The Combination of Contracts in *Shariah*: A Possible Mechanism for Product Development in Islamic Banking and Finance

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Executive Summary

The combination of contracts is a potential mechanism of product development in Islamic finance. However, this concept encounters legal issues due to ahadith that prohibit two contracts in one deal. The article argues for the validity of combining two or more contracts to structure Shariah*-compliant products. It discusses many aspects of combination of contracts, including terminologies and purposes of the contracts, the degree of uncertainty and ambiguity, and the nature of the bargain in the contracts combined. If the contracts combined pass the tests established by legal principles, there will be no legal objection to combine such contracts into one deal.* *© 2007 Wiley Periodicals, Inc.*

INTRODUCTION

The banking sector is witnessing a dramatic change, especially in the age of electronic transactions, and faces various competitive forces, including product development in order to meet the current needs of business and trade. Islamic banking is no exception. After decades of operation, the transactions of Islamic banking seem to depend on only a handful of financial products. Deferred pay-

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ment transactions, such as *murabahah* or *bay bi thaman a'jil*, and profit-and-loss sharing contracts (*mudarabah* and *musharakah*) form the main, if not the sole, focus of Islamic banking operations. Islamic investors have, therefore, considerably fewer investment outlets and choices. It thus becomes necessary that Muslim scholars adopt, sooner rather than later, a creative approach toward exploring various effective banking products from the *fiqh*[1] literature that may further strengthen Islamic banks and secure financial returns for their clients. One possible mechanism of product development is the combination of different contracts into one transaction.

The fiqh *literature suggests that the rationale for the combination of contracts is the need to avoid* riba *transactions and at the same time meet the financial needs of individuals.*

However, the combination of contracts is controversial because of the traditions that prohibit "two contracts in one transaction." The literal interpretation of these sources may potentially defeat any attempt to allow the combination of contracts, irrespective of the features and nature of the contracts combined. This is further aggravated by the fact that when contracts are combined, the law does not look at them in isolation (i.e., being single contracts). The combined contracts would be viewed as having a different status altogether by virtue of the process of combination. From this perspective, the combination of contracts provides a complex legal process. Nevertheless, an examination of the sources in respect to two contracts or two deals indicates that a transaction may comprise more than one contract provided the structure is not in conflict with basic principles of the Islamic law of contracts.

MEANING AND RATIONALE OF THE COMBINATION OF CONTRACTS INTO ONE DEAL

There is no definition as such for the combination of contracts in *fiqh* literature. However, the combination of contracts (*ijtima al-uqud*) may be defined as an agreement between two or more parties to put together two or more contracts with different features and legal consequences to achieve a desired viable transaction. In this case, all obligations and legal consequences arising from the combined contracts are to be realized as one single obligation (Hammad, 1998, p. 511).

The *fiqh* literature suggests that the rationale for the combination of contracts is the need to avoid *riba* transactions and at the same time meet the financial needs of individuals. For example, one may defer collection of a countervalue in a sale contract to a future date. This is not allowed in the case of currency exchange. The jurists developed a product whereby one may sell *dinar* together with a commodity for

U.S. dollars on a deferred payment basis. This is an example of the combination of sale and currency exchange, the aim of which is to avoid *riba* transactions. At the same time, the combination of contracts meets the economic needs of individuals since not everyone can buy on a spot payment basis.

DISTINCTION BETWEEN TYING ARRANGEMENTS (*ISHTIRAT AQD FI AQD*) AND THE COMBINATION OF CONTRACTS (*IJTIMA' AL-UQUD*)

It is realized from modern fiqh *writings that some juristic terminologies with respect to tying arrangements are considered similar to the concept of combining contracts* (ijtima' al-uqud).

It is realized from modern *fiqh* writings that some juristic terminologies with respect to tying arrangements are considered similar to the concept of combining contracts (*ijtima' al-uqud*). Thus, this concept will not become clear unless these terminologies—namely, (a) *ishtirat aqd fi aqd*, (b) *tardid al-aqd*, and (c) *ta'dud al-safaqa* or *ta'dud al-aqd*—are clearly defined and explained.

The inner meaning and objectives of the above terminologies confuse a number of researchers. These terminologies are presented as though they have similar meanings and legal implications (see al-Shadhily, 1993, pp. 280–297). However, scrutiny of the nature of these terminologies and the juristic examples in this respect suggest that the first two terminologies differ from combination of contracts (*ijtima' al-uqud*). The closest though, with some variation, to the concept of combination of contract is the term *ta'dud al-safaqa*, which means a deal in consideration for another deal (see Abu Ghuddah, 2000, p. 12).

The term *ishtirat aqd fi aqd* (tying arrangements) differs from the combination of contracts in that the former represents a transaction in which the obligation of one contract is dependent on the execution of the other contract. For example, in a sale-leaseback transaction, the sale agreement cannot refer to the lease, because the lease must be an independent transaction that will occur at a future time. When the sale contract refers to the lease, the transaction violates Islamic contract rule due to the fact that the different contractual obligations and rights are connected to each other. This is termed as *ishtirat aqd fi aqd* or *rabt bayna al-uqud* on which the jurists differ in opinion as to whether it falls under the ruling of the tradition that prohibited *bay'atayn fi bay'ah*. A typical example of *ishtirat aqd fi aqd* is a statement similar to "I sell you this car at 1,000 *dinars* on the condition that you buy so and so item for 500 *dinars*." An event of *ishtirat aqd fi aqd* would be created when the sale—for example, of a

car—is a condition for securing a loan from the buyer or where there is a stipulation that the seller would have a right to be a partner in an investment venture as a consideration for selling the car. Therefore, contractual stipulations do not always create a state of combined contracts. This is because the combination of contracts into one deal is a state of creating a contract itself and not a stipulation.

When two or more persons offer to sell an asset jointly owned by them to another party and the offer is accepted, then a state of tardid al-aqd *exists when a portion of the asset is defective.*

Tardid/ta'dud al-aqd, *tafriq al-safaqa*, or *ta'dud al-safaqa*[2] is different from the combination of contracts in many respects. *Tardid* or *ta'dud al-aqd* is a transaction that involves quoting two or more prices (*tafsil al-thaman*) in one deal, one of which is for spot payment and the other is for undivided assets to be paid in the future whereby the contracting parties disperse without the buyer choosing a particular price or stating acceptance of one price. The jurists, such as Ibn Muflih (1400 AH, Vol. 5, p. 214) and al-Nawawi (1405 AH, p. 424), largely applied this concept to sold items that are receptive to partition of prices, such as real estate. The seller of land could break it up into three parts and identify each part with a number. The seller will then assign a price to each meter of parts one and two and assign a different price to each meter of part three, in which case a state of *tardid al-aqd* is created.

The jurists (e.g., Ibn Muflih, 1400 AH, Vol. 5, p. 214) also used this concept for a deal that involves a number of sellers or buyers at one time. When two or more persons offer to sell an asset jointly owned by them to another party and the offer is accepted, then a state of *tardid al-aqd* exists when a portion of the asset is defective. In this case, the buyer is entitled to terminate the transaction in part, leading to a break-up of a contract involving two persons that may lead to dispute (al-Nawawi, 1405 AH, p. 420; al-Sharbini, n.d., p. 42). Therefore, *tardid al-aqd* is another way of forming a contract and not a combination of contracts or even a conditional option.

