

**ISTIHSAN AS THE BASIS OF SHARIAH COMPLIANCY IN
BAI BITHAMAN AJIL END FINANCING WITH SPECIAL
REFERENCE TO THE CASE OF *MALAYAN BANKING BHD V
YA'KUP BIN OJE & ANOR* [2007] 6 MLJ 389**

by

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Concept of Istihsan

Istihsan as applied by the Madinite Imam Malik connotes promoting human interests and justice. Accordingly, the obligation to put an end to injury and harm for the Maliki School of thoughts, is the cornerstone of Islamic law. *Istihsan* is highly regarded as very important to Imam Malik as his disciples attributed him of having said that *istihsan* is nine tenth of knowledge¹. Likewise, *Al-Ghazali* too is of the view that 'the basis of the Shariah is wisdom and welfare of the people in this world as well as the Hereafter. This welfare lies in complete justice, mercy, well-being and wisdom. Anything that departs from justice to oppression, from mercy to harshness, from welfare to misery and from wisdom to folly, has nothing to do with the Shariah².' *Al-Ghazali* is also attributed to having said that if anyone has failed to master the science of logic, his knowledge is not trustworthy³.

Istihsan as the bedrock of the lawgiver's intention of promoting human interest could be clearly seen in the following verses of the Quran. Allah says;

- 1 Read Dr Ahmad Al-Raysuni (2006) *Imam al-Shatibi's Theory of the Higher Objectives and Intents of Islamic Law* (Translated from the Arabic by Nancy Roberts) at pp 53-54, The International Institute of Islamic Thought, Islamic Book Trust, Kuala Lumpur
- 2 Quoted from Datuk Syed Othman Al-Habshi, *Islamic Fund In Malaysia*. A Paper presented at The Funds Management Industry Conference, organised by BF Conferences Sdn Bhd, 14-15 February 1995, Crown Princess Hotel, Kuala Lumpur.
- 3 See *al-Mustaffa*, Vol 1, p 10 — cited by Dr Ahmad Al-Raysuni (2006) *Imam al-Shatibi's Theory of the Higher Objectives and Intents of Islamic Law*, at p xvii.

And devour not one another's possessions wrongfully, and neither employ legal artifices with a view to devouring sinfully, and knowingly, anything that by right belongs to others (Quran 2:188)

O ye who believe! Eat up not your property among yourselves in vanities: But let there be amongst you traffic and trade by mutual good will. (Quran 4: 29)

Behold, God enjoins justice, and the doing of good, and liberality to kith and kin; and He forbids all shameful deeds, and injustice. (Quran 16:90)

The above verses are wide enough to cover all forms of malpractices whether they are done discreetly or under a camouflage such as hoarding of foodstuff to artificially increase price through faking shortage in supply, the manipulation of share market prices through insider trading etc to unjustifiably enrich oneself to the detriment of others. Likewise, any dealings between two or more parties if they are tainted with undue influence, deceit/ stratagem, manipulation, oppression, coercion, and the like to unjustifiably enrich one party against another cannot be made legal or enforceable, nor can there be, in these kinds of agreements or transactions, free consent so to speak. The Quran in relation to the above noted verses provided examples of malpractices leading to injustice and oppression. In this respect, usury (riba) is one glaring example. Allah says;

Those who devour usury will not stand except as stands one whom the Satan by his touch hath driven to madness. That is because they say: 'Trade is like usury,' but Allah hath permitted trade and forbidden usury (Quran 2:275)

In usury, there is unjustified enrichment or a win lose situation where only one party benefits to the detriment of another. In business, there is a positive mutual need in the sense that it is a win-win situation. In usury, one can see an element of exploitation or undue influence, and the relation between the parties are one sided. This cannot be deemed to be business when only one party is profiteering on other people's sweat who, often than not, ended up bonded into debt slavery and remain impoverished. In usury, money is no longer a convenient medium of exchange but is by itself a commodity to be used to breed artificial wealth, nowadays, in the form of paper money without being backed by any productivity or intrinsic value. Taking money for rental of a car is business and is reasonable, but this cannot be the same with taking interest from capital. This paper, however, is not intended to discuss usury but suffice to say that the evils arising out of usury are that it is inherently evil leading to more evils to the extent that the people as a whole in the society is exploited of their wealth and had to sustain and pay for those evils with their own meager wealth if they have any so that those few capitalists who had monopoly of the

wealth could continue to thrive and to continue exploiting those majority that make up the society.⁴ Such act is, indeed, prejudicial to the well being of the society and must be curbed at all cost. Allah says:

O ye who believe! Fear Allah, and give up what remains of your demand for usury; if ye are indeed believers. If ye do it not, take notice of war from Allah and His Messenger: But if ye turn back, ye shall have your capital sums; Deal not unjustly, and ye shall not be dealt with unjustly. (Quran 2: 278-279)

Bai Bithaman Ajil (BBA)

BBA end financing banking facility is a form of murabahah (cost plus mark up profit) for long term financing facility (often than not for purchase of residential house), premised on Syariah principles, whereby the banking institution will finance borrowers who wish to acquire an asset but to defer the payment for the asset for a specific period or to pay by installment (deferred payment sale). In essence, the bank will purchase the property and thereafter sell the property to the borrower and the difference between the purchase price paid by the bank and the sale price is considered to be the profit earned by the bank for the tenure of the facility. However, In *Dato Hj Nik Mahmud Bin Daud v Bank Islam Malaysia Berhad* [1996] 4 MLJ 295 where it was held that BBA does not involve any transfer of ownership but only a right to a registrable interest. The contemporaneous execution of the property sale agreement and the property purchase agreement merely constituted part of the process required by Islamic banking procedure before the bank customer could avail him of the financial facilities provided by the bank under the BBA principle.

