

# Islamic Law of Contracts

*By*

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# Law of Contract

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- The law of contract is the branch of law which determines the circumstances in which a promise shall be legally binding on the person making it. (Ansons law of Contract)

# GENERAL PRINCIPLES OF CONTRACTS

- 1- Free Mutual Consent**
- 2- Lawfulness of Subject Matter**
- 3- Legality of Motivating Cause**
- 4- Prohibition of *Gharar* (Uncertainty)**
- 5- Prohibition of *Riba***
- 6- Prohibition of *Qimar* (Gambling) & *Maysir* (Games of Chance)**

# GENERAL PRINCIPLES OF CONTRACTS

- 7- Prohibition of *Khilabah* & *Ghishsh*  
(Fraud & Deception)**
  
- 8- Prohibition of *Bayatan fi Bayah*  
(Combining Two Inconsistent Contracts)**
  
- 9- Principles of *Entitlement to profit with Risk* & **Liability for Loss****
  
- 10- Observance of *Maslahah* & *Maqasid al-Shariah***
  
- 11- Permissibility as General Rule**

## **Principle – 1: Free Mutual Consent**

- No Coercion & Undue Influence
- No Fraud & Deception
- Definite Knowledge of Transaction
- Knowledge of Rights & Obligation
- Documentation Recommended
- Medium of Consent: Offer and Acceptance or Conduct

## PRINCIPLE – 2: LAWFULNESS OF SUBJECT MATTER

- Commodity or Service not Prohibited
- What is not Prohibited is Permissible
- Permissibility under Dire Necessity

# PRINCIPLE – 3: LEGALITY OF MOTIVATING CAUSE

- Contract should not Contradict Objectives of *Shariah*.
- Should not Frustrate the Purpose
- *Hiyal* حيل (subterfuges) not Allowed
- *Bay al-inah* بيع العينة (Buy-Back Agreement) Prohibited
- *Bay bil-wafa* بيع بالوفاء
- *Tawarruq* تورق

## □ ***Bay al-Inah (Buy-back Agreement):***

It is to sell commodity on cash and then buy it back at a higher price to be paid at some specified time in future.

### Example:

A, a client sells a computer to B, a bank for Rs.30,000 on cash and then at the same time buys it back from B for Rs.40,000 on credit of one year. A has in fact obtained a loan of Rs.30,000 with the interest of 10,000 rupees.

## LEGALITY OF MOTIVATING CAUSE - CONTD...

### □ ***Bay al-Wafa'* (redeemable sale):**

This is a transaction in which a person in need of money sells a commodity to a lender on the condition that whenever the seller wishes, the lender (the buyer) would return the purchased commodity to him upon surrender of the price.

**Example:** A sells his house to B for **20** lac rupees on the condition that he will repurchase it after one year on the same price.

## LEGALITY OF MOTIVATING CAUSE - CONTD...

### □ ***Tawarruq.***

Converting an article to cash; it means buying a commodity with deferred payment and selling it to a person other than the buyer for a lower price with immediate payment.

## OTHER FORMS OF TAWARRUQ - CONTD...

### □ **How Tawarruq Works:**

The bank would identify a commodity (asset) with stable historical price behavior, buy the commodity from a third party at its spot price, sell it to the customer at a higher deferred price, and the customer then sells the commodity to the third party (or any other) at the spot price. The net result is that the customer receives the needed cash immediately, and has an obligation to pay the larger deferred price to the bank.

## PRINCIPLE - 4: PROHIBITION OF GHARAR (غرر)

- Meaning: Grave Uncertainty, Indeterminacy
- Uncertainty about Ultimate Outcome of Contract
- One's Right Vague & Undefined
- Uncertainty about Existence
- Sell not what you do not have

Contd...

# Gharar

- *Salam* سلم, *Istisna* استصناع Allowed
- Uncertainty about Delivery
- Unknown Quality, Quantity, Specification
- Unknown Time of Performance: Contingent Contracts
- Unidentified Subject Matter

Contd...

