (*jahl*) are found to be the same.

102 Mustfa al Zarqa, *Al Madkhal Al Fighi Al a’am*, volume 1 (Damascus: Dar Al Qul’am, 2004) 475
of expression of consent of that party. Here, the difficulty is that a mistake has occurred against the will of a contracting party yet the will is determined by actions. It is therefore not surprising that the Maliki School regards mistake as not vitiating consent but instead renders the contract to be non binding (void) on the basis that the subject matter is not what was stipulated. The Hanafi School by contrast renders the contract to be non-exist.

Mistakes can occur at different stages during the formation and the course of a contract. Mistakes can be classified in a variety of ways: a mistake as to the identity of the contracting parties, as to the price to be paid, and as to the subject matter. It should be noted that, apart from the principles underlying these classifications of mistakes, there is no mistake *per se* that can render a contract void or voidable under Islamic law. In this section we shall classify mistake within the scope of the classifications mentioned previously but with extensive explanation. However, mistake as to the law is irrelevant for our purpose thus it is excluded. Generally ignorance in law is no excuse with regard to mistake. Islamic law may take mistake as to the law (i.e. a misunderstanding of the law) into account if ignorance is not associated with negligence.

1.7.3.1. Mistake as to intention.

The expression of intention is formulated in two ways: nomination (*tasmiya*) or by indication (*ishara*). The former represents a genuine intention of the contracting party and thus the contract is binding. The latter represents apparent intention which leads to a variance in the validity of the contract. Consequently there may also be an error of expression as to intention or apparent intention due to the nature of the subject matter and exceptional circumstances. Let these situations be considered briefly.

1.7.3.1.1. Nomination.

Expression of intention might be right or it might be wrong. If it is right then intention has been expressed properly and the contract is legally valid. But when the expression is wrong then the consent of at least one party is vitiated and thus the validity of the contract is open to
question. Under Islamic law, error of expression, that is when a word is used mistakenly, does not affect the conclusion of the contract as the latter satisfies all the requirements of the contract formation of. But the contract is not valid! The reason is to be found from the rules apply to duress i.e. the lack of consent. Thus, for a contract to be annulled on the basis of mistake, it should be evident that the determining factor in entering the contract was an error of expression. Al sanhuri gave two explanatory examples as to error of expression. First, a seller sells a sapphire but calls it a stone without knowing that it is a sapphire. In this case there is no mistake as the intention of the seller has not been revealed to the buyer. The second example is that a buyer asks for an article at y value a seller provides the article at x value. A mistake is observable which granted the seller the right to void the contract. Now whether y is much more expensive than x or vice versa is irrelevant according to the Hanfi school of thought whereby the Shafi school stood exactly on the contrary. The legal reasoning by the Shafi School behind the contract being void is that the price change creates an unfair allocation of resources.

1.7.3.1.2. Indication.

The intention of the contracting parties may not be expressed but rather inferred from conduct. In this case several assumptions may occur. First, both nomination and indication expressions are expressed. If the indication given is different from the expression of intention then a consideration will be given to the real intention of the seller as he is informed by the real intention of the buyer. However, if the indication given refers to the subject matter of a different substance to the nominated article or for different use of purpose, the contract is void due to a mistake as to the meaning. To the same extent, if the delivered article is found to be contrary to its previous description, the buyer has an option to rescind the contract. However, the maliki School extends the right of rescission even after delivery and regards satisfaction at the inception of the contract to be a mistake. On the other hand, the Hanfi

103 Rayner, the Theory of Contracts in Islamic Law, A comparative Analysis with Particular Reference to the Modern Legislations in Kuwait, Bahrain, and the United Arab Emirates (London: Graham & Trotman,1991)186

104 Due to the seller’s ignorance in the nature of subject matter.

105 The mistake in this case may also be based on the quality of the substance desired by the buyer. This is because value is associated with verbal deceit for an annulment of the contract. In this case the seller did not deceive the buyer.
School stated that if the use of the subject matter is of no substantial difference than the description given by the buyer, the only remedy will be the option of description.

The second assumption is that intention may not be expressed but is understood from its circumstances and customs. A party may reasonably understand that a mistake has occurred due to the other parties’ circumstance and origin. For example, if a seller sells, in a market of jewellery, a stone at a jewel value, it may be assumed that he is aware that the buyer has made a mistake. Thus the buyer has an option of defect. Customary knowledge is assumed to be known by both contracting parties.