Malayan Banking Berhad v Ya'kup bin Oje & Anor was a case decided on 30 August 2007 in the High Court of Sabah & Sarawak at Kuching before the Judicial Commissioner YA Dr Haji Hamid Sultan bin Abu Backer in respect of the plaintiff's originating summons seeking an order for sale under s 148(2)(c) of Sarawak Land Code (Cap 81) ('SLC') in consequence of the defendants' breach of a facility agreement under the Syariah principle of *Al-Bai Bithaman Ajil* (BBA) by non-payment of the sum of RM167,797.10 due and owing to the plaintiff as at 26 June 2006⁵. The brief facts were the plaintiff had granted the defendants a financing facility amounting to RM80,094 on 15 July 2003 under the Shariah principle of BBA for which the

⁴ Read Dr Hussain Hussain Shehatah (1998) *Usury: The Root Cause of The Injustices of our Time*, El-Falah for Translation Publishing And Distribution, Egypt (ISBN: 977-5813-13-1).

⁵ [2007] 6 MLJ 389.

defendants had to sell and buy back from the plaintiff the property at the agreed sale price of RM184,094 by deferred payment for a period of 26 years the monthly installments sum of about RM409. The facility was secured by a charge over the property in favour of the plaintiff. The defendants, however, defaulted after paying the sum of RM16,947.62 for over a period of just above three years.

Though, the facility sum actually received by the defendants was only RM80,065.00, the amount they have to repay is RM167,797.10 as at 26 June 2006 which the learned Judicial Commissioner YA Dr Haji Hamid Sultan bin Abu Backer noticed as '*abhorrent to the notion of justice and fair play when compared and contrasted with the secular banking facilities.*' In the face of this 'glaring injustice' the learned Judicial Commissioner referred to two similar cases of *Affin Bank Bhd v Zulkifli bin Abdullah* [2006] 3 MLJ 67; and *Malayan Banking Bhd v Marilyn Ho Siok Lin* [2006] 7 MLJ 249 whether he should allow the order for sale for the repayment of the sum in the original form or restrict the order for sale as set out in the above two cases, or make suitable orders or directions as the justice of the case requires and demands.

Unmindfulness of Istihsan Under the BBA Contract

The ongoing 'pain in the butt' issue in BBA Islamic end financing is whether a financier is entitled to claim the full profit from the borrower in the event the agreement is prematurely determined upon the default of the borrower. The case of *Affin Bank Bhd v Zulkifli bin Abdullah* [2006] 3 MLJ 67 suggests that banks cannot claim the full sale price of the property in the event of default by the borrower. On the other hand, the case of *Arab-Malaysian Merchant Bank Bhd v Silver Concept Sdn Bhd* [2005] 5 MLJ 210 permits banks to claim the profit of the full tenure from the borrowers.

In *Affin Bank Bhd v Zulkifli bin Abdullah* [2006] 3 MLJ 67, the defendant obtained a secured housing loan of RM394,172.06 from the plaintiff under the BBA in 1997. The defendant defaulted in 2002 after paying the plaintiff RM 33,454.19 and the plaintiff claimed the full sale price of RM958,909.21, inclusive of the plaintiff's profit margin for the full term of the loan. The plaintiff applied for an order for sale of the charged property and the defendant challenged the amount claimed. In granting an order for sale and reducing the amount of repayment, Abdul Wahab Patail J had the common sense of seeing that this Islamic financing just make no sense or lack logic so to speak, and held:

- (1) If the customer is required to pay the profit for the full tenure, he is entitled to have the benefit of the full tenure. It follows that it would be inconsistent with his right to the full tenure if he could be denied the

tenure and yet be required to pay the bank's profit margin for the full tenure. To allow the bank to also be able to earn for the unexpired tenure of the facility, means the bank is able to earn a profit twice upon the same sum at the same time (see para 29).

(2) The profit margin that continued to be charged on the unexpired part of the tenure cannot be actual profit. *It was clearly unearned profit.* It contradicted the principle of Al-Bai Bithaman Ajil as to the profit margin that the provider was entitled to. Obviously, if the profit had not been earned it was not profit, and should not be claimed under the Al-Bai Bithaman Ajil facility (see para 29).

(3) The profit margin could be calculated and derived with certainty. Even if the tenure was shortened, the profit margin could be recalculated with equal certainty (see para 34). The total due on the date of the judgment was RM616,080.99 and after crediting the defendant with all the payments he had made of RM33,454.19, the balance due on the date of judgment was RM582,626.80 (see para 37).

(4) Once it was established that there had been a default, then unless there was cause to the contrary, the order for sale must be given since a charge is an ad rem right to dispose of the security to recover a secured debt (see para 45)."

