

**PARTNERS' LIMITED:  
LIMITED LIABILITY IN PARTNERSHIPS STRUCTURE: AN  
OVERVIEW OF THE COMMON LAW AND THE SHARIAH**

by

**DR ZUHAIKHAH ARIFF ABD GHADAS**

*Private Law Department, Ahmad Ibrahim Kulliyah of Laws,  
International Islamic University Malaysia*

and

**ASSOCIATE PROFESSOR ENGKU RABIAH ADAWIAH ENGKU ALI**

*Private Law Department, Ahmad Ibrahim Kulliyah of Laws,  
International Islamic University Malaysia*

**D Abstract**

*Unlimited liability of partners is undoubtedly the hallmark of partnerships structure/laws. This principle emphasises on partners having collective responsibilities for debts and liabilities of the firm. The extent of unlimited liability of partners in partnership includes their personal assets. The principle of unlimited liability in partnership is constantly criticised because it impose heavy obligation and high business risk upon partners. As business expands and the firm gets bigger, it is more difficult for partners to know each other and what more to trust them to the extent of bearing each other's liabilities. The concept of unlimited liability may be appropriate for small and family partnerships whereby partners know each other but in big and international firms where partners are mostly strangers, it is not practical to apply unlimited liability. In recent years, the partnerships structure/laws went through rapid changes from mere general partnership to limited partnership ('LP'), limited liability partnership ('LLP') with a separate legal entity and LLP with a status of body corporate. Under the Islamic law, partnerships structure (sharikah) has an established reputation and clear recognition as a valid business vehicle. The application of limited liability in sharikah is also well established and clearly justified. This paper intends to highlight the development of common law partnerships structure/laws with special reference to the application of limited liability. The Islamic perspectives are deliberately included to highlight the apparent possibilities of implementing limited liability in partnerships structure.*

**H INTRODUCTION**

**I** Under the common law, the existence of partnerships structure as a business association is claimed to be as old as the co-operative activity. It was said to originate in family and clan activity of the most ancient form since the Babylonian sharecropping through classical Greece and Rome to the trading enterprises of the Renaissance. Nevertheless, despite references

made to the medieval era that partnership litigation was part of the law of the merchant, evidence showed that the legal incidents of the modern law of partnerships were not developed by equity until the 18th and 19th centuries.

Under the Islamic law, one of the structures recognised for the purpose of trading, investment and profit-making is the structure known as *sharikah/shirkali* or *musharakah*. This structure has been frequently construed to be similar, or at least analogous, to what is contemporarily termed as partnership. Yet, a more careful study of the usage of the term *sharikah* or *musharakah* reveals that the term connotes a wider meaning than the one implied in normal partnership. The term may include not only the modern partnership structure, but also any other structure that involves capital contribution and the subsequent profit and loss-sharing, including that of shareholding in modern companies, and even, certain parts of financing arrangement in a joint venture.

In Malaysia, the partnerships law inherits the common law and the Partnership Act 1961 in *pari materia* to the English Partnership Act 1890.

## PARTNERSHIPS STRUCTURE

The general partnership has four main characteristics, namely identification of individual partner with the firm, unlimited personal liability of each partner, non-transferability of a partner's interest and the right of all partners to take part in the management of the firm.<sup>1</sup> Unlimited liability of partners is undoubtedly the trademark of general partnerships. The Partnership Act 1890 clearly provides that partners are collectively liable for debts and liabilities of the firm as long as they are partners in the partnership.<sup>2</sup> The extent of unlimited liability of partners in partnership also covers up to their personal assets. This means, when the partnership's assets are not sufficient to pay the business debts, partners are personally liable to settle debts of the firm. As such, personal property of partners can be seized to settle the business debts when the firm's fund is insufficient.

The principle of unlimited liability in partnership is constantly criticised because it imposes a huge obligation and high business risk upon the partners. As business expands and the firm gets bigger, it is more difficult for partners to know each other, what more to trust them to the extent of bearing each other's liabilities. The concept of unlimited liability may be appropriate for small and medium size partnerships whereby partners know each other but in large or international firms where partners are mostly strangers, it is not practical to apply unlimited liability.

Despite the disadvantages it carries, the principle of unlimited liability in partnerships structure has not been replaced. Recent development shows

1 Keith L Fletcher, *The Law of Partnership in Australia and New Zealand*, (7th Ed, 1996), LBC Information Services, Sydney, at pp 11-12.