The term *ijtima' al-uqud*, or combination of contracts, connotes, as stated earlier, an agreement between two or more parties to conclude a deal involving two or more different forms of contracts of distinct features and legal characteristics to form a viable investment product that is acceptable to the buyer for being an added value transaction. In this case, all effects, obligations, and rights created by the combined contracts are viewed as inseparable obligations, not subject to partition.

Al-Nawawi (1405 AH, p. 420) and al-Sharbini's (n.d., p. 42) discussion shows that a typical example of combination of contracts is man-

ifested in the case of ownership of two different assets whereby one of the assets (e.g., a house) may be disposed of by lease and the other asset (e.g., textile) may be disposed of by sale. In this example, the desired profit may not be realized if the textile is sold alone. The seller will thus prefer to combine, for example, a sale contract and an *ijarah* contract by agreeing to rent one of the assets and selling the other to the lessee in one transaction. By this, the seller is adjusting possible losses that might occur due to selling the item that is to be disposed of by sale from the rent contract through combination of these two contracts. This structure is known in *fiqh* literature as *ijtima'shay'ayn fi safaqa* and is approved by traditional Muslim jurists provided that certain conditions are observed.

There is no explicit Qur'anic *provision that directly prohibits or permits combination of contracts.*

PROHIBITION OF *ISHTIRAT AQD FI AQD* OR *BAY' TAYN FI BAY'AH* TRANSACTIONS

There is no explicit *Qur'anic* provision that directly prohibits or permits combination of contracts. The provisions that seem to reject the concept of combination of contracts are stated in the *Sunna* literature evidenced by five famous versions of ahadith in this respect. The first hadith that was reported by Malik (n.d., Vol. 5, p. 657) disapproves combining a loan contract and a sale contract. The second hadith that was reported by Ahmad Ibn Hanbal (n.d., Vol. 2, p. 174) disapproves two sales in one contract (*bay'tayn fi bay'ah*), and similar to this is the hadith that prohibits two contracts in one deal (*safqatayn fi safaqa*). Al-Asbahani (1415 AH, p. 267) reported another hadith that states that the Prophet, peace be upon him, has prohibited a sale that is circumscribed with a condition (*bay' wa shart*). The contents of these ahadith suggest that the combination of contracts may be formed in several ways, including the following:

1. *Tying a contract with a condition, either appropriate or inappropriate to the contract.* An example of an appropriate condition is the requirement of collateral attached to a contract of sale for deferred payment. An example of an inappropriate condition is a condition required by the seller against selling the purchased item to a particular person by the buyer. After the contract of sale, the Islamic law considers a seller as not entitled to restrict the action of the buyer vis-à-vis the purchased item. Any condition that restricts the right of the purchaser to dispose of the purchased item is considered an unfounded condition (i.e., not enforceable). This form of arrangement may be termed as a contract circumscribed with a condition and is

not the form of arrangements intended by the term *combination of contracts.*

2. *The combination of various contracts without any condition attached to the desired transaction*. This is what the concept of combination of contracts tries to address.

In principle, Islamic law will not object to the combination of a number of contracts in one deal because of the general principle of freedom of contracts in Shariah.

The jurists have intensively tried to explain the legal effects of these ahadith, which is not the scope of this article. Nevertheless, it may be suitable to state that the main impediments for disapproving tying arrangements or *ishtirat aqd fi aqd/bay'tayn fi bay'ah* are one of the following: (a) *riba*, (b) *gharar*, and (c) injustice, exploitation, and taking advantage of people's need. For example, the rationale for prohibiting combination of a loan contract and sale or leasing is the fear of favoritism and partiality. This is because the seller or lessor may consider discounting the price in favor of the lender due to the loan facility, leading to a contract of loan that extracts profit. By this, there is no justice and freedom of contract without any external influence and this leads to inequality and injustice. It is for these reasons that some of tying arrangements are unequivocally prohibited, especially when the process of combination involves a loan contract and one of the *Shariah*-nominated contracts. Therefore, the issue at hand is to see whether these prohibiting factors exist in the concept of combination of various contracts in one transaction.

LEGAL RULING OF COMBINATION OF CONTRACTS

In principle, Islamic law will not object to the combination of a number of contracts in one deal because of the general principle of freedom of contracts in *Shariah.* Ibn Taymiyyah (1398 AH, p. 132) argued that the parties are free to conclude whatever contracts they deem necessary and of added value, and fulfill contractual expectations as far as there is not an explicit source prohibiting their actions. Therefore, a deal that consists of a number of contracts may be valid and acceptable or may be void and impermissible, depending on the nature of the contracts involved.

In this regard, al-Shatibi (n.d., p. 193) argued that combination of contracts has different ruling and legal effects that do not exist in solitary contracts. A structure on the basis of combination of contracts could be declared void despite the fact that each of the contracts involved in the combination is separately valid. For example, each of a loan and a sale contract is valid if concluded in isolation. However, if they are combined in one deal to the effect that one party finances

another party and the other party (the financed person) gives the financier a right to purchase shares from the venture at a price less than fair value or market value as a consideration, then both contracts become void and null. The reason is that this combination of contracts in one deal involves an impermissible transaction due to either conflict of purpose or conflict of rulings of each contract involved. This shows that the rules and principles governing combination of contracts are different from rules and principles governing solitary contracts.

Islamic law would not reject transactions that serve the valid purpose of the contracting parties on the basis that they involve a number of contracts.

Al-Shatibi's preliminary argument suggests that, in principle, the jurists agreed that a financial product or service may be structured using a number of contracts. Some jurists—al-Dardir (n.d., p. 136), al-Nawawi (1996, Vol. 9, p. 363), and al-Mardawi (n.d., Vol. 4, pp. 321–322)—suggested, for example, that a contract of sale and an *ijarah* (leasing) contract or a contract of sale and a currency exchange contract or a contract of sale and *salam*—a contract for which delivery of the sold item is deferred with spot payment of the price—may be grouped in one transaction. This is because an appropriate combination of contracts serves a valid purpose. For this reason, Islamic law would not reject transactions that serve the valid purpose of the contracting parties on the basis that they involve a number of contracts. In addition, the combination of contracts that does not violate any basic principle of Islamic law falls under the principle of freedom of contract, as stated earlier. For example, Ibn Taymiyyah argued that all contracts concluded by individuals are generally permissible, valid, and enforceable. Individuals are not allowed to proclaim a contract invalid except a contract that is prohibited and declared void by God the almighty or His messenger (see Ibn Taymiyyah, 1398 AH, Vol. 29, p. 132).

Ibn Qayyim (1991, Vol. 1, p. 344) argued that contracts concluded by individuals are generally permissible, valid, and enforceable. According to Ibn Qayyim, this approach to contracts is the most authoritative, correct, and preferred juristic view and that a contract or a condition is nullified only when there is an explicit textual source to that effect. Ibn Qayyim further observed that declaring contracts and conditions permissible and valid or otherwise is the prerogative of the Lawgiver and His messenger. Therefore, one is not in a position to declare certain contracts valid or invalid unless the Lawgiver and His messenger unequivocally states so. The Lawgiver, the Almighty God, has clearly clarified prohibited deals so much so that all invalid agreements and conditions are clearly explained. The event that renders contracts valid or invalid is only known by a provision from the textual sources of Islamic law.

