



## *Al-'aqd Al-sahih: The Legal Basis for Determining the Validity of Islamic Financial Transactions*

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### ABSTRACT

There is no modern activity premised on Islamic law that does not have a link with one of the traditional practices in the classical Islamic law society. Failure to find its root in the past may even be a justification for such activity to be rejected as alien to Islamic law. The contemporary Islamic financial transactions (IFT) otherwise referred to as Islamic banking system, cannot equally be free from that inevitable litmus test. Consequently, through the principles of *al-'aqd al-sahih* (a valid contract) in Islamic law, the inexplicable requirements for the activities of the Islamic banking and finance (IBF) to be *Shari'ah* compliant could be more easily and reasonably spelt out while the extent of such a compliance could be clearly assessed. This paper, therefore, examines the role of *al-'aqd al-sahih* as the pivotal instrument for validating any IFT and its obligations. Thus, what will make any contract to be invalid in Islamic law is primarily applicable to any IBF transactions in the modern world. The study emphasises the danger in losing the sight of the contractual nature/basis of IBF Transactions and hypothesis that *al-'aqd al-sahih* is the pivotal legal basis for the validity of IFT.

**Keywords:** Islamic Financial Transactions, Islamic Banking and Finance, *Al-'aqd Al-sahih*, *Shari'ah* Compliant, Islamic Law

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### 1. INTRODUCTION

A deep look at the general nature of the modern financial business transactions and the usage of technology to effect its transactions reveals that except for a change in terminology and nomenclature and perhaps, to some extent, in the packaging, it can hardly be said that there is anything new about them. At least, with respect to Islamic law, they cannot be said to have come with principles that were never articulated at all, however scanty it may be. A deep study of the Islamic Financial system reveals this as a truthful juxtaposition. The observation of Nadwi (n.d., p. 15) in this direction instructs this assertion when he posits that:

Most of the trade transactions that go on today are the same thing as that went on thousands years ago. The trade of the Muslim world was conducted under these laws for fourteen centuries, and the abandonment of these laws by the (contemporary) world and by the people who call themselves Muslims today has not brought anything except scandalous luxury and corruption for a few and the most utter misery and oppression

to the vast majority of mankind... The commercial laws that are in use today also derive in large measure from these very laws.

It therefore follows that, for a proper appreciation of the position of Islamic law on any activity, such a kind of activity must be put in the perspective in which a similar traditional activity is placed. This cannot be proved otherwise, as the recent decades have witnessed strong assertion and corroboration of the classical Islamic identities (Alamer et al., 2015), and it is only by adopting this kind of approach that the Islamic issues will not be addressed through the terms that are dictated by other legal systems (Oba, 2004). Thus, a well-grounded approach to any study in Islamic Law must be holistic in nature.

Notably, diverse views have been expressed on the legality of the contemporary Islamic financial transactions (IFT), commonly referred to as the Islamic banking system (IBS). The polemics have so much been heated in arguments that some Muslim writers

have come to the conclusion that what is referred to as IFT or IBS is most un-Islamic, i.e., *haram* (Vadilo, 2006). This has not just been stirred up; it has been informed by inability or ignorance of those who have made that position to appreciate the basis for IFT in Islamic law. This however is not to suggest that, if IFT cannot find any basis in Islamic law, their view will still not be corrects; definitely it will be. However, this paper stands to demonstrate that their view is highly misconceived and most unfounded.