2 Partnership Act (UK) 1890 s 9; Partnerships Act (Malaysia) 1961 s 7.

- A that the general partnership structure is still widely practiced but expanded to include alternatives, such as limited partnership and limited liability partnership.

### THE ISLAMIC LAW PERSPECTIVE

- B Under the Islamic law, partnerships structure is observed to be equivalent to the concept of *sharikah*. The literal meaning of *sharikah* is 'intermingle', implying the intermingling of properties that form the capital, whereby, one cannot be differentiated from the other.<sup>3</sup> A study of the classical definitions of *sharikah* reveals a variety of legal meanings given to the term. For example, the Malikis define *sharikah* as a permission to transact (*tasarruf*), where each of the partners permits the other to transact with the partnership property while at the same time retaining his right to transact with the said property also. The Hanbalis define *sharikah* as the amalgamation of rights or freedom to transact (*tassaruf*). The Shafie is define *sharikah* as the confirmation of the rights of two persons or more over a common property.
- D The Hanafis define *sharikah* as a contract between two parties in relation to capital and profit.<sup>4</sup>

An overall analysis of the definitions shows that first; *sharikah* is essentially a contract between two or more parties. Second, that the focus of *sharikah* is authorisation to transact with the capital or partnership property. Third, the Hanafis' definition adds another dimension to the focus of *sharikah* contract, ie, the profit-sharing element. These three definitional characteristics of *sharikah* are also manifested in the juristic discussions on the essential elements (*arkan*) of the *sharikah* contract. Majority of the jurists<sup>5</sup> agree that there are three essential elements for the contract of *sharikah*, namely:

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- offer and acceptance, since *sharikah* is essentially a contract;
  - the two parties to the contract who have full legal competency to contract;<sup>6</sup>

G 3 Al Zuhaili, Wahbah (1989), *Alfiqh al Islamiyy wa Adiliatuhu*, Dar al Fil, Syria, (3rd Ed), Vol 5, at p 792 and Sabiq, Sayyid (1987), *Fiqh al Sunnah*, Dar al Kitab al 'Arabiyy, Vol 3, at p 287.

4 *Ibid*, Al Zuhaili prefers the Hanafis definition since it incorporates the essence of *sharikah*, ie, it being a contract, whilst the other definitions explain more on the objectives and legal implications of *sharikah*.

H 5 Except for the Hanafis who consider offer and acceptance as the only essential element for all contracts, including that of *sharikah*. Actually, the difference between the Hanafis and the majority is purely academic because the Hanafis consider the contracting parties and subject matter as automatically covered by the requirement for offer and acceptance.

I 6 The jurists discuss the contractual competency in *sharikah* especially in relation to the capacity to appoint and be appointed as agents (*wakil*), because the main underlying legal relation between the partners in *sharikah* is that of agency (*wakalah*).

- the subject matter of *sharikah*, which can be in the form of monetary/proprietary capital, and labour capital.<sup>7</sup>

A comparison of these three definitional characteristics of *sharikah* with that of modern partnership shows some similarities. The English as well as Malaysian law definition of partnership is, a 'relation which subsists between persons carrying on business in common with a view of profit'.<sup>8</sup> This definition implies similar characteristics, ie, the contractual relation between the persons; carrying on business in common, partly implying the authorisation to transact with a common property; and the profit-sharing element. Yet, some noticeable difference in focus between the definition of *sharikah* and modern partnership can also be traced. *Sharikah* focuses more on the authorisation by partners to transact with the capital. Modern partnership focuses more on the commonality of actions by the partners for the purpose of business or profit.

Applying the definitions of *sharikah* to modern companies, it appears that the shareholders may be construed to be the 'partners' who contribute to the capital of the company, and thus, are entitled to certain rights (eg, to profits/dividends, and management through general meetings) and liabilities (to contribute to the debts and losses incurred by the company). In fact, under Islamic law, shareholding implies a contribution to the capital of the company whereby the shareholder has a general/common proprietary right in the assets of the company including real properties, usufructs, rights, money and debts.<sup>9</sup> Thus, in Islamic law, the legal principles governing partnerships and companies are basically similar. This concept is different from the common law approach which clearly distinguishes partnerships from companies, both in definitions/concepts, as well as the governing legal principles.