## EXAMPLES:

- Sale of Fruits on Tree in the Beginning of Season
- Fetus in Womb
- Sale of Debt
- Short Selling of Shares
- Conventional Derivatives
- Commercial Insurance
- Undefined Piece of Land

*Contd...*

## EXCEPTIONS:

- *Gharar* in Gratuitous Contract is Allowed
- *Gharar Yasir* (Non-Substantial / Nominal Uncertainty) is Allowed
- *Gharar* in Commutative Contracts not Allowed

# PRINCIPLE - 5: PROHIBITION OF RIBA (ربا)

## □ Definition:

“A stipulated excess not covered by corresponding capital, labour and liability for loss”

## Ingredients:

- 1- Increase over the Principal Sum
- 2- Payable as Contractual Obligation
- 3- Without any Consideration i.e. Capital, Labour & Liability

## PRINCIPLE - 6: PROHIBITION OF QIMAR

(قمار)

- Every form of money acquisition of which depends on luck and chance as opposed to others equally eligible for it.
- Lottery & Lucky draws
- Speculative gains in Conventional Financial Markets

# THE QURAN:

□ يَا أَيُّهَا الَّذِينَ ءَامَنُوا إِنَّمَا الخمر و الميسر و الأنصاب و الأزلامُ رجسٌ من عمل الشيطان فاجتنبوه لعلكم تفلحون (5:90)

□ “O you who believe: Indeed intoxication, Gambling, Dedication of Stones, Divination by Arrows are an Abomination of Satan’s handwork so avoid such abomination” (5:90)

# PRINCIPLE - 7: ENTITLEMENT TO PROFIT WITH RISK & LIABILITY

□ **Hadith:** الخراج بالضمنان

- A person is entitled to profit only when he bears risk of loss
- Application in Loan, *Musharakah*, *Ijarah*, sale
- Risks in *Murabahah*, *Ijarah*

# PRINCIPLE - 8: PROHIBITION OF *GHISHSH, KHILABAH* (FRAUD & DECEPTION)

- *Tatfeef*: Giving short weight and short measure
- *Najash*: False bidding to raise price
- Falsely Swearing
- Hiding Defects of Commodity
- *Ghabn-e-Kaseer*: Exorbitant Profits

# PRINCIPLE – 9: PROHIBITION OF COMBINING TWO INCONSISTENT CONTRACTS

- 1- **Loan and Sale**
- 2- ***Ijarah* and Sale (Hire Purchase)**
- 3- **Sale of single object for two prices**
- 4- **Contingent Contracts**
- 5- **Conditional sale is allowed if condition is appropriate to Contract**
- 6- **Loan/Debt and *Hawalah* allowed**
- 7- **Loan/Debt and guarantee allowed**
- 8- **Co-ownership & *Ijarah***

# PRINCIPLE – 10: OBSERVANCE OF MASLAHAH AND MAQASID

- The objective of *Shari'ah* is the happiness and well-being of human beings.
- **Primary Objectives** are protection and preservation of Religion, Life, Progeny – family unit, Property, Intellect and Honour.
- **Secondary Objectives** are:
  - 1-The establishment of justice and equity in society.
  - 2-The promotion of social security, mutual help and solidarity.
  - 3-The maintenance of peace and security.
  - 4-The promotion of cooperation in matters of goodness and prohibition of evil deeds and actions.
  - 5-The promotion of supreme universal moral values.

# Agreement and Contract

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## Steps of Conventional Contract