## 2. THE PRINCIPLES OF *AL-'AQD AL-SAHIH* UNDER THE ISLAMIC LAW

A treatment of *al-'aqd al-sahih* as the pivotal legal basis for determining the validity of the contemporary IFT demands a background information on the concept of *al-'aqd* itself. In business dealings, up to the point of mutual agreement, the principles of Islamic law and those of other legal systems like the English common law, for example, are in tandem, and the understanding of one could still be utilized to appreciate the other. Although, it has to be asserted, from the onset, that the concept of *al-'aqd* in Islamic law is connotatively wider when it is compared with the term 'contract' in the common law (Doi, 2008). In the ordinary English language, the term "contract" is defined as "an official legal agreement" (Hornby, 1995). In a legal parlance, the Osborn's Concise Law Dictionary explains that "contract" connotes "an agreement enforceable at law." An essential feature of contract is a promise by one party to another to do or forbear from doing certain specified acts. The offer of a promise becomes a promise by acceptance. Contract is that species of agreement whereby a legal obligation is constituted and defined between the parties to it (Rutherford et al., 1993). In a similar vein, a legal writer on commercial law from the common law perspective, while giving a vivid explanation of what "contract" connotes states that a contract is an agreement which legally binds the parties. Sometimes contracts are referred to as "enforceable agreements." The underlying theory is that a contract is the outcome of "consenting minds," each party being free to accept or reject the terms of the other (Abbott and Pendlebury, 1996). By the provisions of the Islamic Law, however, there are certain salient requirements needed to be fulfilled before *al-'aqd* on IFT could be considered as valid, and these are as highlighted below.

### 2.1. *Al-'aqd Al-sahih* as the Cornerstone of Every *Mu'āmalah*

Within the scope of Islamic law, *al-'aqd al-sahih* is the cornerstone of the various subjects of transactions known as *mu'āmalāt*, and it is under this category that the modern IFT fall. In other words, all forms of transactions in the modern world are regulated through the *mu'āmalāt* (Islamic law of transactions). It therefore follows that in order for any developed Islamic Finance products to meet the Islamic standard, the Islamic principles of *mu'āmalāt* must be the yardstick. *Mu'āmalāt* have been described as "the ways and means by which a man earns his living and makes the necessities of life available to the people." Undoubtedly, as observed by Nadwi (n.d.), there are countless ways of earning a living, but in general outline, people basically obtain their livelihood by means of trade, agriculture, manufacture, labour, investment and partnerships, loans and securities, and by their mental skills. As

long as the IFT is clothed with any of the means of *mu'āmalāt* described above, it will, therefore, be sanctioned as being legal and being valid. In explaining the notions of legality and validity, Doi (2008) clarifies that 'the Arabic word for contract is "*aqd*, which literally means an obligation or a tie. It is an act of 'putting a tie to a bargain.'" When two parties enter into contract, it is called in '*iqad*, that is joining or tying the offer and the acceptance together. The obligations thus arising out of contracts are called '*uqud*.

### 2.2. *Al-mal* as the Subject of *Al-'aqd Al-sahih*

One of the conditions applicable to *al-'aqd al-sahih*, is that it has to centre on the property (Zubair, 1991). Therefore, anything that could not be validly regarded as property in the Islamic points of view cannot constitute the object of *al-'aqd al-sahih*. It should be a yardstick that in order to develop a product for IFT, such a kind of product must qualified as a property (*al-mal*). Accordingly, one could easily distil the legality or otherwise of the modern Islamic banking and finance (IBF) products like *sukuk* and *takaful* etc., if it is assessed from the perspective of whether their object, as being packaged, qualifies each of them as *al-mal* in the context of Islamic law (Doi, 2008).

### 2.3. Observation of the Guiding Principles of *Al-'aqd Al-sahih*

The guiding principles of *al-'aqd al-sahih* in Islamic law are of two kinds; positive and negative. The positive principle is that all transactions must be based on mutual agreement, while the negative principle is that the transaction must not be *batil* (useless or wrongful). For example, in buying and selling, it is necessary that the buyer and the seller should both agree. In the same way when any arrangement is made between an employer and an employee, it is necessary that it be done by mutual consent. If either one of the parties does not consent to the arrangement, then such a kind of transaction in Islamic law, will be declared as impermissible. With respect to the negative condition which is set together with that of mutual agreement, the Islamic law is quite different to other systems in the sense that, it is a stipulated condition that this mutual agreement must not involve any wrongful transaction or anything that is prohibited (Nadwi, n.d., p. 21). It is not enough, as it appears to be the general trends, to pay attention only to the satisfaction of the negative guiding principle by ensuring that any IFT product does not contravene such rules on *riba* (usury), *gharar* (deception) and *maysir* (gambling). Rather, a significant focus should also be placed on the satisfaction of the positive guiding principle by ensuring that there is sincere, voluntary and clear mutual consent into the transactions by the consumers at the receiving end.