Still, it could be seen that the defendant Zulkifli bin Abdullah ended up paying more than he bargained for considering that the loan sum was RM394,172.06. He had to pay RM616,080.99 less the payments he had made of RM33,454.19, making it RM582,626.80 as at 31 May 2006 and profit per day thereafter at RM106.16 until the date of satisfaction of the sum owing under the charge. He 'lost roughly RM211,908.93' which are hefty for defaulting: he may never recuperate from this shocking experience. In other words, under the DBA financing facility, there is more risk than gain, and it does not pay to default. For facility of RM394,172.06, the bank could make RM211,908.93 plus profit per day thereafter at RM106.16 until the date of satisfaction of the sum owing under the charge without risk. Is not this case of money breeding money? What is the fate of the defendant Zulkifli bin Abdullah is not an uncommon sight if one care to look at the newspaper advertisement on foreclosing of properties, and furthermore, is not one man's meat another man's poison. After all, the common saying, if you can't beat them, then join them.

The learned Judicial Commissioner YA Dr Haji Hamid Sultan bin Abu Backer in *Malayan Banking Berhad v Ya'kup bin Oje & Anor Bank Bhd* 20 [1997] 1 MLJ 77 in relation to s 256(3) of the National Land Code 1965 (NLC) when construing the Sarawak Land Code (SLC) as was opined by Datuk Skinner Clement J. in the case of *Public Bank Bhd v Teck Huat Bricks and Tiles Factory Sdn Bhd* [2004] 3 MLJ 88.

In *Low Lee Lian Lian v Ban Hin Lee Bank Bhd* [1997] 1 MLJ 77, the order for sale may not be granted if there is 'cause to the contrary' shown by the charger which among others is when a chargor could demonstrate that the grant of an order for sale would be contrary to 'some rule of law or equity'. The learned Judicial Commissioner is of the view and said:

..the phrase 'some rule of law or equity' cannot be encapsulated in a narrow and restricted manner. Equity is always a practical and vibrant concept based on which the court must decide on the facts of each case to administer substantive justice (my emphasis).

The case of *Kuching Plaza Sdn Bhd v Bank Bumiputra Malaysia Bhd and another appeal* [1991] 3 MLJ 163, and the learned Judicial Commissioner's own recent decision in *RHB Bank Berhad v Alom Industries Sdn Bhd* [2007] 3 AMR 670 were referred in dealing with s 148(2)(c) of SLC, and that settled the fact in issue that an order for sale is a discretionary relief. In the case of *RHB Bank Berhad v Alom Industries Sdn Bhd* [2007] 3 AMR 670, the same learned Judicial Commissioner said:

However, for the purpose of a sale under section 148, the court can consider whether the conduct of the plaintiff was just, otherwise an order for sale can be refused. In that sense, an order for sale of property under SLC is not a statutory right to the chargee but is a discretionary relief vested on the court to exercise in the event it is just. In my view, the test will be that once the defendant places prima facie facts to satisfy the court, the conduct of the plaintiff is unjust and is not within the letter, interest and spirit of the charge document, it is necessary for the chargee to satisfy the court that the decision to recall for the facility and proceed with the sale was necessary and expedient to protect the chargee's interest on the circumstance of the case.

... The powers vested in the courts to refuse an order for sale under SLC is much wider than that given under the National Land Code 1965 (Code). For, under the Code, an order for sale is almost always granted if all statutory and procedural requirements are duly complied with, unless the chargor can satisfy the court of the existence of cause to the contrary. However, under the SLC, to some extent the law enables the court to subject the exercise of the legal rights of the chargee to equitable considerations; considerations that is of a personal character arising between one individual and another which may make it unjust, or inequitable, to insist on legal rights or to exercise them in a particular way...

The issue in the case of *Malayan Banking Berhad v Ya'kup bin Oje & Anor* was not whether the BBA is valid, but whether the plaintiff is entitled as of right to the full profits in the event the BBA is terminated very much earlier, taking into consideration s 148(2)(c) of SLC or for

that matter s 256 of NLC. In *Affin Bank Bhd v Zulkifli bin Abdullah* [2006] 3 MLJ 67, the court in allowing the order for sale reduced the amount of profit. In *Malayan Banking Bhd v Marilyn Ho Siok Lin* [2006] 7 MLJ 249 the court refused to grant the balance of the sale price amounting to RM928,589.12 for the facility sum of RM500,000. In allowing the order for sale, the court held:

- (1) Even though the court is faced with such plain language in the clauses in the memorandum of charge and property sale agreement, the power of this court under s 148(2) of the Sarawak Land Code (Cap 81) is a discretionary one as held in *Kuching Plaza Sdn Bhd v Bank Bumiputra (M) Bhd* [1991] 1 CLJ 223 (Rep). The words used in s 148(2)(c) Sarawak Land Code (Cap 81) and they are 'and the court after hearing the evidence may make such order as in the circumstances seems just'. These words empower the court with the flexibility (as opposed to the imperative power in s 256 of the National Land Code) to make any order even it means ignoring the terms contained in the BBA documents provided it is just in the circumstance (see para 35).
- (2) The court must have good reasons to ignore or put in another way rewrite the terms in the BBA documents. This involves the process of taking into consideration of 'all the circumstances of the case'. That would include the public interests, the peculiarities of the contract, and the compliances by the parties of the agreed terms contained therein. Of course at the end of the day, the primary aim must be to make an order as in the circumstance seems just (see para 35).
- (3) Section 148(2) of the Sarawak Land Code (Cap 81) talks of what is just which revolves squarely on the question of whether or not equity in the circumstance should intervene. It would not be equitable to allow the bank to recover the sale price as defined when the tenure of the facility is terminated prematurely (see paras 37, 43); *Affin Bank Bhd v Zulkifli Abdullah* [2006] 3 MLJ 67 referred.
- (4) Applying the formula used in *Affin's* case, the amount owing as agreed by counsels is RM598,689.10 as at 31 May 2006. The court grants an order of sale of the defendant's charged property pursuant to the Sarawak Land Code (Cap 81) to recover the sum of RM598,689.10 as at 31 May 2006 and profit per day thereafter at RM106.16 until the date of satisfaction of the sum owing under the charge (see paras 46-47)."