The discussion on the principle of freedom of contract and the underlying rules of *fiqh*-nominated contracts suggest that the jurists have alluded to the possibility of combining two or more of the nominated contracts in one deal, whereby the deal becomes a separate obligation consisting of the characteristics of the combined contracts (see al-Sanhuri, 1953/1954, Vol. 1, p. 62). The jurists have stated a number of examples that indicate their approval of the combination of contracts. For example, *fiqh* literature sees no wrong in combining binding or nonbinding contracts and charitable contracts or combining a sale contract and *ijarah* or a sale contract and currency exchange contract (*sarf*). The majority of jurists permitted combination of sale and *ijarah*. After systematic explanation of the subdivisions of various forms of *ijarah* that may be combined with sale in one deal, al-Hattab, a *Maliki* jurist, concluded that "all these elaborations had proven that the prevalent view of the *Maliki* school is the permissibility of the combination of ijara and sale in one deal" (see Al-Hattab, 1398 AH, Vol. 5, p. 397).

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The *Shafi'i* jurists (al-Ghazali, 1417 AH, Vol. 3, pp. 93–96; al-Sharbini, n.d., Vol. 2, pp. 41–42) had generally allowed combination of contracts, such as leasing and sale or currency exchange and *salam* because the contracts involved are valid separately; hence, there would be no objection to combine them in one deal. They also allowed combinations of nonbinding contracts, such as *sharika* and *qirad* (*mudarabah*), in one deal. Nevertheless, they object to combining binding and nonbinding contracts in one deal, such as a reward contract (*ju'ala*) and a sale contract, because of conflicting rules of these contracts (i.e., a reward contract tolerates uncertainty, whereas a sale contract does not tolerate uncertainty).

The *Hanbali* jurists, including Ibn Qudama (1405 AH, Vol. 4, p. 260), argued that it is valid to combine currency exchange and leasing contracts or a sale of which taking of immediate possession is not necessary. An example of this is when one sells real estate and leases another property for one price. This is valid because both may be sold separately; hence, their disposal may be structured in the manner described.

Therefore, the validity of the combination of contracts is not an issue in the *fiqh* literature. The main issue concerns the nature and the forms of combination. Hence, the validity of the combination of contracts must be qualified with the nature and features of the contracts involved in the process of combination. A valid structure on the basis of combination of contracts would depend on the comprehension of

the categories of contracts (i.e., whether binding, nonbinding, or a hybrid of binding and nonbinding contracts) and the criteria necessary for a valid combination of contracts in one agreement.

CRITERIA OF DETERMINING COMBINABLE AND NONCOMBINABLE CONTRACTS

It must be noted that a product or an instrument designed based on a single contract poses no legal complexity. The reason is that in case of operating based on single or solitary contracts, each contract would have independent principles and separate criteria, objectives, and obligations. However, if a number of contracts are combined in one transaction to form a single outcome, then issues of *Shariah* compliance pose a daunting and challenging task. This is because a number of *Shariah*-nominated contracts conflict from various perspectives. In order to deal with this situation, the jurists stated a number of parameters and criteria that may assist one to determine whether the process of combination of some contracts comply with *Shariah* requirements (see al-Shadhily, 1998, pp. 472–478).

A group of contracts may share similar and common features that would make them combinable in some perspectives from one hand and, on the other hand, have different legal results from other perspectives.

Again, these parameters and criteria are rendered in various perspectives. The Islamic commercial contracts are classified taking into consideration various aspects and common features of contracts. The basis, purpose, subject matter, characteristics, or rulings of each contract are taken into consideration as far as the classification of contracts is concerned. Those contracts that share similar and common features can be categorized in one group with one single legal consequence. A group of contracts may share similar and common features that would make them combinable in some perspectives from one hand and, on the other hand, have different legal results from other perspectives. Therefore, the legal effect of these perspectives is very much necessary for the combination of various contracts to meet *Shariah* requirements of a valid contract, and these are discussed in the sections that follow.

Principle of Freedom of Contract

The principle of *Shariah* in respect to formation of contracts is that any form of contract and investment or financing instrument cannot be declared invalid unless expressly prohibited or proclaimed as forbidden. The absence of a clear-cut legal authority to the contrary, all transactions are considered under the original principle of permissibility, and this permissibility is more evident when it comes to financial transactions. Hence, when a structure or any component thereof

does not explicitly involve prohibited features and invalidating elements, this should be considered to be an acceptable mode of financing in Islamic law (Ibn Qayyim, 1973: Vol. 3, pp. 388–391). This general permissibility (*ibaha*) suggests that the important requirement for a valid combination is to examine each component of a financial structure on the basis of hybrid contracts. This would assist in identifying the possibility of the existence or nonexistence of the prohibited features in the structure.

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Terminology-Based Criterion

For a valid combination of contracts for an acceptable product, one needs to take into account the terminology of each of the contracts combined. This is because each contract is distinguished from the other by a designation. At first glance, the terminology-based criterion would mean that all contracts are noncombinable due to the fact that a designation for something is intended to distinguish it from other things in terms of features and qualities. Thus, two designations would not be applicable to one thing simultaneously. However, the jurists did not give much weight to terminologies[3] as far as legal rulings of contracts are concerned. In other words, although terminologies have some effect on the intention of contracts, the important issue is the objective of the contracts. In this respect, the legal maxim goes *al-ibrah bi al-ma'ani la bil alfadh.* This legal maxim means, in brief, in deciding on the validity of contracts, "attention must be given to the objectives and meaning (substance), and not to words and form" (see al-Qurtubi, 1952, Vol. 5, p. 113; al-Shawkani 1405 AH: Vol. 4, pp. 222, 343; The *Mejelle*, 2001, Article 3). In this respect, the combination must be focusing on whether the structure serves economic and societal interest within the parameters of the principle of public interest.

Objective-Based Criterion

The objective and effect (*athar*) of contracts is one criterion in the process of combining contracts of different status and rulings for a new *Shariah*-compliant product. In combining contracts of various status, one needs to identify objectives that contradict each other in order to know whether objectives of the combined contracts legally conflict. When there is a conflict, a process of combination will be invalid. From this perspective and for identifying conflicting objectives of various contracts, the *Shariah*-nominated contracts may be divided into the following categories (see al-Shadhily, 1998, pp. 472–478):

1. *Contracts of transfer of ownership, legal title, or possession.* The purpose of these contracts is to assign ownership of tangible

assets or usufruct of certain properties to a particular person or persons. The contracts in this regard are also divided into three main categories. The first category is manifested in contracts of exchange relationships, and these contracts are meant for bilateral exchange proprietary interests. This exchange of interests may be in the form of money, benefit, or rendering services. The second category is manifested in contracts of charity, the aim of which is a unilateral transfer of ownership and entitlement to utilize property without taking a consideration from the beneficiary. This transfer can take place through gift, will, borrowing of a tangible item (*i'arah*), and the like. The third category is exemplified in contracts combining characteristics of exchange and charity. These are contracts that are entered into at the outset as charity contracts but end up being contracts of consideration at their due date (e.g., loan and gift for consideration [*hibah al-thawab*]).[4] For example, a loan contract is primary a contract of charity at the outset of the contract, but a contract of exchange when payment is made.

2. *Contracts of rebates.* The purpose of these contracts is to relinquish a right, such as discharging one from paying the debt.
3. *Contracts of partnership.* The purpose of these contracts is profit or loss sharing through a joint venture on the basis of capital contribution in the form of money, skills, or services (e.g., *musharakah*, *mudarabah*, and sharecropping).
4. *Collateral contracts and quasi-security contracts.* These contracts secure future financial rights (e.g., personal guarantees, pledge of security, and *hawala* [transfer of right or debt]).
5. *Contracts of custody.* The purpose of these contracts is safekeeping of a property, such as a contract of deposit.
6. *Contracts of awards and services.* The aim of these contracts is offering services in lieu of consideration, such as contract of *ju'ala* (contract of award or wages) and contract of maintenance.
7. *Contracts of authorization (e.g., agency and* mudarabah*).* The objective of these contracts is to entitle one to discharge a duty in the name of another person that cannot be performed by such a person prior to the authorization.