## 3. THE TENETS OF *AL-'AQD AL-SAHIH* UNDER THE ISLAMIC LAW

From the foregoing analyses, the following points could be referred to as the tenets of *al-'aqd Al-sahih* under the Islamic law:

- i. *Al-'aqd al-sahih*, under the Islamic law, involves an agreement (mutual when two or more parties are involved), and or a sole decision (when the choice is unilateral, e.g., divorce).

- ii. The subject-matter of *al-'aqd al-sahih* must be permissible under the Islamic law.
- iii. *Al-'aqd al-sahih* must be for lawful purpose (s).
- iv. The scope and limitation of the agreement in *al-'aqd al-sahih* must be observed; e.g., the transaction must not involve *riba* or *gharar* or any other act that is prohibited under the Islamic law.

It must be quickly added here that for every contract to be valid in Islamic law, except for some special contracts that can be unilateral, the conditions of offer and acceptance (*al-ijab wa al-qabul*); consent of parties or valid legal capacities of parties or furnishing of consideration, among others, must be satisfied (Nawawi, 1999). Any transactions where all these factors or elements are found are, therefore, qualified to be regarded as *al-'aqd al-sahih*.

#### 4. RELATIVITY OF THE CONTEMPORARY IFT WITH *AL-'AQD AL-SAHIH*

While it is not disputable to say that it was not too long that Muslims were able to fine-tune what they now regard as the contemporary IFT, it can, however, not be validly said that it is solely a product of the present era because any issue that has affiliation with Islam must be traceable, in one way or the other, to the time of the Prophet or the eras of the rightly guided caliphs. IFT, in this case, is not an exception (Abikan and Jaffar, 2006). Ismail (2015) provides a relatively detailed background information on this when he observes that the origin of Islamic Finance, as with all things Islamic, is dated back to the time of Prophet Muhammad, Peace Be Upon Him (P.B.U.H). Islamic history is replete with the fact that the Prophet (P.B.U.H) himself happened to be an epitome of honesty with regards to his trading activities under Khadija (May Allah be pleased with her), refraining from usury and ensuring transparency. These specific qualities, among others, earned him the title *al-amin* (the trustworthy) in the pre-Islamic Arabia. Many other principles and qualities exhibited by the Prophet (P.B.U.H) came as a result of the direct orders he received from the *Qur'an*, such as the prohibition of interest which now forms the cornerstone of IFT. What will then follow, at this juncture, is to identify the basic products of the contemporary IFT and see what constitute their basis. The most commonly practiced policy and products in IFT are three, and they are as follows:

- i. *Mudarabah* (profit-sharing)
- ii. *Musharakah* (partnership); and
- iii. *Murabahah* (cost-plus sales).

##### 4.1. *Mudarabah* (Profit-sharing)

This has been defined as a contract in which one party; the owner (*rabb al-mal*) provides capital, while the other party (*darib*), brings labor and effort with the intent to share the profit in some predetermined proportions (Moshood, 2003). A critical look at the above definition of *mudarabah*, like any definition for other products that are similar, states categorically that it is a contract. This presupposes that, it does observe the tenets of *al-'aqd al-sahih* earlier outlined in this paper. To demonstrate this further, it must be noted that the parties to the *mudarabah* financial transaction must enter into the contract mutually and freely without any compulsion. Omipidan (2006) aptly explains this point when he says:

One of the conditions governing *mudarabah* is that the *rabb al-mal* or the provider of the finance should voluntarily release the needed capital to the *mudarib*. This means that the decision to release money to the *amil* (agent) must not be coercive, and there should be no concoction or deception either. Where the *rabb al-mal* is forced to provide money, such a contract is vitiated.

Similarly, under this contract, the business to be entered into must be legalized in Islamic law." It must also be stated that, in compliance with the tenets of *al-'aqd al-sahih* under the Islamic law, the Islamic financial institution utilizing the product of *mudarabah* must ensure that the object or material involved in such a kind of transaction should not be prohibited in Islam. It is, therefore, evident that *al-'aqd al-sahih* is the legal basis for determining the validity of this kind of a product.