The learned learned Judicial Commissioner YA Dr Haji Hamid Sultan bin Abu Backer in *Malayan Banking Bhd v Ya'kup bin Oje & Anor*

held that both these judgments of *Affin Bank Bhd v Zulkifli bin Abdullah* [2006] 3 MLJ 67, and *Malayan Banking Bhd v Marilyn Ho Siok Lin* [2006] 7 MLJ 249, under the secular law has rightly attempted to act within the parameters of justice and equity to attain a just result and to ensure that excess profit is not made in name of Islamic principles. Even at common law, the learned Judicial Commissioner reiterated that the doctrine of equity is often raised to mitigate the harshness of contractual obligation in limited circumstances. The learned Judicial Commissioner is of the view that under Shariah, equity is the fulcrum of justice. Without equity, justice cannot be administered, and, justice and equity must be read conjunctively and not disjunctively. In support, the learned Judicial Commissioner quoted the quranic verse from surah al-maida: verse 42 which reads:

If though judge, judge in equity between them for Allah loveth those who judge in equity.

The learned Judicial Commissioner pointed out that the court must, therefore, be vigilant to arrest traders or venture capitalists from exploiting Islamic principles at the expense of the consumers. This is a constitutional duty and is not alien to Islamic concept. The learned Judicial Commissioner held among others that:

- (a) Section 148(2)(c) of the SLC makes it mandatory to exercise equity and the court may not grant the order if it is going to be perverse to the defendants. When it comes to justice and equity, similar powers is also preserved under s 256 of the NLC.
- (b) As matter of practice, most of the Islamic Banks do exercise their discretion and give a rebate, thereby keeping with the true spirit and intent of justice and equity under the Syariah law. Further, Islamic law of commercial transaction will not permit the bank to state the rebate for default under the BBA as Islamic law of contract, though it may appear to be similar to the secular law, is not the same. The Shariah law does not generally permit conditional contract, contract upon a contract etc., the principles and practice of which I will elaborate at an opportune moment. However, this does not mean that Islamic Bank cannot openly state their policy and rates of rebate without encapsulating in BBA agreements. This will promote transparency and equity. The fact that 'Ibrar' is unilateral does not stop Islamic Banks from voluntarily relinquishing part of their claim or the court upon default by the customer to demand that proper concessions be granted to the customer on equitable grounds when exercising its jurisdiction and powers for order for sale under s 148(2)(c) of SLC or that of s 256 of NLC.

- (c) Equity in this case applies both to the plaintiff as well as to the defendants. To obtain a just result and without dismissing this Originating Summons, I will give an opportunity to the plaintiff to demonstrate equitable conduct by filing an affidavit stating:
- (i) that upon recovery of the proceeds of sale they will give a rebate.
 - (ii) and specify the rebate. The amount specified *must not be a nominal rebate* but a substantial one taking into account the prevailing market force by banks generally, and the meaningful decision in the cases of *Affin Bank Bhd* and *Malayan Banking Bhd*.
- (d) If I am satisfied that the proposed rebate is just and equitable, I shall make an order in terms of the plaintiff's application, subject to the terms set out in the proposed affidavit.
- (e) If I am not satisfied, I may not make the order as prayed or make some other order as the justice of the case requires, taking into consideration the thoughtful proposition in the case of *Century Land Resources Sdn Bhd*.

In the case of *Century Land Resources Sdn Bhd v Alliance Bank Malaysia Bhd* [2004] 4 CLJ 793, Gopal Sri Ram JCA made the distinction between the said provision and s 256 of the NLC, particularly the fact that under the SLC, the court has the option to make one of three orders; either an order entitling the chargee to enter into possession and be registered as proprietor (s 148(2)(a)), to receive the rents and profits of the charged land (s 148(2)(b)) or an order for the sale of the charged land (s 148(2)(c)).