...if contracts are considered from their objective, it may be concluded that all contracts are noncombinable since each contract is naturally permitted to serve a particular objective.

Again, if contracts are considered from their objective, it may be concluded that all contracts are noncombinable since each contract is naturally permitted to serve a particular objective. Nevertheless, there is another aspect of considering combinability or noncombinability of contracts from their objectives. This aspect is the common objective that the combined contracts share. Some contracts that transfer inter-

ests are most likely to be combinable depending on the nature of the combination and the desired objective. The contracts that play a complementary role, such as collateral contracts, can be, in principle, combined with the principal contracts, such as combination of guarantee and sale. This is because although contracts might differ from the perspective of their objectives, the objective of some contracts is to ensure that certain contracts are timely fulfilled—hence, a possible combination between these contracts. The following therefore is noteworthy:

…it is possible to combine the contract of a pledge and the contract of a deferred payment sale in one deal.

1. The supplementary contracts—the contracts that encourage fulfillment of obligations, whether they are collateral contracts or contracts of custody—do not conflict with the principal contracts (i.e., the contracts of exchange relationships). This is because these supplementary contracts (e.g., collateral contracts) protect the original contracts from being breached. Consequently, these contracts can be combined with the original contracts. Therefore, it is possible to combine the contract of a pledge and the contract of a deferred payment sale in one deal.
2. The differences of opinion among the jurists in respect to validity or invalidity of combination of contracts is basically confined to contracts of conferring ownership, whether such conferment is triggered by consideration or by willingness to donate charitably. The combination in this regard could take place between contracts of reciprocal exchange of interests, such as exchange of properties (as in the case of a sale contract) or contracts of reciprocal exchange of money or usufruct of chattels (as in the case of *ijarah*). The combination may take place between contracts of exchange on one hand and contracts of charity on the other, such as a sale contract and a contract of gift or *ijarah* contract and gift, which create what is now known in Islamic banking as *ijarah muntahia bi al-tamlik/ijarah wa iqtina/ijarah thumma al-bay*. In other words, one feature of a financing lease is a combination of lease and gift, whereby such gift takes place at the end of the lease tenure with a new contract (AAOIFI, 2003–2004, pp. 135–158).

Quality-Based (*Wasf*) Criterion

The validity of the combination of certain contracts is contingent upon the attributes of the combined contracts. In the process of combination of contracts, it is necessary to know whether or not the combined contracts are receptive or unreceptive to certain descriptions,

such as *gharar* (uncertainty) and *jahala* (ambiguity). This is because the basic principle of Islamic law is that uncertainty and ambiguity render contracts null and void. However, this principle is not applicable to all contracts and in all circumstances. Uncertainty (*gharar*) or ambiguity (*jahala*) do not affect the validity of some contracts, such as a contract of *ju'ala* (award) and contract of charity or donation. On the other hand, some contracts, such as a sale contract, do not tolerate uncertainty and ambiguity. Hence, uncertainty affects the validity and enforceability of such contracts. In this respect, uncertainty and ambiguity invalidate a contract of sale, whereas a contract of *ju'ala* is receptive to uncertainty and ambiguity.[5] Therefore, the combination of contracts that are receptive to uncertainty and contracts that are not receptive to uncertainty would violate criteria of an acceptable combination. It is thus noteworthy to consider the following:

Whether two or more designated contracts of Islamic law can be combined to form a novel contract depends on the binding and non-binding nature of the combined contracts.

1. If the contracts combined were receptive to uncertainty and ambiguity, then the combination would be valid because there exists no conflict between the objectives and rulings of this category of contracts.
2. If one of the contracts combined does not tolerate uncertainty and the other contract tolerates uncertainty, the contracts from this perspective conflict, and the combination becomes invalid (see al-Qarafi, n.d., Vol. 3, p. 142).

Criterion of Tolerability or Intolerability of Unilateral Termination

Whether two or more designated contracts of Islamic law can be combined to form a novel contract depends on the binding and non-binding nature of the combined contracts. Some *Shariah*-nominated contracts may not be terminated unilaterally. The contracts in this regard are divided into the following (see AAOIFI, 2003–2004, pp. 57–66; al-Dimyaty, n.d., Vol. 3, p. 32):

1. *Binding (*lazim*) contracts, which are contracts that cannot be unilaterally cancelled by a party to a contract without a valid reason and the consent of the other party.* These include proprietary exchange contracts (e.g., a sale contract and a currency exchange contract) and contracts of nonpecuniary consideration, such as matrimonial contracts, *salam* contracts after lapse of the option period, and *hawala* contracts (transfer of debt or right). The proprietary exchange contracts can only be cancelled by way of *iqala*: agreement of the contracting parties to cancel a contract with or without consideration. The nonproprietary contracts may be terminated, for example, through divorce or *khul'* (a

right of a married woman to terminate a marriage contract through repayment of the dowry to the husband). The effect of these contracts being binding is that the person who initiated or caused the cancellation or termination of the contract is not entitled to claim any expenses or losses incurred.

2. *Nonbinding* (ja'iz*) contracts, which are contracts that can be terminated unilaterally after notifying the other party, irrespective of the consent of this party to the termination*. These contracts include, among others, *mudarabah* contracts, partnerships, *ju'ala*, agency, will, deposit, and loan contracts.[6]
3. Unilateral binding contracts, which are contracts that bind one party while the other party is at will to fulfill or not to fulfill his or her obligation created by the contract, such as a contract of pledge and guarantee. For example, the contract of a pledge binds the pledger, while the pledgee is entitled to relinquish the right to ask for a pledge in a credit transaction. In the same vein, the creditor is not under obligation to require security for a debt transaction, but the guarantor cannot terminate the guarantee without the consent of the creditor.

For the validity of combination of contracts, it is a necessary requirement that the structure is not fashioned in a way that would place it in conflict with an explicit source.

PARAMETERS FOR LEGITIMACY OF COMBINATION OF CONTRACTS

It is noted that the combination of contracts to form a novel contract is, in general, an acceptable structure. However, this legality is circumscribed with certain parameters and conditions that are derived from general principles of Islamic law of contracts. These parameters include, among others, the following matters.

The Process of Combination Must Not Contradict an Explicit Text

For the validity of combination of contracts, it is a necessary requirement that the structure is not fashioned in a way that would place it in conflict with an explicit source. If there is an explicit source to the effect that certain contracts cannot be combined for whatever reason, then the product that depends on such a combination becomes unacceptable in Islamic law. This is evidenced by the tradition prohibiting combination of sale and loan contracts. Thus, a product structured on the basis of combination of these two contracts will be against an explicit source of law—hence, impermissible. It is invalid, for example, to give out a credit facility so that the customer, in addition to payment of the amount of the loan, sells goods to the provider of the facility. The reason is that the transaction falls under the principle of loan that accrued benefit, which is vividly disapproved by the *Shariah* (Hammad, 1998, p. 526).