The third assumption relies on the nature of the subject matter but is associated with the option of defect. The intention of the party is that the nature of the subject matter is sound. His intention, needless to say, is a valid condition for the contract. Had the subject matter been defect then the party’s intention would have been vitiated and the contract, consequently, is voidable subject to the option of defect. In this sense the option of defect is similar to mistake. Anything that may destroy the value of the subject matter is regarded as a defect that gives rise to the option of defect. So in a contract where a guarantee is required it is regarded as an implied term because the nature of the subject matter may be diminished. However, if the defect is known before possession then the option of defect is dismissed.

1.7.3.2. Mistake as to contracting parties.

The origin of this mistake is traced to Roman law where the lack of identity of the contracting parties renders the contract void if it is material. Otherwise identity is irrelevant. In Islamic law, mistake as to person is to be drawn from a marriage contract in which a right of annulment is given to the party who suffered from such a mistake. Thus a distinction was made between qualities and essential qualities of the person. If the mistake is as a result of essential qualities then it would invalidate the marriage contact. This rule also applies to unilateral contracts where the identity of the person is essentially significant such as in gift and bequest contracts. The mistake of identity applies to the contracts of pre-emption

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107 Al Kasani stated that consent is very essential in these transactions because there is an offer of property or a connection to property. Thus there is no doubt that the well is an offer of property in all regards. Al Kasani, *al-bada‘i*, VII,355.
(shuf’a) and agency (wakala), and the hire of a wet nurse. Among modern authors arguments vary as to whether or not a mistake in person is an essential fraud relating to consent. It is reported that Al- Sanhri regarded mistake in persona to be a determining factor whereas others are either less certain or not at all in favour of this mistake raising an action.\textsuperscript{108} However, the general rule on the mistake of identity is that the knowledge of the contracting party is essential under Islamic contracts law and thus if there is a mistake then the contract is null.

1.7.3.3. Mistake as to the subject matter.

When the subject matter of the contract turns out to be significantly different than it is supposed to be, the mistake vitiates consent. It is indifferent whether the mistake is unilateral or mutual or whether it is induced or not by misrepresentation. There is simply no contract because the subject matter has not been ascertained properly.\textsuperscript{109} The subject matter contains counter values, i.e. price and property. The first (price) is associated with flagrant misrepresentation (ghabn fahish) the second (property) is related to the consent of the contracting parties.

1.7.3.3.1. Value.

When there is an excessive deception in the value of the subject matter the status of the contract is analyzed on three bases:\textsuperscript{110}

1 When a mistake as to the value of the subject is associated with flagrant misrepresentation, unless it is accompanied by verbal deceit, it does not give rise to rescission from the contract.\textsuperscript{111}

\textsuperscript{108} S.E. Rayner, the Theory of Contracts in Islamic Law, A comparative Analysis with Particular Reference to the Modern Legislations in Kuwait, Bahrain, and the United Arab Emirates (London: Graham & Trotman, 1991)193. Al Kasani states that “where a person purported to sell a jewel which is in fact only a piece of glass … there is no contract because the object of sale does not exist”. See al kasani, Bada ’i al-Sana’i, V,140.

\textsuperscript{109} Noel J. Coulson. Commercial Law in the Gulf States, the Islamic Legal Tradition (London : Graham & Trotman, 1984) 68

\textsuperscript{110} S.E. Rayner, the Theory of Contracts in Islamic Law, A comparative Analysis with Particular Reference to the Modern Legislations in Kuwait, Bahrain, and the United Arab Emirates (London: Graham & Trotman,1991) 194- 195

\textsuperscript{111} Shafi ’i insisted that mistake must be accompanied with deception otherwise misrepresentation alone does not give rise to rescission.
2 A rescission from the contract, due to a mistake, may be given to those\textsuperscript{112} who need public protection even in the absence of misrepresentation. It should be noted that there is no requirement for misrepresentation to be accompanied by fraud or flagrant misrepresentation\textsuperscript{113}.