- Negotiation
- Agreement
- Contract

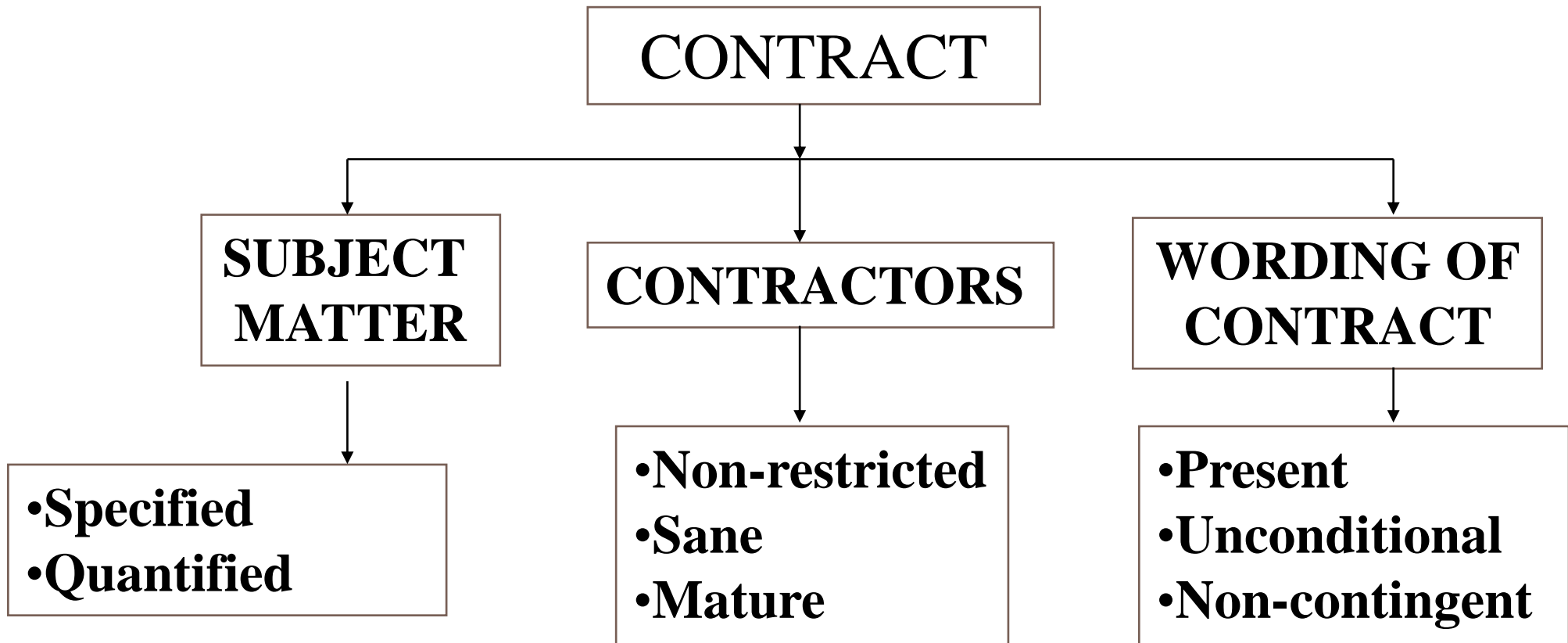
Contract is an agreement which is enforce- able by law, recognized by law and effects legal rights and duties of the parties.

# LAW OF CONTRACT

- **Islamic Contract:** It is connection between the offer and the acceptance in a manner that it affects subject matter.
  - Offer
  - Acceptance
  - Subject matter
  - Contracting Parties

# CONTRACT IN ISLAM

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# Contract/Promise

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## □ Promise (WADA)

It basically refers to a unilateral understanding or promise extended by one person to another in which he offers to sell or buy something in future.

# Promise

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## □ Promise WADA):

The consensus of present Ulama is this that Wa'da is enforceable by law until and unless the promisor is not in a position to fulfill it. In this case, if it is not due to any of his negligence then he has to make good the loss to the promisee.

# Muaada or Mu'ahida (Agreement)

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- It means bilateral undertaking (promise) or agreement.
- According to majority of the Arab Sharia Scholars, Mua'ida is similar to Aqd and not allowed in situations where Aqd is not allowed (e.g. forward contracts), and thus is not enforceable by law.
- But sub continent Scholars allowed Bilateral promise in all such places where Aqd is not allowed.

## Continued ...Muaada or Mu'ahida (Agreement)

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- The rationale behind it is that in some cases Muwaada is genuinely required, for example, importer need to hedge foreign exchange but since future contract is not allowed in Islam they can do through bilateral promise. The difference between future contract and bilateral promise is as follows:
- Unlike Aqd, the ownership in Mua'ida is not transferred at the time of signing the agreement.