Observation of Impermissible Transactions

A product structured on the basis of a combination of contracts must not be intended to circumvent impermissible transactions, such as *riba*. If the structure appears to involve *riba* or *gharar* in a roundabout way, it then becomes unacceptable. It is argued, for example, that the ahadith that prohibit combination of some contracts presumed that a combination of such contracts involves *riba* transaction. In other words, one may combine an *ijarah* contract and a loan contract in order to benefit from a loan contract in the name of *ijarah*. Some combinations of contracts could involve sale and buy-back arrangements, known as *i'nah*. In this respect, an agreement may be reached for selling an item on a deferred payment basis and then be repurchased on an immediate payment basis. Here, there is a combination of a contract of deferred payment and a contract of immediate payment, which leads to *riba* in the name of an ordinary sale contract (see Hammad, 1998, p. 521).

A product structured on the basis of a combination of contracts must not be intended to circumvent impermissible transactions, such as riba.

The Combination Must Not Involve Contradictory Contracts

It is a necessary requirement for a valid combination of contracts that the principal objectives of the contracts combined do not contradict each other, either customarily or legally. Therefore, if the legal consequences of contracts do not conflict with each other, then the combination becomes valid and acceptable. For example, nonbinding contracts can be combined with each other. However, nonbinding contracts and binding contracts juristically conflict in terms of rulings. Hence, their combination becomes unacceptable. However, it is argued that the majority of the examples furnished by the jurists to clarify contradiction of contracts are in one way or another combinable. This is because in Islamic law contradiction is distinguished from disparity or differences in status. Hence, the majority of contracts are dissimilar in their legal rulings, not contradictory, and, as such, combinable (see Hammad, 1998, p. 522).

It has, therefore, become evident that products that are structured based on a combination of contracts are acceptable when certain rules and principles are observed. This conclusion is further supported by two resolutions on combination of contracts that emerged in a seminar organized by the Kuwait Finance House. One of the resolutions that emerged from the forum held on April 27–29, 1993, states that:

> The *Shariah* does not object to combination of two contracts in one deal (safaqa wahida) irrespective of whether such combination involves contracts of exchange of values or charitable contracts, because of the general sources that ordered Muslims to ful-

fil conditions (they made) and contracts they concluded. This ruling does not apply to the following:

1. combination of contracts in a manner that leads to *riba* or potential *riba* transaction, such as combination of loan contract and other contracts.
2. combination of deferred payment sale and spot payment sale in one deal.

In Islamic banking and finance, the concept of combination of contracts is currently used to offer several services.

Nevertheless, the above-mentioned resolution was not conclusive. Therefore, the committee of the resolution recommended that another forum be organized to discuss various aspects of the combination of contracts or tying arrangements. This saw the birth of another forum organized by the Kuwait Finance House on November 2–3, 1998. It was concluded that:

> It is permissible that a number of different contracts are combined in one contract. This is the case whether these contracts agree or differ in their rulings so long as each contract of the contracts put together fulfils its fundamental *Shari'ah* requirements. It makes also no difference whether the combined contracts are binding contracts, non-binding contracts or a hybrid of both. However, the process of combination of contracts requires that (a) the combination was not prohibited per se by the *Shari'ah* and (b) the combination must not lead to prohibited transactions.

The exceptions mentioned in the first resolution were squashed by the second resolution. This means it is possible to combine loan contracts and other contracts as far as such a combination does not lead to prohibited transactions. This equally applies to a combination of deferred payment transaction and spot payment transaction.

SOME PRACTICES OF THE CONCEPT OF COMBINATION OF CONTRACTS

In Islamic banking and finance, the concept of combination of contracts is currently used to offer several services. A typical example is a documentary credit. The modern Islamic banking scholars had allowed dealings in documentary credit because it combines a number of valid contracts, which are guarantee to pay, agency to carry out some services (e.g., communications, follow-up, and examination of documents), and loan when payment is made on behalf of the client. In the following sections, we will try to shed light on the concept of combination of contracts through discussing some practical examples.

Combination of Contract of Loan and Other Contracts

Combination of Loan and Musharakah

Based on the traditions that prohibit combination of loan and sale, it may be argued that a contract of loan cannot be combined with a number of contracts.[7] This can be clarified by what is known as venture capital based on combination of a loan contract and a *musharakah* contract. A typical example is when one approaches a financier for an amount of 6,000 *dinars* and the repayment will be made after two years. The financed person gives the financier a counter contract that will make the financier recover the amount of his or her debt or to receive 6,000 shares in the venture. If the venture performs well, the financier will definitely prefer to take the shares. This is because their value exceeds the amount of the debt. This constitutes a profit for financing on the basis of a loan contract. If the venture is unsuccessful, the financier will take back the amount of his or her debt.

The absence of practical fund mobilizing mechanisms that will assist Islamic banks and financial institutions to compete with conventional institutions led to the creation of a mechanism called bills of exchange…

The question is whether this form of structure is valid under the principles of Islamic commercial law. It is clear that the mechanism involves a combination of a loan contract and a partnership in profit. Therefore, the finance will be classified as a loan deal. In this sense, the combination becomes invalid because the share in the profit of the venture or to buy its shares less than market price will be in lieu of providing the loan facility and this would be in the meaning of a loan that accrued benefit. This corresponds to the interpretation of the hadith forbidding "two sales in one." It is also trapped under the principle of combination of a sale contract and a loan contract that is explicitly and specifically prohibited by ahadith. This is because if the financier chooses to accept the shares because they appreciate, it will be in the meaning of a prior sale of shares, the countervalue of which is the amount of financing. This constitutes a sale of an item not owned at the conclusion of the contract of loan—hence, not permissible by the *Shariah*. The transaction simultaneously involves uncertainty or *gharar* because it is not clear at the signing of the contract whether the financier is a creditor or a partner. The uncertainty as to the status of the financier affects the validity of the arrangement—hence, impermissible.

Combination of Loan and Hawala

The absence of practical fund mobilizing mechanisms that will assist Islamic banks and financial institutions to compete with conventional institutions led to the creation of a mechanism called bills of exchange or, as it is called in Malaysia, Islamic Accepted Bills

(Haron & Shanmugam, 1997, pp. 177–178). These bills are traded in the secondary market on a discount basis. Islamic Accepted Bills are said to operate on the basis of a *murabahah* instrument. It is argued that these bills represent underlying assets sold on a *murabahah* basis; hence, they may be traded based on sale of debt. The mechanism is simple in that the holder of the instrument might be in need of cash and cannot wait until the maturity date of the bill. The holder of the bill will then sell it at a discount, and the buyer recovers at the maturity of the bill a sum of money greater than the money paid. This is said to be based on the principle of *bay' al-dayn* or debt trading.

Islamic Accepted Bills are said to operate on the basis of a murabahah *instrument.*

The question that arises is whether this instrument is a sale instrument. Although this instrument is commonly known as a debt-trading product,[8] it can be rightly argued, on the other hand, that this instrument is rather closer to the concept of combination of contracts that is manifested in a contract of loan and a contract of *hawala mutlaqa* (i.e., unrestricted transfer of debt or right). This is because the financial institution buying a bill of exchange at a discount is, in fact, as one scholar rightly observed, providing loan facility to the holder.[9] The holder, on the other hand, is empowering, by way of transfer, the financial institution (the buyer) to collect the amount of the debt at maturity from the drawer of the bill. From the Islamic law perspective, the bill is therefore a security for recovery of the debt. This is evidenced by the fact that the accepter of the bill is not at risk of nonperformance by the drawer as clearly endorsed by the civil law principles (Wu & Vohrah, 1979/1991, pp. 326–327). In the event of nonperformance, the accepter of the bill would have a right of recourse to the holder. This process is the nature of transfer of debt according to the *Hanafi* school of law (Usmani, 2000, pp. 23–24). This is because should this transaction be considered a sale, then the financial institution accepting the bill at a discount is not entitled to reclaim payment from the seller in the event of nonperformance.