3 Excessive deception as to the value of the subject matter, without fraud being found, does not annul the contract.

The argument of mistake as to the value of the subject matter is then redirected to the interaction between misrepresentation and deception. It goes to the heart of the question of what is the rule of misrepresentation in the absence of deception. Three different opinions are given in this case. First, a contract is valid but equally subject to being rescinded. Second, rescission is not available. Third, if deception occurs rescission is available but it is not necessarily for the sake of public interest\textsuperscript{114}. The Hanbali School on the other hand, stated that misrepresentation in the presence of deception gave rise to an option for rescission from a contract in three situations: a dispatch contract (when the carrier is unaware of the value of the goods, \textit{al-Najsh})\textsuperscript{115}, a sale by a trading caravan, and a sale of goods. Reference should also be made as to the price of commodities at the contract session. It was the Maliki School who held that rescission may be available but with three conditions. The first condition is the necessity of \textit{ghabn fahish} (flagrant misrepresentation) occurring in a sale where an excess of more than a third of the original price has been imposed.\textsuperscript{116} The second condition assumes that a person, with reasonable consideration, would have been deceived in such a sale if the buyer did not have knowledge of the value at the inception of the contract. The third condition is that a claim of \textit{ghabn} should proceed within one year of the action of deceit.\textsuperscript{117} Therefore, a mistake as to the value is irrelevant in the absence of flagrant misrepresentation. Relatively speaking, flagrant misrepresentation is irrelevant in the absence of a verbal deception.

\textsuperscript{112} An example is that a property of treasury, minor, and donor.

\textsuperscript{113} This is the view of \textit{Shfi`i}, Hanafi, and hanbali schools.

\textsuperscript{114} Ibn Hammam, \textit{al-Bahr al-Ra`iq}, VI,115-6

\textsuperscript{115} Is a trickery sale in which a third party, with no intention to buy, acting with a seller to deceive a buyer or the buyer acting in collusion with competitors to deceive the seller.

\textsuperscript{116} Public auction is not included in this condition.

\textsuperscript{117} S.E. Rayner, \textit{the Theory of Contracts in Islamic Law, A comparative Analysis with Particular Reference to the Modern Legislations in Kuwait, Bahrain, and the United Arab Emirates} (London: Graham & Trotman,1991) 197
1.7.3.3.2. Meaning.

A mistake in the substance (*jins*) of the subject matter renders the contract void as the subject matter is one of the elements of contract formation. Thus a contract is officially non-existent. An example given by Muslim jurists is that of a stone sold as a diamond but it turns out to be glass indicating a mistake. In English law it may be called non-performance. The contract in the stone example will be void due to the lack of meaning between the contracting parties.\(^\text{118}\) The doctrine of mistake as to meaning extends also to the case where the substance is in the same class yet the purpose of the use of the subject matter is different than to what is intended. As such Islamic law seems to take a wider scope of the doctrine of mistake. Mistake as to meaning may be based on the common mistake of declared interests\(^\text{119}\). Generally, Islamic law will recognise the revealed consent at the inception of the contract. However, Islamic jurists may not rely only on intention to determine mistake. This is true in a commercial contract where it has been suggested that the purpose of the subject matter should be determined by commercial custom.

1.7.3.3.3. Quality.

A contract is valid but not binding when the quality (*wasf*) of the substance in the subject matter of the contract is almost similar to what has been agreed i.e. there is no insubstantial difference. The legal reasoning for this remedy is based on the virtue of the option of description and not on the basis of mistake. More precisely the affected party can use the ‘option for the lack of desired quality.’\(^\text{120}\) If, on the other hand, the subject matter of a contract is a red apple and it turns out to be a green apple, then the contract is valid as no mistake is to be found. However, the representation by a seller as to its quality is at fault thus the contract

\(^\text{118}\) The approach here is of Roman doctrine *error in corpora*.

\(^\text{119}\) This type of mistake was discussed by Muslims scholars under the contracts of agency, hire, agriculture and others.

\(^\text{120}\) This term is used by the *Hanfi* School. In Arabic it is called ‘*khiyar fawat al-wasf al-marghub*’
is voidable. Of course if the mistaken party ratifies the contract then consent has been maintained thus the contract is valid. However, the Hnabali school asserted that compensation to the mistaken party is allowed for the reduction in the value of the subject matter. So if the subject matter turns out to be in the same class but with a different description, the contract is valid but subject to the option of description due to a false description in the subject matter. In the final analysis, the determination of mistake as to the quality of the subject matter was summarised by Rayner as:

“Where the article referred to proves essentially different from what was mentioned, the sale is supposed to relate to the article named. If the article is of a different species, then the sale is null. If, on the other hand, the article referred to prove[s] to be of the same species but of a different quality, then in this case the sale relates to the article referred to. If the article referred to is found to be of a different quality, the purchaser is accorded an option to rescind because the article is not of the quality contracted for.”