# Islamic Law of Contract

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- Ownership (Milkiyat)
- Wealth (Maal)
- Contract (Aqd)

# (1)-Ownership (Milkiyat)

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- Reasons and Causes of Ownership (Asbaab ul Milkiyat)
- To acquire Authorised and Permitted things (Ahraz ul Mubahhat)
- Contracts (Aqd)
- Successor (Khalf)
- Addition (Idafa)

# Nature of Ownership (Milkiyat)

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- ❑ Ownership of Asset (Milk ul Ain)
- ❑ Ownership of debt (Milk ud dain)
- ❑ Ownership of Usufruct (Milk ul Manfaat)

# Characteristics of Ownership (Milkiyat)

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- If some get Ain he gets manfaat but not other way around.
- Milkiyatulain is not related with time.
- Milkiyatul Manfaat is related with time.
- Milkiyaatul Ain cannot be finish but transfers (Waqf is exception).

## (2)- WEALTH (MALL)

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- Every thing that is consumable and has a valuable use.

### Conditions

- Posses able (Sun light)
- Valuable Use (Dust)

# Money

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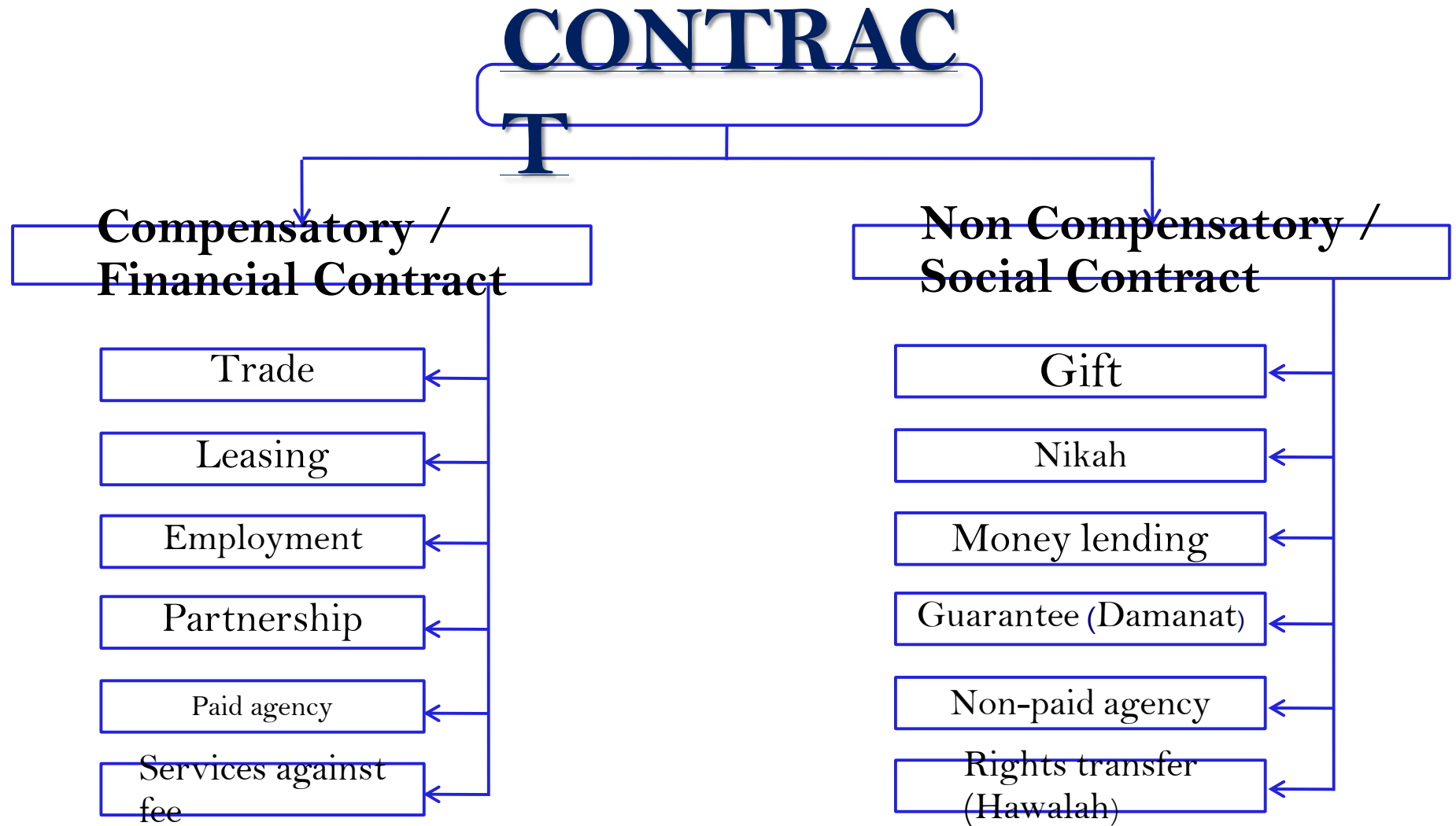
- The standard by which the value of commodity is measured or the medium of exchange.
- According to it Money is part of Maal.