D Istihsan and BBA's Shariah Compliancy

The learned Judicial Commissioner in arriving at his decision also garner support from Habib Rahman bin Seni Mohideen's article, *Affin Bank Bhd v Zulkifli Abdullah — Shariah Perspective* [2006] 3 MLJ i on the necessity to apply justice and equity to Islamic banking disputes to avert injustice between parties. The learned Judicial Commissioner strongly disagree with some Muslim scholars on Islamic banking who in 'a mischevious manner' asserted that under the Shariah, 'if you agree to pay, you must pay' is to learned Judicial Commissioner 'hogwash within the framework of Islamic Jurisprudence.' The learned Judicial Commissioner quoted the author of the article who wrote:

The Islamic banking industries must be given space to find its own solution in remedying the situation. However if the current trend continues the court may intervene to remove the exploitation and injustice. The court as

guardian of justice can interfere in the contract between the banks and its customers on the principle of 'Adl Wa Ehsan (justice and equity). It is revealed in the Al Quran 16:90 'God commands justice and fair dealing'. The court may readjust the contractual obligations judicially if the parties are unable to find an amicable settlement. There are various legal maxims which are applicable in financial transactions such as:

No harm may either be inflicted or reciprocated

Necessities allow actions which would otherwise be prohibited

Harm must be removed

If a contract between the contracting parties becomes an instrument of injustice, a judge cannot ignore the unfairness and insist on strict adherence to the letter of contract. Hence, a judge is empowered to set aside a contract when the fact discloses gross unfairness on one of the parties as Islamic system is a just and equitable system that promotes close relationship between the banks and the customers based on cooperation and equitable sharing of risks and rewards.

The learned Judicial Commissioner in his judgment then commented as follows:

... that Islamic Banks are only traders or venture capitalists. As any traders or venture capitalists, they are subject to the laws of the country and obliged to trade within the norms of their trading license. There is nothing sacrosanct about the service they provide. Courts have to ensure that nobody exploits the public by dubious methods and propagate justification through formulas and concepts with which the public is not well acquainted currently. It is the constitutional obligation of the courts to ensure that at all material times, justice prevails in the right perspective, both for Islamic Banks as well as consumers. In this respect, the courts must not reduce the status of Syariah banks to charitable institutions but ensure and respect that they are trading institutions entitled to earn profits out of their investment and only in exceptional circumstance such as where there is default to adjust their profits according to the facts and justice of the case as required under the Syariah principles and practice.

Further down in his judgment, the learned Judicial Commissioner emphasizes the crux of Islamic law among others as follows:

... Islamic Administration of justice will never permit trader or venture capitalists to *strip the loin cloth of the borrowers*. This is one of the major distinctions from the secular system. Under the secular system, contracts can be framed reducing all risks and earn a profit by way of interest. Under the Syariah Administration of justice, such legal trick and scholarly arguments to perpetuate injustice will not be entertained. It is most unfortunate event for Islamic banks to insist on the legal rights under the facility agreement and finally proceed to make a person a bankrupt under the secular law and not Islamic law for Islamic law as I said earlier will not allow indignation to a person. My reasons are as follows:

- (a) Islamic law of commercial transaction fundamentally is rooted on the premise of total eradication of *riba* and *gharar* (uncertainty). It is seen as a coherent system designed to cater for human welfare to achieve maximum benefit. The law of commercial transaction balances the moral and material needs of society to achieve socio-economic justice. The very objective of the *Syariah* is to promote the welfare of the people, which lies in safeguarding their faith, life, intellect, posterity and property.
- (b) The Quran emphatically instructs Muslims not to acquire each other's property *bi-al-batil* or wrongfully (2:188 and 4:29).

... Principles of Islamic commercial transaction are nurtured to check exploitation, inequities and the creation of economic imbalances in society. All Islamic transaction is subject to Islamic worldview and has to be developed according to a methodology that is founded upon this worldview. Islamic law has developed various principles applicable to commercial transaction to eliminate exploitation in business transaction and to eradicate unjust enrichment. The most striking principles are seen in respect of *riba* and *gharar*. It will appear that these principles have never been advocated by Islamic Banks operating its business here or there are no fatwas directing Islamic Banks to comply with the related Quranic injunctions or Islamic worldview. *A borrower under Islamic commercial transaction cannot in the true sense be a subject of insolvency proceedings under the Syariah law or practice.*

... it will be appropriate if they are renamed 'Syariah trading house' or 'Islamic trading house' or 'Islamic trading instruments' or worded to bear similar effect respectively. This is so because the Quran only permits trading activities and not financial activities as understood in the conventional sense. However, it is now generally accepted by those who are familiar with Islamic commercial transaction that 'Syariah bank' or 'Islamic bank' or 'Islamic financial instrument' or like expressions connotes institutions and instruments which deal (or purportedly deal) with trading activities within the spirit and confinement of Quranic verse 2:275.

All trade-related documents under the *Syariah* must have the element of employment of capital, labour and risk, failing which it may be tainted as a 'riba' transaction and treated as forbidden (*haram*). The fixing of profit or definite returns in terms of percentage as opposed to sharing of profits in *Syariah* banking activities are more akin to 'riba' than trade. It must be emphasized that the basic and most important characteristic of Islamic financing is that it does not deal with fixed interest rate or pre-determined profits. It is based on a profit and loss sharing contract. In crux, it is equity-based financing. In a word, *Syariah* banking principles invites banks to be venture capitalists rather than lender. However, it is not uncommon to find literature by 20 Islamic jurists who have approved or authored Islamic trading instruments in form and not in substance to adulterate the meaningful injunction of verse 2:275 for commercial gains. This activity has been perpetuated for centuries under the concept of *helah* (legal