1.7.3.3.4. Non-disclosure.

Other evidence of the role of the option clauses in the development of the doctrine of mistake, under Islamic contracts law is apparent. That is the option of inspection (khiyar al-ru'ya). The subject of the contract may be passed to a buyer in the absence of a disclosure of its content. The contract is formed on the basis of possession rather than ownership. Thus, once the buyer inspects the subject matter and finds it mismatches his original intention he may remedy the mistake under the option of inspection. The legal reasoning is to be found in the failure of consent on the other bargaining side. A contract compromises consent between parties not just one party. Therefore a victim in such a sale can either rescind (return the subject) or ratify the contract. In this type of mistake it seems that Islamic law is less strict and opts for a wider scope than the doctrine of mistake in English civil and English common

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121 S.E. Rayner, the Theory of Contracts in Islamic Law, A comparative Analysis with Particular Reference to the Modern Legislations in Kuwait, Bahrain, and the United Arab Emirates (London: Graham & Trotman,1991) 182

122 Here, it seems the intention of the contracting parties is irrelevant but rather an identification of the subject matter.

123 S.E. Rayner, the Theory of Contracts in Islamic Law, A comparative Analysis with Particular Reference to the Modern Legislations in Kuwait, Bahrain, and the United Arab Emirates (London: Graham & Trotman,1991) 183
It should be noted that the mistake as to non-disclosure is neither based on deceit nor revealed consent at the inception of the contract. The application of such a doctrine is serious in commercial transactions as it provides an element of instability and a lack of confidence in the market. On the hand, a tendency to a disclosure requirement on securities markets, for example, may prove that such a doctrine is not at all unhelpful.

1.8. Conclusion.

This chapter has analysed the allocation of risk in Islamic contract law. It has been argued that contract law is the main instrument of facilitating social interactions and distributing legal entitlements. The normative justice in private arrangements is unresolved issue functionally. While the current trend is in favour of distributional function, corrective function is widely popular among economists.

Risk in Islamic contract comes generally from illegality and informational failure. The former seems to fall within the zone of distributive justice as the law stats its invalidity. Usury and gambling contracts are illegalised due to the inequality inherited in these transactions which require a redistribution of legal entitlements based either on social or efficient justice. On the other hand, informational failure, mistake and fraud, seems to be treated by the corrective measures existed within the doctrine of contract. The very existence of both risks will normally be the inequality in allocating resources which may lead to exploitation or monopoly.

However, and as an introduction to the next chapter, it should be stated that classical legal analysis of private contracts assumed a complete contingent contract in which barging take place between contracting parties, at minimum cost, to allocate future risks. Contract rules, upon the identification of the rules of bargaining process, then become a common risk allocation by any individual party. This led to the conclusion that allocation of risks can be

124 E. Rayner, the Theory of Contracts in Islamic Law, A comparative Analysis with Particular Reference to the Modern Legislations in Kuwait, Bahrain, and the United Arab Emirates (London: Graham & Trotman,1991) 190


optimally dealt with by negotiations\(^{127}\) or alternative legal rules. Islamic contract rules emphasize the point of free negotiation between contracting party at contract inception to allocate future risks less costly and efficiently.

Complexity and ambiguity of modern market has rendered the classical legal analysis of rules of contract law inadequate. Contracting parties can no longer optimally bargaining future arrangements. Relational contracts cover complicated arrangements such as agency and employment contracts. Complete contingent contract is simply rare in modern market.

\(^{127}\) The Prophet said, "The buyer and the seller have the option to cancel or to confirm the deal, as long as they have not parted or till they part, and if they spoke the truth and told each other the defects of the things, then blessings would be in their deal, and if they hid something and told lies, the blessing of the deal would be lost" Narrated by Hakim bin Hizam, *Sahih Bukhari* Volume 3, Book 34, Number 296.