In terms of the legal effects of the contract of *sharikah*, majority of the Muslim jurists agree that it is not a binding contract ('*aqd ghayr lazim*'), meaning that the partners can terminate the contract at anytime they wish to. This may be quite similar to the concept of partnership at will under English and Malaysian law. Another important legal effect of a contract of *sharikah* is the fiduciary position (*amanah*) that the partners hold in relation to the partnership property and capital, whereby the exercise of necessary prudence and avoidance of harm (*darar*) is the overriding principle.<sup>10</sup> This may be analogous to the common law concept of good faith and fiduciary duties of partners to each other.

<sup>7</sup> Monetary/proprietary capital is allowed by all jurists, whilst labour capital is allowed by majority of jurists except the Shafie.

<sup>8</sup> Section 3(1) of the Malaysian Partnership Act 1961 (revised 1974).

<sup>9</sup> Hussain Hamid Hassan, *Mukawwinat al ashum wa atharuha ala tadawuliha wa dawabit al qurud wa al fawa'id fi mua'malatiha*, in Al Baraka Symposium for Islamic Economy, 25–27 June 2001, Kuala Lumpur, at p 6.

<sup>10</sup> See Al Zuhaili, op cit, Vol 4, at pp 827–828.

## A THE TYPES AND THE LIABILITY REGIME OF SHARIKAH

B There are many ways<sup>10</sup> of categorising *sharikah*. The classical categorisation of *sharikah* is based on a variety of factors. If origin of the partnership becomes the determining factor, *sharikah* can be divided into two broad categories, namely, *sharikah al mulk* (proprietary partnership) and *sharikah al 'aqd* (contractual partnership).

C For *sharikah al mulk* (proprietary partnership), the origin of the partnership is the joint ownership of property. Joint ownership is its only qualification, and no joint exploitation of property is necessary. It occurs when two or more people are partners in the possession of property. The rule governing this type of *sharikah* is that any increase in the property shall be shared by the co-owners in proportion with the extent of their ownership. Each of them is in the category of a stranger in regard to any action on the part owned by his colleague. In other words, it is not lawful for either partner to perform any act with respect to the other's share except with the latter's express permission.<sup>11</sup> Thus, in terms of liability of the partners, they are quite independent of each other, except for actions based on express authorisation by any of the partners. Their partnership is only in terms of ownership and potential sharing of any profit or increase in the co-owned property, not in terms of sharing the liabilities arising from the partners' actions. This type of *sharikah* may not be known in the common law or D Malaysian law. In fact mere joint ownership is generally insufficient to constitute a partnership in common and Malaysian law.<sup>12</sup>

E For *sharikah al 'aqd* (contractual partnership), the origin of the partnership is the contract between the parties. The structure of this type of *sharikah* may have more similarities with the normal partnership in common law and Malaysian law. For *sharikah al 'aqd*, joint ownership is not an element necessary for the establishment of the partnership. The emphasis is rather on the joint exploitation of capital and the joint participation in profits and losses,<sup>13</sup> based on the terms of the partnership contract. Joint ownership is one possible consequence, and not a prerequisite for the formation of *sharikah al 'aqd*.<sup>14</sup>

G The jurists further sub divide *sharikah al 'aqd* into various other categories. The subdivisions depend on a number of factors. If the underlying factor is the subject matter of capital contribution, *sharikah al 'aqd* can be sub divided into three main categories, namely, *sharikah al amwal*, *sharikah al a'mal* and *sharikah al wujuh*. When the subject matter of the capital is money, it becomes *sharikah al amwal* (monetary partnership). H

11 Al Qusi, Abdul Mun'irn (1982), *Riba, Islamic Law and Interest*, unpublished PhD dissertation, Temple University, at pp 205–206.

12 See s 4(a) of the Malaysian Partnership Act 1961.

I 13 This is analogous to the concept of carrying on business in common with a view of profit in normal partnership.

14 Al Qusi, op cit.

If the capital is in the form of labour, it becomes *sharikah al a'mal* (labour partnership). If the capital is in the form of reputation or creditworthiness, it becomes *sharikah al wujuh* (reputation partnership).

The jurists also make further sub divisions to *sharikah al 'aqd* based on the terms of the contract, ie, whether the partners are required to contribute equally to the capital and enjoy full equality in exploiting the capital and sharing the profit or not. Based on this consideration, *sharikah* can be divided into two types, *sharikah al mufawadah* and *sharikah al 'inan*.