# Types of Contract (AQD)

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- Lexically: Conjunction to tie.
- “It is connection between the offer and the acceptance in a manner that results the proper affects”.
  
- Two Types:
- (1)- Aqd Mawadda (Compensatory/Remunerative Contract)
- (2)-Aqd Ghair-Mawadda (Non Compensatory/ Non-Remunerative Contract)

# Types of contract



# Conditional Contract

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1. **A condition, which is not against the contract, is a valid condition.**

*For example a condition of free delivery to buyer's premises.*

2. **A condition, which seems to be against the contract, but it is in the market practice, is not void, if its voidness is not proved with the clear injunctions of the Holy Quran and Sunnah.**

*For example a condition that the seller will provide five-year guarantee and one year free service.*

# Conditions

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3. A condition that is against the contract and not in market practice but is in favor of one of the contractors or subject matter, the condition is void.

*For example if 'A' sells a car with a condition that will use it on a fixed date every month, this contract will be void he.*

4. A condition, which is against the contract, not in the market practice and not in favor of any contractor, that is not a void condition.

*For example if both A and B decide to give to charity, a certain percentage of both subject matter and consideration, upon completion of sale.*

# VOID CONDITIONS AND VOID CONTRACTS

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- **The contracts of compensation (Uqood Muawadha) like sale, purchase, lease agreements become void by putting void condition.**
- **Non-compensatory (voluntary) agreements (Uqood Ghair Muawadha) like contract of loan (Qard-e-Hasanah), do not become void because of void condition. The void condition, however, becomes itself ineffective.**

# SALE (BAI)

Types of Sale (Bai)

# ISLAMIC SALE

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- DEFINITION OF SALE (BAI)
  - **exchange of a thing of value with another thing of value with mutual consent.**
  - **the sale of a commodity in exchange of cash.**

# ISLAMIC SALE

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## TYPES OF SALE

1. **Valid sale ( *Bai Sahih* )**
2. **Void/Non existing Sale ( *Bai Baatil* )**
3. **Existing sale but void due to defect ( *Bai Fasid* )**
4. **Valid but disliked sale ( *Bai Makrooh* )**

# ISLAMIC SALE

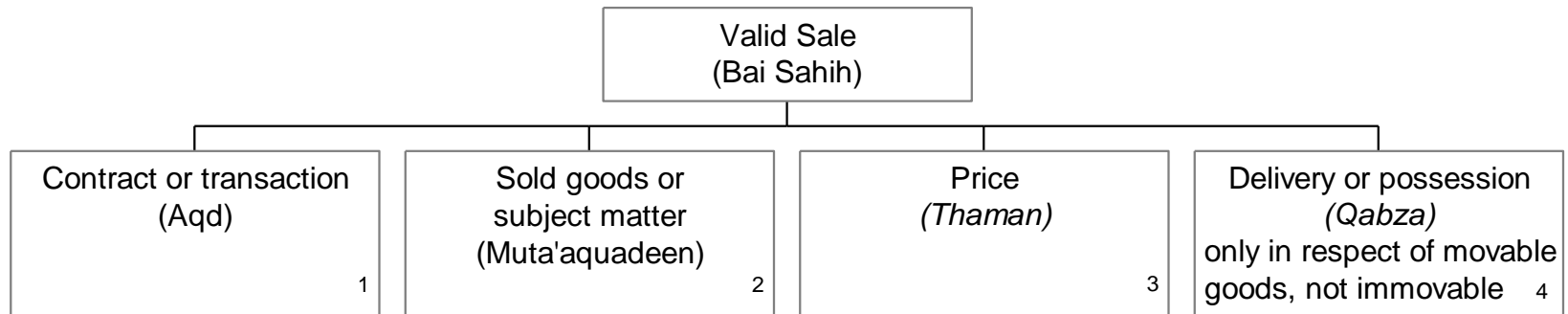
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## (1)-VALID SALE ( *Bai Sahih* )