##### 4.2. *Musharakah* (Partnership)

Generally, the word *sharikah* is the legal term for partnership. But in the modern world, the term is used to refer to both "partnership" and "corporation." Although in differentiating partnership from corporation, a company is called *sharikah musahamah* in some Arab countries. However it may be, the essence of this product is explained by Ruxton (2004) when he says that a partnership, in the widest sense of the term, exists where property is held in common between two or more co-proprietors. It is a contract by which a person alienates an undivided share of his property, in return for an undivided share of the property of another, each having a right to administer the whole. Thus, a partnership, therefore, is a contract by which each partner is authorized and is enabled to empower another to administer the common property. On the other hand, the Hanafis define *sharikah* as a contract between a group of individuals who share the capital and profits. Al-Zuhayli (2003) is of the opinion that the definition given by the Hanafis is the best for the term "*musharakah*" since it explicitly states the nature of partnerships as a contract, whereas the other definitions only mention the goals and outcomes of having a partnership. What Al-Zuhayli is emphasising is no other than a demonstration that *musharakah* has no other basis for its validity rather than being *al-'aqd al-sahih*. This cannot be proven otherwise because if not for *al-'aqd al-sahih* which it has as its basis, how would it have derived its authority from the *Qur'an*, the *Sunnah*, and the consensus of the Muslim scholars? (Mustapha, 2010). The point which must, therefore, be made is that it is because this product of IFTs has its basis as a valid contract that it is been specifically referred by the jurists as *sharikat al-'aqd* (Nyazee, 1997). The recent illustration of this product which Nyazee has come up with, further draw home the point that *al-'aqd al-sahih* is the legal basis through which the validity of this product is determined. To draw curtain on this analysis, it is because of its nature as *al-'aqd al-sahih* that it is stipulated that it can only exist between the persons under no legal disabilities, and it becomes binding by the mere consent of the parties either tacitly in accordance with local custom or expressly by statements which is followed with a conformable answer (Ruxton, 2004). Equally, this kind of a product cannot be inherited by the heir who is not a party to it (Rushd, 1996). All in all, it is clearly demonstrated that being an *'aqd-sahih* is the legal basis for which the contract of *musharakah* is validated.

### 4.3. Murabahah (Cost-plus Sales)

*Murabahah* has been identified as one of the innovations of the modern IFT because it was not, originally, a mode of financing in the *Shari'ah*. By its nature, it is a form of trust sales in IBF (Saliu, 2010). It can, however, be explained as a sale on a cost-price where payment of the price (including the mark-up) is deferred to a later date. A further description *murabahah* implies that it is a form of transaction that covers short term commercial financial agreement. Under a *murabahah* contract, the lender takes the actual title and sells the goods to the borrower on an agreed date, at a profit (Moshood, 2003). Usmani (2009), on the other hand is of the view that *murabahah* is a specific kind of sale where the commodities are sold at a cost-plus basis. What should be of concern here is the fact that *murabaha* is “a kind of sale,” and sale, which is otherwise referred to as trade, is a contract on the basis of being an *'aqd-sahih*. Thus, if this is the case, there cannot be any other legal basis for *murabahah* rather than being an *'aqd-sahih* (Alamer et al., 2015). It must be added here that the ultimate goal of trade in Islamic law is to ensure that the parties mutually relate for commercial purposes, and this is also the targeted notion in the *murabahah* transaction.

## 5. CONCLUSION

This paper has critically examined what could be said to be the pivotal legal basis for determining the validity of IFT. The paper, thus, comes up with a finding that *al-'aqd al-sahih* is the central legal basis for the contemporary IFTs and it occupies, exactly, the position which a contract in the anal of Islamic legal corpus occupies. It is, particularly, demonstrated in the course of our analyses that the evolution of IFT in the modern world is an offshoot of the privilege given by Islamic law to the law of contractual obligations to develop and nourish throughout the different epochs and eras within the limit permitted by the *Shari'ah*. The paper further posits that to declare IBS as *haram* is to declare contracts and all contractual activities of which IFT is one as *haram*. The above submission is particularly significant as it buttresses the notion that says that once there is no dispute as to the permissibility of trading in Islamic Law, the dimension brought into the trading in form of Islamic banking and financial activities should not be a problem as well. IFT have its basis as being an *'uqud* (contracts) which are regarded as valid activities in Islamic law. Therefore, the validity and permissibility that inundated the *'uqud* also inure to the favor of variety of modern contracts and products being developed through the IFT.

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