Basically, *sharikah al mufawadah* means an unlimited investment partnership, whereby each partner must contribute equally to the capital, and enjoys full and equal authority to transact with the partnership capital or property. The Hanafis consider each partner as an agent (*wakil*) for the partnership business and stands as surety (*kafil*) for the other partners. Thus, the partners can be made jointly and severally responsible for the liabilities of their partnership business provided that such liabilities have been incurred in the ordinary course of business.<sup>15</sup> This type of *sharikah* clearly implies unlimited liability on the part of partners since they are both agents and guarantors of each other.

On the other hand, *sharikah al'inan* can be loosely defined as a limited investment partnership. Whereby each partner may only transact with the partnership capital according to the terms of the partnership agreement and to the extent of the joint capital. Hence, their liability towards third parties is several but not joint.<sup>16</sup> In other words, the liability of partners in *sharikah al'inan* resembles that of modern day limited liability partnerships.

Both *sharikah al-mufawadah* and *sharikah al'inan* can occur in all the three earlier types of *sharikah*, ie, *sharikah al amwal* (monetary partnership), *sharikah al a'mal* (labour partnership) and *sharikah al wujuh* (reputation partnership).

The jurists differ with regards to a special type of commercial dealing, ie, *mudarabah* (profit-sharing),<sup>17</sup> whether it is a kind of *sharikah* or not. Some of them, ie, the Malikis and Hanbalis regard it as a form of *sharikah*, while others, ie, the Hanafis and Shafie categorised it as a separate kind.

*Mudarabah* is basically a form of commercial arrangement where one of the contracting parties act as the provider of capital (termed as *rabb al mal*), while the other party acts as the entrepreneur (termed as *mudarib*). The essential difference between *mudarabah* and other forms of *sharikah* is whether or not all the partners make a contribution towards the capital as well as management of the partnership, or only one of these. In *mudarabah*,

<sup>15</sup> Umar Chapra, *Towards a Just Innately System*, at p 253.

<sup>16</sup> *Ibid.*

<sup>17</sup> Also known as *qirad* or *muqaradah*. It has been said to be the possible origin for the commend of medieval Europe, see for example, Hillman, RW, *Limited Liability in Historical Perspective*, Wash & Lee Law Review, (1997), at pp 621-622.

- A one party provides capital whilst the other provides management skill. In *shariakah*, all partners contribute to both capital and management of the partnership.

- B In *mudarabah*, the *rabb al mal* is the dormant partner, while the *mudharib* is the active partner who provides the entrepreneurship and management for carrying any venture, trade or industry with the objective of generating profit. Any accruing profit shall be shared between the *rabb al mal* and *mudharib* according to a pre fixed ratio. In the event of loss, the *rabb al mal* bears the financial losses to the extent of his contribution to the capital, while the *mudharib* suffers the frustration of a fruitless effort. Again, in the *mudarabah* arrangement a limited liability regime is created. However, the regime is quite different from modern limited liability. On the one hand, in *mudarabah*, it is the active partner who is exempted from financial liability (except if proven negligent or fraudulent). On the other hand, the passive partner, though bears the bulk of financial liability also enjoys limited liability because his financial liability is just to the extent of his capital contribution.

- D From the many types of *sharika*, the one mainly used in contemporary Islamic banking and finance is that of *sharika al 'inan* in the category of *sharika al amwal*. *Sharika al mufawadah* is rarely opted for due to the higher degree of responsibility and the practical difficulty to achieve full equality between the partners in all aspects of the partnership. Another commonly utilised contract is that of *mudarabah*, which, some jurists consider distinct from the other forms of *sharika*. Actually, *mudarabah* can be construed as a *sharika* with monetary capital on the one part and labour on the other part.

## F LIMITED LIABILITY

- G The concept of limited liability was introduced 200 years ago in order to enable the large scale investment necessary for the Industrial Revolution to take place.<sup>18</sup> With the severance of investment in the business from the management of that business there was considered to be a need for the protection of the investors, who were often individuals with a relatively small amount of capital, from the possible fraudulent actions of the managers of the business.<sup>19</sup> This paved the way for the attraction of many more investors, thereby enabling the growth in size of the business enterprises, with those investors secure in the knowledge that they were protected from any loss greater than the sum they had invested in the enterprise. Thus for relatively small levels of risk they were able to expect potentially great rewards and thereby escape from some of the

I <sup>18</sup> David Crowther, *Limited Liability = Limited Risk = Limited Accountability*, retrieved from <http://www.le.ac.uk/ulmc/research/crowther.pdf> (24 February 2008).