- ▣ a sale is valid if all elements together with their conditions are present
  
- ▣ elements of valid sale are
  - Contract ( **Aqd** )
  - Subject matter ( **Mabe'e** ) - consideration
  - Price ( **Thaman** )
  - Possession or delivery ( **Qabza** )

# ISLAMIC SALE

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# CONTRACT ( Aqd )

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- **Offer & Acceptance ( Ijab-o-Qobool)**
  - **Oral ( Qauli )**
  - **Implied ( hukmi )**
- **Buyer and seller ( Muta'aquadeen ) must be**
  - **Sane**
  - **Mature**
- **Conditions of contract ( Sharaet-e-Aqd )**
  - **sale must be non-contingent**
  - **sale must be immediate**

# SOLD GOOD OR SUBJECT MATTER ( Mube'e )

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- Existing
- Valuable
- Usable
- Capable of ownership/title
- Capable of delivery/possession
- Specific & Quantified
- Seller must have title & risk

# SOLD GOOD OR SUBJECT MATTER

( Mube'e )

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## ■ 1.Existing

The subject matter of sale must exist at the time of sale.

Thus, a thing which has not yet come into existence cannot be sold. If a non-existent thing has been sold, even with mutual consent, the sale is void according to shari'ah. Eg. 'A' sells the unborn calf of his cow to 'B'. The sale is void.

# SOLD GOOD OR SUBJECT MATTER

( Mube'e )

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## ■ 2.Valuable

The subject of sale must be a property of value.

Thus a thing having no value according to the usage of trade eg. a leaf or a stone on a roadside cannot be sold or purchased.

## SOLD GOOD OR SUBJECT MATTER

( Mube'e )

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### ■ 3.Usable

**The subject of sale should not be a thing which is not used except for a haram purpose, like pork, alcohol etc.**

# SOLD GOOD OR SUBJECT MATTER

( Mube'e )

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## ■ 4. Capable of ownership/title

The subject matter should not be anything, which is not capable of ownership/title for eg. sea or sky.

## SOLD GOOD OR SUBJECT MATTER

( Mube'e )

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- 5. Capable of delivery/possession
- If subject matter is not deliverable sale is void.

It is called in Arabic

ADM UL QUDARAT ALATTASLEEM.

For e.g.. an un constructed building, cannot be possessed since it is non-existent.

# SOLD GOOD OR SUBJECT MATTER (

## Mube'e )

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### 6. Specific & Quantified

The subject of sale must be specifically known and identified either by pointing or by detailed specification that can distinguish it from other things, which are not sold. Eg. There is a building comprising of a number of apartments built in the same pattern. 'A' -

# SOLD GOOD OR SUBJECT MATTER ( Mube'e )

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## 6. Specific & Quantified

- the owner of the building says to 'B', "I sell one of these apartments to you"; 'B' accepts. The sale is void unless the apartment intended to be sold is specifically identified or pointed out to the buyer.

# SOLD GOOD OR SUBJECT MATTER

( Mube'e )

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- 7. Seller must have title & risk
- The subject matter of sale must be in the ownership of the seller at the time of sale. The well mentioned hadith of Hakeem bin Hizam that( Don't sell which you don't owned).
- Thus what is not owned by the seller cannot be sold. If he sells something before acquiring its ownership and risk, the sale is void.

# SOLD GOOD OR SUBJECT MATTER

( Mube'e )

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## ■ 7. Seller must have title & risk

Eg. 'A' sells to 'B' a car which is presently owned by 'C' but 'A' is hopeful that he will buy it from 'C' and shall deliver it to 'B' subsequently. The sale is void, because the car was not owned by 'A' at the time of sale. The speculation in shares is another example.