fiction or legal trick). This doctrine was developed by jurists to achieve a purpose, which in form is seen to be within the spirit of Syariah law, but the end result was not seen to be important by the jurists. In principle, these jurists take the view that intention is not an essential element in the Islamic banking system, as long as the form subscribes to the compliance of Islamic norms on 'riba'. If not for the acceptance of helah in modern Islamic literature, the operation of many products or instruments offered by the Syariah Banks will appear to be an infringement of the Quranic injunctions. Criticism of modern Syariah banking is based on this. Notwithstanding objections and controversies by jurists in respect of the doctrine of helah, the doctrine has contributed to the modern literature on Syariah banking. The objections are not without reasons. The extensive number of legal stratagems used by jurists to avoid or limit the strict prohibition of Quranic injunctions is seen to adulterate the pure and divinely ordained system. For example, despite the prohibition of 'riba', a loan with interest in modern times is neatly camouflaged and justified by circuitous logic by the method of a double sale. This is simply done by A, a lender who would purchase an object from B, for an agreed price X payable immediately in cash. B would then contract to re-purchase the same subject matter from A for a price X + I (I representing the agreed interest though defined as profit) payable by future specified date. The authors of those instruments will often argue jurisprudential justification for its creation as they are often financially rewarded for their efforts. Such arguments will appear to be in breach of Syariah principles. As a result, presently we see many innovative Islamic financial instruments parallel to conventional banking instruments, which may not be within the spirit and intent of the Quranic injunctions. Such arguments have failed in Pakistan.

... The Supreme Court of Pakistan, pursuant to an appeal by the Government and different banks and financial institutions of the country related to interest, delivered a judgment, which is hailed as 'Historic Judgment on Interest'. The Supreme Court in its judgment had declared that interest as unlawful according to the Quranic injunctions. The bench in that case had invited more than 20 scholars consisting of bankers, lawyers, economists, businessman, and chartered accountants etc., to address the critical issues involved in respect of interest in Syariah Banking. (see Justice MMT USMANI, 2000. *The Historic Judgment on Interest*. First Edition Karachi: Idaratul Ma'arif Karachi).

(Emphasis added.)

Certain parts of the judgment by Justice Maulana Muhammad Taqi Usmani were quoted by learned Judicial Commissioner, and partly as follows:

Some of the appellants have complained that the Federal Shariat Court, in its impugned judgment, has declared the mark-up system, too, as against the injunctions of Islam. It means that Murabahah cannot be used by an Islamic bank as a permissible mode of financing.

... This complaint is misconceived. The Federal Shariat Court has not held the Murabahah transaction as invalid in principle.

... We have already observed that the 'mark-up system as in vogue in Pakistan' is not a Murabahah transaction in the least. It is merely a change of name. The purported sale of goods never takes place in real terms. If Murabahah is effected with all its necessary conditions, it is not impermissible in Syariah, nor has the Federal Court declared it as an absolutely impermissible transaction per se. We have already mentioned above while describing the background of the objection of the infidels against the prohibition of riba that "sale is similar to riba" (in paras 50 and 51 of this judgment) that they used to sell a commodity on deferred payment for a higher price. Their objection was that when they increase the price at the initial stage sale, it has not been held as prohibited but when the purchaser fails to pay on the due date, and they claim an additional amount for giving him more time, it is termed as 'riba' and haram. The Holy Qur'an answered this objection by saying 'Allah has allowed sale and forbidden riba'. As explained earlier (in para 190 of this judgment) Murabahah is a sale and not a financing in its origin. It must, therefore, conform to all the basic standards of a sale. It may be used only where the client of the bank really wants to purchase a commodity. The bank must purchase it from the original supplier and after taking into its ownership and (physical or constructive) possession sells it to the client. All these elements must be visibly present in a valid Murabahah with all their legal and logical consequences, including in particular, that the bank must assume the risk of the commodity so long as it remains in its ownership and possession. This is the basic feature of the Murabahah which makes it distinct from an interest-based financing and once it is ignored, though for the purpose of simplicity, the whole transaction steps into the prohibited field of interest-based financing.

¶ An objection frequently raised against Murabahah transaction is that when used as a mode of financing it contemplates an increased price based on the deferred payment. It means that the price of commodity in a Murabahah transaction is more than the price of the same commodity in spot market. Since the price is increased against the time given to the purchaser, it resembles the interest-based loan transaction. We have already explained in para 136 to 140 of this judgment that Islam has treated money commodity differently. Having different characteristics both are subject to different rules and principles. Since money has no intrinsic utility, but is only a medium of exchange which has no different qualities, the exchange of a unit of money for another unit of the same denomination cannot be effected except at par value. If a currency note of Rs1000 is exchanged for another note of Pakistani rupees, it must be of the value of Rs1000. The price of the former note can neither be increased nor decreased from Rs1000 even in a spot transaction, because the currency note has no intrinsic utility nor a different quality (recognized legally), therefore, any excess on either side is without consideration, hence, not allowed in Syariah. As this is true in a spot exchange transaction, it is also true in a

credit transaction where there is money on both sides, because if some excess is claimed in a credit transaction (where money is exchanged for money) it will be against nothing but time.