<sup>19</sup> *Ibid.*

consequences of the actions of the enterprise. In short, limited liability encourages entrepreneurial risk-taking, which encourages economic growth.

Limited liability is normally justified by its economic benefits, which include:<sup>20</sup>

- (a) the decreased cost to shareholders of monitoring the actions of managers;
- (b) the increased incentive to managers to act efficiently and in the interests of shareholders by promoting the free transfer of shares;
- (c) the increased efficiency of securities markets since share trading does not depend on an evaluation of the wealth of individual shareholders, only the company itself;
- (d) its encouragement to shareholders to hold diverse share portfolios, thereby permitting companies to raise capital at lower costs because of the shareholders' reduced risks; and
- (e) the facilitation of optimal investment decisions by managers by pursuing projects with positive net present values rather than being concerned with the risk to shareholders that such projects may bring.

From the legal perspective, limited liability of business enterprises is conceived to stem from the principle of separate legal entity. For example, in a company structure, limited liability flows from the fact that the companies are vested with a distinct legal personality by law when properly incorporated, and as such, the debts of the incorporated entity are distinct from the personal assets of the entrepreneur. In other words, the personal estate of the entrepreneur cannot be attached or utilised by creditors of the incorporated entity, in order to settle amounts owing by the incorporated entity to such creditors. This is perhaps one of the greatest advantages to trading through an incorporated entity.

Nonetheless, with the development of laws which recognised entities other than companies as a legal person, partnerships structure could also offer the advantage of limited liability similar to a limited liability company. Examples of this are the LLP and incorporated LLP.

### THE LIMITED LIABILITY REGIME IN PARTNERSHIPS STRUCTURE

In 1408, Florence enacted a statute which allowed the creation of *societa in accomodite* or limited partnership whereby the essential characteristic of the business structure involved limitation of liability of the passive partners up

20 Easterbrook and Fischel, *The Economic Structure of Corporate Law*, Harvard University Press, 1991, at pp 41–44, summarised in *Ford's Principles of Corporations Law* at [4.160]).



- A to the amount of their investment.<sup>21</sup> From here, the development of limited partnership was traced to the French *societe en commandite*, which was introduced in French law in 1671 during the reign of Louis XIV and later included in the French Code de Commerce of 1806.<sup>22</sup> The *societe en commandite* was widely used in French and later became the model for the Irish Anonymous Partnership Act of the late 18th century and the early American limited partnership statutes.<sup>23</sup>

B In England, limited partnership was unknown prior to 1908.<sup>24</sup> The Limited Partnership Act 1907 was enacted when the Partnership Act 1890 failed to cover the problems on partnerships. The Act allows partnership to be formed, which did not display three of the essential characteristics of general partnership, namely:

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- (a) unlimited liability of every partner;
  - (b) implied authority of each partner to bind the firm in all matters within the ordinary scope of the partnership business;
  - D (c) right of each partner to take part in the management of the business, subject to any contrary agreement.<sup>25</sup>

The main objective of the Act is to allow persons to enter into a partnership, subject to certain requirements, with the terms that the liability of some of them will be limited to the amount contributed by them in cash or property when the partnership was originally created. However, it is a fundamental condition that the liability of at least one of the partner should be unlimited. The former type of partner is called the 'limited partner' while the latter is known as the 'general partner'. During the continuance of the partnership, the limited partner has no implied authority to bind the firm, has no right to take part in the management of the firm and may not be repaid any part of his capital contribution. Hence, even though the limited partners may limit their liability in the business, they have to take a passive role akin to that of the more traditional dormant partner. Another important point to note is that, other than subjected to the provisions of the Limited Partnerships Act 1907, limited partnerships are also governed by the Partnership Act 1890 and the rules of law and equity applicable to ordinary partnerships.<sup>26</sup>

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- 21 Robert W Hillman, *Limited Liability in Historical Perspective*, Washington and Lee Law Review, Vol 54, 1997, at p 626.
- 22 *Ibid.*
- 23 *Ibid.*
- 24 RC Panson Banks, *Lindley & Banks on Partnership*, Sweet & Maxwell, London, 1990, at p 733.
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- 25 *Ibid*, p 735.
- 26 *Ibid.*

### Limited Liability Partnerships ('LLP')

There are two types of LLP which are available in the United Kingdom. The first one is a LLP with the status of partnership, for example, the Jersey Limited Liability Partnerships whilst the other one is LLP with status of a body corporate, ie, the UK LLP.