Combination of Loan and Mudarabah (Qirad) *Contract*

It is noted that the funds that are mobilized by Islamic banks are savings accounts, investment accounts, and current accounts. The first two are juristically classified as *mudarabah* capital, and the accountholders deserve profit on their funds as capital providers. The current account deposits are classified by the majority of modern jurists as loan to Islamic banks. This is because the Islamic banks guarantee the return of the whole or part of current account deposits on demand. They are obliged by the laws of the respective countries to do so. By

this, the current accounts are parallel to the nature of a loan contract in Islamic law (see International Islamic Fiqh Academy: Resolution No. 86 [3/9]). In this case, current account deposits may be combined with the contract of *mudarabah*. It is thus permissible for Islamic financial institutions to structure a product to the effect of converting, with the consent of the current accountholder, a current account into *mudarabah* investment if the client did not withdraw from the account within a specific duration (say, three months). The account will then deserve investment profit from the fourth month onward (al-Darir, 2000, p. 4). In this respect, a combination of loan contract and *mudarabah* has taken place in an acceptable manner.

…the conversion of current account deposits into mudarabah *and assigning it a profit retroactively means regarding such an account as a loan and a* mudarabah *capital at the same time, and this is not possible.*

However, the legal issue arises when the combination of a loan and *mudarabah* is structured to take effect retroactively (i.e., by an agreement between the contracting parties to convert, after lapse of time [say, four months] on the opening of a current account, the current account into a *mudarabah* contract and assign it profit, if any, retroactively). The intention of this structure is to attract depositors. This combination of a loan (current account deposit) and *mudarabah* (assigning it profit retroactively) is not permissible, as it involves the combination of two contradictory contracts in one deal. The explanation is that, as one scholar rightly observed, the transaction remains a loan contract if the client has withdrawn a sum of money from the account in the past three months and a *mudarabah* contract if the client did not withdraw from the account until the stipulated date of conversion. Another legal issue is the uncertainty as to the status of the bank before a *mudarabah* contract takes place. In other words, the question is whether the bank acts as the owner of the money in the current account for being a loan or as a trustee in case such current account is considered *mudarabah* capital. The bank stands between two uncertain situations before conversion. Thus, the conversion of current account deposits into *mudarabah* and assigning it a profit retroactively means regarding such an account as a loan and a *mudarabah* capital at the same time, and this is not possible (see al-Darir, 2000, p. 5; al-Qarri, 2000, p. 8).[10] Therefore, the structure falls under the category of contradictory contracts in terms of objective.

However, if one looks at the structure from binding and nonbinding perspectives, the structure may be acceptable because both the contract of loan and *mudarabah* are nonbinding contracts and therefore are combinable without a *Shariah* objection. The structure may be accepted from the perspective of combination of contract of charity and exchange. The assignment of profit retroactively may be considered under the principle of good performance (*husn al-qada*) as

encouraged by a number of ahadith when it is not agreed upon earlier (Ibn Hajr, 1379 AH, Vol. 5, p. 57), hence creating a combination of a charity contract and a loan contract.

The Hanafi scholars pioneered a structure that combines a loan and mudarabah, *the purpose of which is to protect the capital invested in* mudarabah *transaction against falling below a certain benchmark.*

The *Hanafi* scholars pioneered a structure that combines a loan and *mudarabah*, the purpose of which is to protect the capital invested in *mudarabah* transaction against falling below a certain benchmark. The structure is that, when entering into *mudarabah* investment, the capital provider may divide the capital into two sets of amounts. The higher portion may be presented to the *mudarib* as loan, and the small portion would be the capital contribution in the *mudarabah* venture. The *mudarib* will then contribute the loan to the venture while the capital provider will pay the small portion and share its profit with the *mudarib*. In this case, the *mudarib* is simultaneously a capital provider and *mudarib*. The parties then may agree on the ratio of profit sharing, taking into account that the lender may get a higher ratio of profit. In this structure, the repayment of the higher amount is guaranteed because it was given to the *mudarib* as a loan. This structure is perhaps prompted due to the need to safeguard the capital provider against losses since a *mudarabah* transaction is a contract of trust. In other words, the *mudarib* is not liable for losses except in circumstances of misconduct and negligence. However, there is an argument against this structure because the *mudarib* cum borrower may not challenge the profit ratio required by the capital provider cum lender. In other words, when being given a loan by the capital provider to contribute to the venture, the *mudarib* (fund manager) cum borrower would likely agree to assign a higher profit rate to the capital provider cum lender to compensate the lending aspect. Thus, the additional profit percentage over the normal profit rate deserved by the capital provider cum lender, if there was no lending, is considered a compensation for mere lending. This possibility makes the combination of a loan and *mudarabah* similar to a loan that accrues interest, which is prohibited (al-Misri, 2001, p. 189). On the other hand, it may be argued that the structure is acceptable in the sense that it is, unlike in the case of the combination of loan and sale, a form of guarantee or hedging against uncertain misconduct and actions.[11]

Combination of Two Sales in One Deal

A combination of two sales in one deal is exemplified in the combination of a deferred payment sale and an immediate payment sale. This structure is commonly known in Islamic law as *bay' 'inah* and commonly termed in Islamic banking and finance as a "sale and buyback arrangement." It requires that one sell an item to a buyer on a spot payment basis due to the need to obtain liquidity. The buyer will buy the item from the seller for investment purposes at an agreed-

upon price. Subsequently, the buyer shall promise to sell the instrument to the seller, who shall agree to buy the instrument at a specified price usually less than the purchasing price. As it appears clear, this combination is objectionable in *Shariah* because it involves *bay' 'inah* that is prohibited according to the overwhelming majority of scholars (see al-Mawsu'ah al-Fiqhiyyah, 2002, Vol. 14, pp. 148–149). This is because the seller is selling an item to a buyer on an immediate payment basis so that the buyer will secure liquidity. The seller will then reacquire the item for a higher price on a deferred payment basis. The process is intentionally arranged to take place in this way. This makes the transaction a mere arrangement for executing an advantageous loan contract—hence, impermissible.

It is well known that Islamic banks are actively involved in remittances that, in essence, combine currency exchange and money transfer.

Combination of Money Exchange and Money Transfer Contracts

It is well known that Islamic banks are actively involved in remittances that, in essence, combine currency exchange and money transfer. The Jeddah-based International Fiqh Academy (Resolution no. 84 [1/9]) and *Sharia* Standards (AAOIFI, 2003–2004, p. 101) have argued that financial transfers are permissible whether with or without consideration. If they are provided for consideration, then such a consideration must reflect the actual services rendered. It is noted that the payment to the receiver by way of transfer of money may be either in the currency that is presented by the applicant for transfer or in any other currency. If the payment is to be realized in a currency other than the currency presented by the applicant for transfer, then the process falls under a combination of a currency exchange contract and a money transfer contract. This is because in reality the bank and the client conclude a currency exchange that meets the requirement of possession in currency exchanges. The possession is evidenced by a bank draft, followed by the transfer of the amount of money converted into the currency to be delivered to the applicant's appointee. This combination is permissible, especially in the eyes of the *Hanafi* jurists, who do not require, for the validity of transfer of debts, that the person referred to for payment on the basis of transfer be a debtor to the transferor.