### 3. PRICE ( Saman )

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#### ■ 1. Quantified ( Maloom )

**The measuring unit of the price should be known eg.  
currency etc.**

**Special care is needed in Barter Sale**

# 3. PRICE ( Saman )

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## ▣ **2. Specified & certain ( Muta'aiyan )**

**For a sale to be valid, the price should be ascertained and**

**specified e.g.. the total amount etc.**

# PRICE ( Saman )

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## **Specified & certain ( Muta'aiyan )**

**If the price is uncertain, the sale is void.**

- 1. If seller says take this thing I will charge you what ever its worth Or I will tell you price later .**
- 2. If 'A' says to 'B': "If you pay within a month, the price is Rs.50 but if you pay after two months, the price is Rs.55". 'B' agrees.**

### 3. PRICE ( Saman )

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**The price in this case is uncertain and therefore the sale is void unless anyone of the two alternatives is agreed upon by the parties at the time of sale.**

## **ELEMENTS OF A VALID SALE (*Bai Sahih*)**

### **4. DELIVERY OR POSSESSION (QABZA)**

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**The subject of sale must be in the physical or constructive possession of the seller when he sells it to another person.**

**This is done only in respect of movable goods, not immovable.**

## **4. DELIVERY OR POSSESSION (QABZA)**

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**For eg. 'A' has purchased a car from 'B'. 'B' has not yet delivered it to 'A' or to his agent. However, 'A' cannot sell the car to 'C'. If he sells it before taking its delivery from 'B', the sale is void.**

## 4. DELIVERY OR POSSESSION (QABZA)

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### ■ Constructive ( Hukmi )

**"Constructive possession" means a situation where the possessor has not taken the physical delivery of the commodity, yet the commodity has come into his control and all the rights and liabilities of the commodity are passed on to him, including the risk of its destruction.**

## **4. DELIVERY OR POSSESSION (QABZA)**

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### **Cont.....**

For eg. 'A' has purchased a car from 'B'. 'B' after identifying the car has placed it in a garage to which 'A' has free access and 'B' has allowed him to take the delivery from that place whenever he wishes. Thus the risk of the car has passed on to 'A'. The car is in the constructive possession of 'A'. If 'A' sells the car to 'C' without acquiring physical possession, the **sale is valid.**

# Types of Sales

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Following are the common types of Valid sales

1. **Bai Musawamah**: It refers to normal sale in which cost price is not known.
2. **Bai Murabaha**: It refers to a sale in which cost and sale price is known to the buyer.
3. **Bai Muqayada**: It refers to barter sale excluding currency sale.
4. **Bai Surf**: It refers to the sale of gold, silver and currency.

## Types of Sales

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5. **Bai Salam**: It is a kind of sale in which payment is spot while the delivery of the good is deferred.
6. **Bai Istisna**: It refers to such sale in which commodity is transacted before it comes into existence. It is basically an order to manufacture.
7. **Bai Muajjal**: It refers to such sale in which payment is delivery is spot while payment is deferred but cost is not known.

## (2)-VOID/NON EXISTING SALE (BAI BAATIL)

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**Certain conditions are not met. These relate to:**

- **conditions of offer and acceptance**
  - **Oral acceptance OR Implied acceptance**
- **conditions for Buyer and Seller**
  - **Sane AND Mature**
- **conditions for Sold Goods where goods should be:**
  - **Existable, Valuable, Usable, Capable of ownership/title AND Capable of delivery/possession**

# VOID/NON EXISTING SALE (BAI BAATIL)

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- ▣ the buyer does not have the title to subject matter
- ▣ the seller does not have title to price
- ▣ Both subject matter and price cannot be used lawfully
- ▣ the produce of both will be unlawful

# VOID/NON EXISTING SALE (BAI BAATIL)

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## Sharia status

- ❑ Transaction is completely null and void.
- ❑ Ownership doesn't transfer.
- ❑ For Seller taking price is not Halal.
- ❑ Transaction is haram from its inception.