The Limited Liability Partnerships (Jersey) Law was enacted and enforced in 1997 whereby a form of partnership known as limited liability partnership ('LLP') is allowed to be form in the UK offshore, ie, Isle of Jersey. The structure of Jersey LLP is basically similar to United States LLPs as it was actually modeled on the Delaware LLP. The Jersey LLP has the status of a partnership but it has a separate legal entity. Partners of the LLP are merely agent to the LLP and not to each other. Hence, members in the LLP are independent from liabilities of the LLP and protected against personal contractual liability.

Pertaining to limitation of liabilities of partners, the Jersey LLP Law 1997 contained provisions which are designed to oust the operation of joint and several liability. The law also protects innocent partners' personal assets from seizure following a successful claim against the firm. Under the LLP (Jersey) Law 1997, 'innocent partners' in the LLP are not liable for the debt or loss of the company caused by the act of another partner in the partnership.<sup>27</sup> Nonetheless, a partner of the LLP who caused loss to the firm due to a default committed within his authority or in his personal capacity will be personally liable for the debts. This means, restrictions on partner's personal liability in Jersey LLP do not apply to partner's personal debts or business loss caused by his default.<sup>28</sup>

Realising the potential of LLP, the Limited Liability Partnership (UK) Act was passed in 2000, which enables LLP to be form in the United Kingdom. However, different from the LLP in Jersey, the UK LLP has the status of a body corporate<sup>29</sup> but with internal flexibility of ordinary partnership.<sup>30</sup> It is similar to general partnerships in the aspect of internal regulation as the members may adopt whatever forms of internal organisation which they prefer but as regards to external obligations, the LLP is subjected to similar requirements applicable to companies such as audit and disclosure requirements. In short, UK LLP represent as a hybrid creature of a partnership and company. Despite applying the internal regulation of a partnership, the UK LLP Act 2000 clearly provides that the partnership law is not applicable to the LLP.<sup>31</sup> The main legislations governing UK LLP are the LLP Act 2000 and the Companies Acts. It is also subjected to insolvency procedures as applied to companies.

<sup>27</sup> *Ibid*, art 5(1).

<sup>28</sup> *Ibid*, art 5(2)(b).

<sup>29</sup> Limited Liability Act 2000 s 1(3).

<sup>30</sup> *Ibid*, s 6.

<sup>31</sup> *Ibid*, s 1(5).

- A Being a body corporate, the UK LLP, incurs its own liability and as such members of the LLP can not be made personally liable for any of the LLP debts and liabilities.<sup>32</sup> Another distinguished feature of UK LLP is its tax status because although it has the status of a body corporate and subjected to the company law, the UK LLP is treated as a partnership for tax purposes.
- B Although both Jersey and UK LLP has similarity as regards to legal entity, there are significant differences between the two. Firstly, the UK LLP has the status of a body corporate whilst the Jersey LLP has the status of a partnership. Secondly, the law applicable to UK LLP is the company laws where as the Jersey LLP is still subjected to partnership laws although it has its own legislation. There are also major differences in the safeguard mechanism of the two LLP. The most significant shield provided for the creditors is the million bond requirement which must be surrendered upon registration of the LLP. The law also provides that any partner of the Jersey LLP who withdraws LLP property including profits at time when the LLP is unable to pay its debts shall be personally liable for any debts or loss of the LLP equivalent to the amount of the withdrawal.<sup>33</sup> A similar sanction is applied if the partner withdraws LLP property during a period of six months proceeding the time when the LLP becomes unable to pay its debts.<sup>34</sup> These restrictions mainly seek to prevent dissipation of LLP property by the partners during or shortly before its insolvency.
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- E Under the Islamic law, *sharikah* and *mudarabah* contracts can and have been utilised across the board, regardless of the formal business structures, ie, whether they are partnerships or companies. For example, if the parties opt for the partnership structure, under Islamic principles, the contract will still be that of *sharikah* or *mudarabah*. The liabilities of partners are still limited up to their capital contribution, unless if they opt for *sharikah al mufawadah*, which is very rare. Similarly, even if the parties choose the company structure, the contract will still be that of *sharikah* or *mudarabah*. It follows that the extent of partners' liabilities remains the same under Islamic law, ie, up to the amount of their capital contribution. There are no separate contracts on the basis of pure business structures — partnerships or companies. Thus, the paramount consideration in determining liability in Islamic law is not the business structure, but the actual *sharikah* contracts between the parties. If the parties want limited liability, they can choose *sharikah al 'inan* or *mudarabah*. If they want unlimited liability, they can choose *sharikah al mufawadah*. Thus, from the foregoing discussions we can see that the origin of limited liability regime in *sharikah* is the contract between the parties, and not the business structure opted for.
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As regards to liabilities, *sharikah* normally refers to contractual obligations. Tortuous obligations are often regarded as personal liabilities