Prepayment and the Combination of Contract

A rebate clause in *murabahah* to the purchase-order transactions plays an important role for early repayments. However, the majority of traditional jurists and modern scholars (see Usmani, 1998, pp. 141–143) argued that a conditional rebate is invalid for being a form of *riba* transaction. Thus, a rebate is only permissible if it is made voluntarily at the time of prepayment. This position made clients of Islamic banks stay away from making early settlements. The Islamic

banks are also compelled to make discounts for early payment, because discount for early payment has become a market practice.

However, this matter could be resolved by applying the concept of combination of contracts. The *murabahah* contract, which is a contract of exchange, can be combined with a contract of *hiba* (gift) or *tabarru'* (donation). For example, the contracting parties could include, at the conclusion of a murabahah transaction, a clause in the documents of the contract to the effect that in case of prepayment, the Islamic bank could make a good gesture in the form of a gift to the client for prepayment without determining the amount or nature of the gift. This good gesture can be in the form of money or tangible asset and constitute a nonbinding clause of promise to make a gift or *ihsan* that is at least morally binding. In this sense, the clause becomes a donation-based clause that does not conflict with the rulings and objectives of exchange contracts. It cannot be said that the clause in this way is similar to the concept of voluntary rebate on the date of prepayment. This is because in voluntary rebate the customer does not know whether he or she will be granted a rebate. In the suggested structure, the customer knows that if a prepayment is made, a discount will be granted based on the promise to donate (as some jurists put it, *wa'dun bi ihsan la jarra naf'an*), which is morally binding. The Islamic bank will, of course, endeavor to fulfill this promise in order to keep its reputation intact. Therefore, the current suggestion benefits both the customer and the Islamic bank without any involvement in *riba*. There is neither unjust enrichment nor gaining of one party at the expense of other party. The *fiqh* literature recorded that a number of jurists would not object to a clause in a loan contract that benefits both parties or benefits the debtor alone (see al-Misri, 1987, pp. 25–41; Ibn Qudama, 1405 AH, Vol. 4, p. 211; Ibn Taymiyyah, 1398 AH, Vol. 20, p. 515; Vol. 29, p. 456).

The murabahah *contract, which is a contract of exchange, can be combined with a contract of* hiba *(gift) or* tabarru' *(donation).*

Combination of *Wakala* (Agency) and *Kafala* (Guarantee)

In several deals, an agreement may be reached to the effect that one party assumes the responsibility of two contracts at a time. Generally speaking, the Muslim jurists opined that it is not permissible to combine agency (*wakala*) and personal guarantee (*kafala*) in a contract at one time (i.e., the same party acting in the capacity of an investment agent on one hand and a guarantor on the other hand), because such a combination contradicts the nature of these contracts. Also, a guarantee by a party acting as an agent for an investment turns the transaction into an interest-based loan since the capital of the investment is guaranteed in addition to the proceeds of investment (i.e., as though the investment agent had taken a loan and returned it with

an additional sum, which is tantamount to *riba*). Ibn A'bidin, a *Hanafi* jurist, argued (see Ibn Abidin, 1386 AH, Vol. 7, p. 368) that agency and guarantee contracts are not combinable in one transaction. The rationale for this is that their combination amounts, among others, to the underwriting of *sharika* (partnership) or *mudarabah* capital.

> *The method of allocating the profit in this combination of contract is that each party will be allocated profit as per his investment from the* musharakah *perspective.*

Combination of *Mudarabah* and *Musharakah*

A contract of *mudarabah* typically presumes that the entrepreneur (*mudarib*) is not an investor. The *mudarib* only manages the fund of *mudarabah*. In return, the *mudarib* is entitled to a share in the profit of the venture. The investor is the capital provider, or *rabb al-mal*. However, for the interest of the venture, the *mudarib* may be in a situation that necessitates mixing his or her money or monies of others together with the business of *mudarabah*. For example, the *mudarib* may encounter a situation in which the *mudarabah* capital is insufficient to enter into certain projects that the *mudarib* realizes as economically viable. In this case, the *mudarib* will prefer to participate in the venture with his or her money or contribution of other interested parties. This mixture of two or more funds with one party assuming investment operations constitutes, according to Ibn Qudama (1405 AH, Vol. 5, p. 16), a combination of *mudarabah* and musharakah contracts in one contract. This combination of *mudarabah* and musharakah is held valid by some jurists. This is because it gives the *mudarib* an opportunity to enter into the partnership while managing the *mudarabah* fund by virtue of general authorization. Hence, it is argued that there is no *Shariah* objection to this form of arrangement. The only requirement for the validity of this arrangement is that the *mudarib* must have obtained permission from the capital provider to do business according to his or her experience and skills in trade and business (see Ibn Qudama, 1405 AH, Vol. 5, p. 29).

The method of allocating the profit in this combination of contract is that each party will be allocated profit as per his investment from the *musharakah* perspective. After this, the profit of the *mudarabah* venture will be distributed between the parties according to agreed-upon ratios. Therefore, the *mudarib* will get profit for his partnership as well as a share in the profit of the *mudarabah* venture, if any. The *mudarib* will allocate for himself a certain percentage of profit on account of his investment as *sharika*; at the same time, he may allocate another percentage for his management and work as a *mudarib*. The normal basis for allocation of the profit will be that the *mudarib* secures one-third of the actual profit on account of his investment. The remaining two-thirds of the profit of the venture shall be dis-

tributed between the *mudarib* and the financier equally or according to the agreement on how the *mudarabah* profit will be distributed. If they have agreed that the total profit will be distributed equally, it will mean that one-third of the profit will go to the *mudarib* as an investor, while one-quarter of the remaining two-thirds will go to him as a *mudarib*. The rest will be credited into the account of the capital provider, *rabb al-mal*. The loss of the venture will be allocated in proportion to the contribution of each party. The remaining, after the deduction of the percentage of loss, will be allocated to the capital provider (see al-Sarakhsi, 1406 AH, Vol. 22, p. 157; Usmani, 1999, p. 215).

In this process, the jurists have regarded the method used for formation of the contracts as a yardstick for determining a permissible combination.

In this process, the jurists have regarded the method used for formation of the contracts as a yardstick for determining a permissible combination. It is argued that it is valid for a person to provide 10,000 *dinars* for another person and ask such a person to add another 10,000 and invest it on the basis of partnership in profit: one-third is for the financier and two-thirds is for the *mudarib*. Ibn Qudama argued that this is a valid combination of *qirad* (*mudarabah*) and *sharika* (*musharakah*), as the two contracts in this example are not connected to each other. By this, Ibn Qudama makes a distinction between tying arrangements and the combination of contracts as explained earlier (see Ibn Qudama, 1405 AH: Vol. 5, pp. 16–17).

Combination of *Musharakah* and *Kafala* (Investment Guarantee)

The combination of *musharakah* and *kafala*, or investment guarantee, can be envisaged in preference shares. In preference shares, the shareholder is guaranteed against any loss, which is a combination of *musharakah* and contract of guarantee (*sharika wa daman*). It is argued that the issuance of preference shares is invalid. This is because the process involves the combination of the contract of partnership and the contract of guarantee, as guarantee is not appropriate in investment contracts. Because if one is entitled to profit, such a person, according to Islamic law, must bear the risk of loss too, in line with the legal maxim *al-kharaj bi al-daman* ("gain is associated with risk of loss"). In other words, it appears as though the issuer of preference shares is calling for partnership in which the risk of loss or the capital of the shareholder is guaranteed. This goes against the principle and purpose of partnership, as this may preclude a sharing of profit.