The case of normal commodities is different. Since they have intrinsic utility and have different qualities, the owner is at liberty to sell them at whatever price he wants, subject to the forces of supply and demand. If the seller does not commit a fraud or misrepresentation, he can sell a commodity at a price higher than the market rate with the consent of the purchaser. If the purchaser accepts to buy it at that increased price, the excess charged from him is quite permissible for the seller. When the seller can sell his commodity at a higher price in a cash transaction, he can also charge a higher price in a credit sale, subject only to the condition that he neither deceives the purchaser, nor compels him to purchase, and the buyer agrees to pay the price with his free will. It is sometimes argued that the increase of price in a cash transaction is not based on the deferred payment, therefore, it is permissible while in a sale based on deferred payment, the increase is purely against time which makes it analogous to interest. This argument is again based on the misconception that whenever price is increased, taking the time of payment into consideration, the transaction comes within the definition of interest. This presumption is not correct. Any excess amount charged against late payment is *riba* only where the subject matter is money on both sides. But if a commodity is sold in exchange of money, the seller, when fixing the price, may take into consideration different factors, including the time of payment. A seller, being the owner of a commodity which has intrinsic utility may charge a higher price and the purchaser may agree to pay it due to various reasons for example:

- (a) His shop is nearer to the buyer who does not want to go to the market which is not so near.
- (b) The seller is more trust-worthy for the purchaser than others, and the purchaser has more confidence in him that he will give him the required thing without any defect.
- (c) The seller gives him priority in selling commodities having more demand.
- (d) The atmosphere of the shop of the seller is cleaner and more comfortable than other shops.
- (e) The seller is more courteous in his dealings than others.

These and similar other consideration play their role in charging a higher price from the customer. In the same way, if a seller increases the price because he allows credit to his client, it is not prohibited by *Syariah* if there is no cheating and the purchaser accepts it with open eyes, because whatever the reason of increase, the whole price is against a commodity and not against money. It is true that while increasing the price of the commodity, the seller has kept in view the time of its payment but once the price is fixed, it relates to the commodity, and not to the time, the

price will remain the same and can never be increased by the seller. Had it been against time, it might have been increased, if the seller allows him more time after the maturity.

To put it another way, since money can only be traded in at par value, as explained earlier, any excess claimed in a credit transaction (of money in exchange of money) is against nothing but time. That is why if the debtor is allowed more time at maturity, some more money is claimed from him. Conversely, in a credit sale of a commodity, time is not the exclusive consideration while fixing the price. The price is fixed for commodity, not for time. However, time may act as an ancillary factor to determine the price of the commodity, like any other factor from those mentioned above, but once this factor has played its role, every part of the price is attributed to the commodity.

● The upshot of this discussion is that when money is exchanged for money, no excess is allowed, neither in cash transaction, nor in credit, but where a commodity is sold for money, the price agreed upon by the parties may be higher than the market price, both in cash and credit transactions. Time of payment may act as an ancillary factor to determine the price of a commodity, but it cannot act as an exclusive basis for and the whole consideration of an excess claimed in exchange of money for money. This position is accepted unanimously by all the four schools of Islamic law and the majority of the Muslim jurists. This is the correct legal position of Murabahah transaction according to Syariah. However, two points must be remembered:

(a) The Murabahah when used as a mode of trade financing is borderline transaction with very fine lines of distinction as compared to an interest bearing loan. These fine lines of distinction can be observed only when all the basic requirements already explained are fully complied with. To ignore any one of them makes it an interest-bearing financing, therefore, it should always be effected with due care and precaution.

①

(b) Notwithstanding the permissibility of the Murabahah transaction, it is susceptible to misuse and keeping in view the basic philosophy of an Islamic financial system it is not an ideal way of financing. Hence it should be used only where the Musharaka and Mudarabah are not applicable.

Apart from Musharakah and Mudarabah there are other modes of financing like Ijara (Leasing), Salam and Istisna that can be used in different types of financing. ... The upshot of this discussion is that the Doctrine of Necessity cannot be applied to protect the present interest based system for ever or for an indefinite period. However, this doctrine can be availed of for allowing a reasonable time to the government necessarily required for the switch-over to an interest-free Islamic financial system.

The learned Judicial Commissioner then added his view and said as follows:

It is elementary knowledge that the Holy Quran has stated that contracts must be honoured. However, this verse will not apply to a contract that is tainted with illegality. Further, one cannot enforce his full legal rights against equity and good conscience under the Syariah law. Argument such as that one is bound by contractual obligation is a fallacy in Syariah law when it has to be tampered with justice and equity. Quranic laws cannot be read out of context for material gains. The Holy Quran verse 2:41 states: 'Do not sell my verses for a little price'.

... Syariah law, being God's law, is easily comprehensible to any Muslims (or persons). For its proper application, what we need are people with a high sense of intellectual honesty and abiding faith in the principles of Islam. These are attributes, which must be present in those professing to be jurists and lawyers in Islamic commercial transaction or claiming to be pioneers in Syariah banking, for Islamic banking in its true form and spirit to be successful. *Mischievous statement such as 'you agreed you pay' when it is a case of inability to pay are crude and very unrealistic proposition in Islamic Administration of justice.*

Whether BBA is valid or invalid depends on the nature of the instruments. However, the concept of BBA is now being widely accepted, provided it does not infringe on the rule against riba. The Pakistan Supreme Court, in the historic judgment on interest stated above, has held that Murabahah and/or BBA transactions (sale by deferred payment), when used as a mode of trade financing, is a borderline transaction with interest-bearing loan. The court stated that unless the basic requirements for its legal validity under the Syariah are strictly complied with, it might amount to interest-bearing loan. Further, the Supreme Court took the view that the Murabahah and/or BBA concept is susceptible to misuse and is not an ideal financing system and should only be used where Musharaka and Mudarabah, a concept of financing (partnership or equity financing), are not applicable. Our courts here have not ventured into the validity of such instruments in detail, as was done in Pakistan.