I 32 *Ibid*, s 1(3).

33 Article 5(3) of the LLP (Jersey) Law 1997.

34 *Ibid*, art 5(4).

on the persons who commit the wrong. In Islamic law, there is no clear-cut separation between civil and criminal wrongs. All are considered as wrongs and if injuries have been caused, should be duly penalised or compensated. The main distinction between the wrongs is the element of intention, which will in turn determine the type and degree of penalty/compensation imposed. As a general rule, culpable causing of injury is regarded as criminal and invites criminal punishment, personal or monetary. On the other hand, unintentional causing of injury is still a wrong, albeit not criminal, and will be subjected to monetary compensation. Both liabilities are considered as personal to the doer, and in normal cases cannot be extended to other parties.

It is also observed that the discussion on liabilities of partners in *sharikah* in the event of liabilities exceeding the assets has not been elaborately made in the classical Islamic law literature. What has been mentioned is just the general principle that liabilities follow the amount of capital contribution. This lack of elaborate discussion is understandable because the way Islamic economics and business works, ensures a built-in mechanism against excessive mismatch in asset and liability ratio. As pointed out by Chapra,<sup>35</sup> in an Islamic economy, since all financial participation in business would be essentially in the form of equity, the only exceptions being suppliers' credits and *qurud hasanah* (beneficial loans), the liability of the partners would in reality be limited to their capital contributions. Prudence would induce the suppliers to keep an eye on total equity, movement of sales and cash flows of the business concerned, while *qurud hasanah* would tend to be limited. All other participants in the business (whether by way of loan or equity) would be treated as equity holders and would share in the risks of business. Since interest bearing loans are not allowed, the total obligations of the business could not be out-of-step with the total assets, and any erosion in their value may not exceed the total equity. Hence, in the ultimate analysis liability would essentially be limited to the extent of the total capital (including ploughed-back profits) invested in the partnership business.<sup>36</sup>

## CONCLUSION

With the development of the economy, the general partnership structure was found to be no longer adequate for many firms particularly the professionals. The rising cost in trade and litigation has forced partners to take precaution as regards the extent of liabilities in the firm. The development and evolution of partnership laws has reached the stage where it is now possible for partnerships to practice attributes of companies without undergoing the incorporation process. It is also proved that the

<sup>35</sup> Op cit.

<sup>36</sup> *Ibid*, for a variant view see SM Hasanuzzaman, *The Liability of Partners in an Islamic Shirkah*, Journal of Islamic Studies, Islamic Research Institute of Pakistan, 1971, at p 332, whereby, he said that the liability of partners in a *sharikah* is unlimited and joint, and Al Qusi, op cit, at p 213.

- A constantly criticised principle of joint and several liabilities in partnership can be replaced with limited liability without changing the status of the firm to a company.

- As regards to the Islamic law, approach to limited liability is quite distinct if compared with the common law approach. Common law approaches limited liability from the perspective of the actual business structure, where clear distinction is made between companies and partnerships. As a general rule, the common law accords limited liability to companies but not to partnerships, because of the separate legal entity attribute of the former structure. Under Islamic law, the determining factor is the actual contract between the parties, not the formal business structure.
- B If the actual contract gives full equality and authority to the partners, thus, making the partner agent and guarantor of the other partners (*sharikah al mufawadah*), there will be unlimited liability. But, anything short of that makes the *sharikah* contract limited and liability will also be limited. In addition to that, if the parties choose the special arrangement of *mudarabah*, a unique situation exist, whereby the active partner is prima facie exempted from financial liability, while at the same time, the passive partner enjoys limited liability.
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