Mudarabah and *Kafala*

In principle, *mudarabah* typically suggests that a *mudarib* is not liable for losses that are incurred during the natural course of busi-

ness without any negligence or misconduct. The combination of *mudarabah* and *kafala* (guarantee) suggests that the *mudarib* guarantees the *mudarabah* capital against losses. The justification for this mechanism is to provide an Islamic instrument for the mobilizing of savings from the general public and Islamic banks. The combination of these two contracts is controversial among the traditional jurists. The overwhelming majority of the jurists are against such a combination. This is because a guarantee of the capital of *mudarabah* by the *mudarib* is against the nature of the *mudarabah* contract. This stand is adopted by the Jeddah-based International Islamic *Fiqh* Academy, the Mecca-based *Fiqh* Academy of Muslim World League (Resolution: Session 14/1995), the *Shariah* Board of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI, 2003–2004, p. 57), and a number of modern scholars of Islamic banking (see al-Rawdah al-Nadiyyah fi al-Fatawa al-Shari'yyah, p. 61). However, a few jurists are of the view that in certain circumstances a guarantee is appropriate in fiduciary or trust contracts. Therefore, if the *mudarib* voluntarily committed himself to guarantee the capital of the *mudarabah* fund, such a guarantee is valid and enforceable. A guarantee in fiduciary contracts is also valid if the customary practice is that certain entities that operate on a trust basis should be held liable for damage or loss of property under their custody. Some modern scholars strongly support the view that a contract of guarantee can be combined with a contract of trust in the sense that a trustee, such as *mudarib*, be liable for losses of the capital of *mudarabah* (see Hammad, 2001, pp. 396–412). If this view is admitted, then *mudarabah* and *kafala* may serve the purpose of raising funds because the customers are certain that their capital will not be affected by any market trends.

…the combination of contracts leading to novel structures or for the development of a financial product is permissible so far as each of the combined contracts fulfills the requirements of a valid contract.

CONCLUSION

In general, the *Shariah*-nominated contracts are precedents for any new contracts or structures. If one of these contracts cannot serve a particular financial purpose, such precedents necessitate that we put a number of these contracts together to meet the desired financial benefit. Therefore, the combination of contracts leading to novel structures or for the development of a financial product is permissible so far as each of the combined contracts fulfills the requirements of a valid contract. This is because the principle that governs novel contracts, structures, or investments is the general permissibility, or *ibaha*. This is simply because any transaction that could coexist with

well-established principles of Islamic law and serve a valid purpose by lifting hardship from people is considered permissible.

Therefore, a number of contracts in an agreement that is intended to meet a particular financial need should be juristically examined, with the flavor of *Shariah*-nominated contracts, as one component that is not subject to partition. In the process of developing a product through composite contracts, one must ensure that the objective of *Shariah* in legalizing a financial transaction is preserved. In this connection, it is required that the process of combination should not contradict an explicit source of Islamic law or involve any impermissible events of contracts, such as *gharar*, *riba*, and *jahala*. Moreover, the purposes of the combined contracts must not contradict each other, because such a contradiction may lead to a potential instability of a transaction and, hence, invalidation of the combination. Thus, the prohibited transactions are contracts that are interconnected to each other so much that the obligation of one contract is dependent on fulfillment of an obligation in the other contract. These forms of contracts are prohibited because they involve one of the unlawful elements of contracts, such as *riba*, *gharar*, or *jahala*, that may lead to dispute and cause instability of transactions.

…in order to create a viable and acceptable combination of contracts, one must know the different status of contracts in Islamic law (i.e., whether a particular contract falls under the category of binding contracts or nonbinding contracts).

On the other hand, any violation of the general objectives of the Islamic law could undermine the permissibility of a combination of contracts. Therefore, in order to create a viable and acceptable combination of contracts, one must know the different status of contracts in Islamic law (i.e., whether a particular contract falls under the category of binding contracts or nonbinding contracts). For example, there will be no *Shariah* reservation on the validity of the combination of nonbinding contracts to develop products. However, the combination of binding contracts or a hybrid of binding and nonbinding contracts needs an expert in Islamic law in order to identify possible conflicts that may invalidate the combination. It is thus recommended that the *Shariah* supervisory boards be involved from the inception of combination of contracts for developing a particular product in order to avoid waste of time and a possible rejection by the *Shariah* scholars of the product after a long process of deliberations and alterations. The involvement of those with *Shariah* knowledge, especially the graduates of *Shariah* faculties, is also necessary to ensure that products conform to the requirements and rules of Islamic law. Last but not least, the fact that Islamic banking needs viable products to compete in global finance should not be a ground

for defeating the purpose and principles of Islamic law for prohibiting certain transactions.

NOTES

1. *Fiqh* is an Arabic word that literally means to comprehend fully. In legal terminology, it is the volume of law literature as understood by the great jurists of Islamic law.

2. A comprehensive discussion on this terminology was provided by al-Sanhuri (1953/1954, pp. 95–124). In this respect, al-Sanhuri argued that some jurists, especially the *Hanafi* jurists, do not see the validity of a transaction of *ta'dud al-safaqa* because this affects the integrity of a contract and involves *riba* in some cases. However, Islamic law has later developed to allow certain exceptions to the general prohibition of *ta'dud al-safaqa* as they see it. However, al-Sanhuri did not clearly make a distinction between *ta'dud al-safaqa*, *ishtirat shart fi aqd*, and combination of contracts.

3. There are *riwayat* (nonfamous version of views) in some school of Islamic law arguing that the rulings of contracts will differ due to different terminologies of contracts. For example, the term *bay'* (sale) creates a certain legal implication different from using the term *ijarah* (lease). These two terminologies cannot replace each other in any way, although they might share certain features from the objective-based perspective, which is the transfer of ownership (i.e., the transfer of assets in the case of sale and transfer of ownership of usufruct in the case of *ijarah*).

4. A *hibah al-thawab* contract is a contract by which one party makes a gift for receiving consideration in the future. This structure is one of the arguments for legalizing the consideration received by the policyholder in the form of indemnity of the perils insured.

5. The awards of governments for showing a criminal or otherwise are categories of the contract of *ju'ala*. The same applies to incentive options and the like.

6. Some of these contracts are, in exceptional cases, binding, such as in the case of *mudarabah* and *ju'ala* after the commencement of investment and work, respectively. In addition, a loan contract is binding in respect to the date of payment according to the *Maliki* scholars and some jurists of other schools of Islamic law.

7. The reasoning for the impermissibility of the combination of loan and various contracts is that when the provider of the loan is a partner, buyer, seller, lessor, lessee, and so forth, there is a possibility that any transaction involving the provider of the loan will be in his or her favor in one way or another. The provider of the loan may gain additional money or secure a discount. This will make the provider of the loan gain an advantage over the loan in all aspects. For this reason, the *Shariah* does not allow combination of loan and a number of contracts, especially when the structure involves contracts of exchange of values.

8. For the validity or invalidity of sale of debts, see Usmani (1998, pp. 216–218).

9. This concept appears in a number of common law and civil law writings on commercial contracts; see, for example, Wu and Vohrah (1979/1991, pp. 326–327).

10. Al-Qarri had argued for the validity of this mechanism from another perspective by saying that if the client will also share losses, then this structure should not be objected to.

11. In modern Islamic finance, a mechanism of capital protection investment has now surfaced. The combination of loan and *mudarabah* may be used to develop this concept further because the combination of a loan contract and a *mudarabah* contract suggests some hedging tool against investment risks, counterparty risks, and operational risks.

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