(Emphasis added.)

The Shariah Advisory Council

The Islamic Banking Act 1983 (IBA) requires that no bank shall in their Islamic banking business indulges in anything involving any element which is not approved by the religion of Islam, and usury (riba) is just one glaring example and not the only one. The bottom line is no injustice should be occasioned. Any bank wishing to do Islamic banking business has to acquire a license to operate which is granted by the Minister of Finance on the advice of the Central Bank (Bank Negara Malaysia), and the bank in question has to incorporate in its articles of associations, a Shariah Advisory Body to advise the bank in question on the operations of its banking business to ensure that it does not involve any element which is not approved by the Religion

of Islam.⁶ Islamic banking business has been defined to mean business whose aim and operations do not involve any element which is not approved by the Religion of Islam.⁷ Bank Negara Malaysia too had in 1997 set up the National Shariah Advisory Council to advise Bank Negara Malaysia on Islamic banking and takaful business, Islamic financial business, Islamic development financial business, or any other business which is based on the Syariah principles and is supervised and regulated by the Bank⁸.

It is disheartening that persons who make up the SAC could not tally *istihsan* into the BBA agreement or to mitigate the injustices in their cause of action against the defaulting party, and have allowed or taken for granted injustices to creep into the BBA agreement. Section 16B(2) Central Bank Act 1958 provides that the Shariah Advisory Council shall consist of such members from amongst persons who have knowledge or experience or both in the Shariah and also (a) banking; (b) finance (c) law; or any other related discipline. Cases discussed above have shown that the Islamic banking business is not yet fully up to the mark by allowing injustice to occur to the detriment of the helpless customers of even his loin cloth, and against the concept of *istihsan* which is sacrosanct under the Religion of Islam. Allah says:

God doth command you to render your trusts to those to whom they are due

(Qur'an : an-Nisaa: 58)

As a matter of fact, section 16B (8) of the Central Bank Act 1958 does provide for the Court to take into consideration any written directives issued by the Bank. This directive could be issued by the bank to mitigate the defaulting sum (*ibrar/ muqassa*) to avoid injustice in the judgment by the court. It is not surprising too to find that there are not many members in the Shariah Advisory Board having renown or good literary work on Islamic banking business, or for that matter related field of knowledge such as on law of contract, evidence such as the parole evidence rule or on documentary evidence just to name a few, or the knowledge to draft a simple but a concise contract. Syariah Advisory Council (SAC) must show that they too are learned in the field that they are expected to advise upon and this can only be discovered if they have at least written a few. It is important that there must be test conducted to be eligible to be a member of the SAC. To be qualified is one thing but a working knowledge is equally

⁶ Section 3(5) of the Islamic Banking Act 1983.

⁷ Section 2 of the Islamic Banking Act 1983.

⁸ Section 124(7) Banking & Financial Institution Act 1989; ss 2 and 16B Central Bank Act 1983 as amended by Act A1213/2003.

crucial when one consider article 20 of the guidelines on the governance of Shariah Committee for Islamic Financial Institutions: It calls for impeccable knowledge of both theory and practical.

Conclusion

The unearned profit under BBA may be akin to usury (*riba*) which is an injustice and unlawful under the Religion of Islam. Getting money out of nothing to the detriment of another is contrary to *istibsan*. One man's meat is another man's poison cannot hold true under the religion of Islam. Abdul Wahab Patail J. in *Affin Bank Bhd v Zulkifli bin Abdullah* [2006] 3 MLJ 67 got it right for a different reason. The only thing being that he did not identify it as usury or pause to consider whether it would be usury. He said ' the profit margin that continued to be charged on the unexpired part of the tenure cannot be actual profit. It was clearly unearned profit. It contradicted the principle of Al-Bai Bithaman Ajil as to the profit margin that the provider was entitled to. Obviously, the learned judge was right not just logically but had the common sense in holding that if the profit had not been earned it was not profit, and should not be claimed under the Al-Bai Bithaman Ajil facility.

It follows that it would be inconsistent with one's right to the full tenure if he could be denied the tenure and yet be required to pay the bank's profit margin for the full tenure. Abdul Wahab Patail J. good logic and common sense in *Affin Bank Bhd v Zulkifli bin Abdullah* [2006] 3 MLJ 67 was referred and followed in *Malayan Banking Bhd v Marilyn Ho Siok Lin* [2006] 7 MLJ 249 which too held that it would not be equitable to allow the bank to recover the sale price as defined when the tenure of the facility is terminated prematurely. Even the learned Judicial commissioner YA Dr Haji Hamid Sultan bin Abu Backer too in *Malayan Banking Bhd v Ya'kup bin Oje & Anor* [2007] 6 MLJ 389 could see how idiotic such an idea is, and held that Islamic Administration of justice will never permit trader or venture capitalists to strip the loin cloth of the borrowers, and the logic to also say that rebate must be given. The rebate cannot be a nominal rebate.

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