### (3)- EXISTING SALE BUT VOID DUE TO DEFECT ( *BAI FASID* )

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Sale will exist but will be void due to defect because of non compliance of conditions of contract

- ▣ the buyer does not have the title to subject matter
- ▣ the seller does not have title to price
- ▣ Both subject matter and price cannot be used lawfully
- ▣ the produce of both will be unlawful

## **EXISTING SALE BUT VOID DUE TO DEFECT ( BAI FASID )**

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### **Sharia Status**

- Sale will exist but will be void due to defect because of non compliance with Conditions of Sold goods and Conditions of Price so it is obligatory to cancel it.

# EXISTING SALE BUT VOID DUE TO DEFECT ( *BAI FASID* )

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the subject matter should not be possessed by the buyer

- ▣ if possessed with the consent of the seller, title or ownership will be passed to the buyer but usage of subject matter will be impermissible
- ▣ Buyer must return the goods to the seller
- ▣ However if the defect is rectified the sale becomes valid

## (4)-VALID BUT DISLIKED SALE (BAI MAKROOH )

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- sale is valid but not liked due to certain conditions like:
  - sale after Juma Azan
  - sale by intervention of a third party while two are negotiating

# KHIYARS (OPTIONS)

# KHIYARS (OPTIONS)

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- The term khiyar refers to the option or right of the buyer & seller to rescind a contract of sale.
- There are **five khiyars** in a sale contract which are as follows:

# KHIYARS (OPTIONS)

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- Khiyar-e-Shart (Optional condition): At the time of sale Buyer or Seller can put a condition that he has an option to rescind the sale within the specific 4 days. This option is called Khiyar-e-Shart.
- Specification of the days is necessary for this Khiyar. Within this period, he has the right to rescind/dissolve the sale without any reason. If the buyer puts the condition, it is called Khiyar-e-Mushtari (option of buyer) and when put by the seller, it is called Khiyar-e-Bai (option of seller). This Khiyar is not transferred to heirs.

# KHIYARS (OPTIONS)

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- 2. Khiyar-e-Roiyyat (Option of inspecting goods):  
Where the goods can be returned after inspection.  
This applies automatically to all contracts.
- e.g. 'A' buys machinery from 'B' without seeing.  
However, 'A' has the option to return the machinery after inspection.

# KHIYARS (OPTIONS)

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## □ 3.Khiyar-e-Aib (Option of defect):

Where the goods can be returned if found defective. It is the responsibility of the seller to supply goods free of error/defect or point out the defect to the buyer. No way is he allowed to cover the defect of the goods which constitutes as fraud. In one of the hadiths, Prophet has stated "He is not amongst us who indulges in fraud." Therefore the buyer has the right

# KHIYARS (OPTIONS)

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to return the good in case of a defect which is considered a defect in the market and which depreciates the value of the goods.

- e.g. 'A' buys batteries from 'B'. However, 'A' has the option to return them to 'B' if the batteries are found to be defective or not in working condition.

# KHIYARS (OPTIONS)

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4. Khiyar-e-Wasf (Option of quality): Where the goods are sold by specifying a certain quality by the Seller but which is absent in the goods.

e.g. 'A' buys a car from 'B' who has specified automatic transmission of the car. However when 'A' uses the car, he finds the transmission to be manual. Therefore he can return the car to 'B' in the absence of a specific quality.

# KHIYARS (OPTIONS)

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## 5. Khiyar-e-Ghaban (Option of price):

Where the seller sells the goods at a price which is far expensive than the market price, a Buyer has the right to return it to the seller. e.g. a Parker pen is sold to 'A' by 'B' at a price of Rs.500/-. However after the sale, 'A' discovers its market price to be Rs.250/-, he has the option to return the pen to 'B'.

# KHIYARS (OPTIONS)

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## Iqala (Recession of Contract):

- Where parties freely consent to rescind the contract i.e. each party will give back the consideration received by it.
- Neither the buyer nor the seller has the sole right to rescind the contract after execution of a contract. Often the buyer wants to rescind the contract after buying goods. In this case, it is necessary that he gets the seller's consent. Therefore this mutual agreement between buyer and seller to rescind the contract is called Iqala.

# KHIYARS (OPTIONS)

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## Iqala (Recession of Contract):

- However, it may be noted that the price of the goods being returned under Iqala will remain unchanged.
- Effect on third Parties: Iqala is treated as a new sale as if a new contract is entered into between the parties rescinding the original contract.

*JAZAK ALLAH*