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WELFARISM IN THE MODERN LAW OF CONTRACT

LATIFAH ALABDULQADER[1]

ABSTRACT

In modern days, there has been an alleged transformation of the law to introduce values of fairness and cooperation. Nevertheless, these notions of fairness are best described as supplementary rather than limiting notions. This indicates that the sanctity freedom of contract is softened but still dominant. The liberal notions of contract seem to be still dominant, and the notion of freedom of contract particularly stands as a serious obstacle to the development of any general doctrine of substantive fairness. However, this paper argues that the modern law of English contract rejects a general doctrine of substantive fairness but not the idea that fairness is a relevant consideration for contract validity. As a result, fairness is dealt with by indirectly and covertly through doctrinal manipulation. This causes issues of inconsistency and stands against the development of the law. In other words, it addresses the extent to which fairness is preserved by the law of contract.

Keywords: Contract, Fairness, Welfarism.

INTRODUCTION

The most fundamental rules of the marketplace are stated by contract law. It serves the enforceability of transactions and imposes restraints on the conduct of obligations created by parties and limits its enforceability by means of self-help or coercion from legal institutions. Furthermore, the law of contract has the potential to enhance community welfare. The marketplace forms a key mechanism for the production and distribution of wealth in most societies. The modern role of contract law requires the balancing of the contractual relationship rather than mere protection of individually acquired positions. Good morals require contractors to act fairly, honestly and to respect the legitimate rights of others. Exploiting vulnerability or weakness of position of the counter-party to yield self interest runs counter to accepted moral standards. This research is concerned with determining when this changes from being a mere moral obligation to become one that is enforced by the English law.

ENGLISH LAW AND PROCEDURAL FAIRNESS

Under the English law of contract obligations are voluntary based on mutual consent. Duress is an essential equity doctrine by which the law ensures that the consent is voluntary and real. Duress is generally regarded as a defect affecting consent in contract and therefore the validity of the consent. Common law duress in its historical form involves actual or threatened violence to the person. It was closely associated with the legal control of criminal and tortuous conduct. The essential elements of duress were established as early as the mid-thirteenth century (Ogilvie, 1980). Early analysis of duress focused on the act of coercion itself and its effect on the victim in inducing fear. The concept of duress in common law used to be a very narrow one that was restricted to actual or threatened physical violence to the person (Peel, 2011). The practice of common law duress in England has developed a wider scope with regard to contractual freedom. Duress is no longer restricted to actual or threatened physical violence to the person but includes the threat to seize another's property or to damage it (Poole, 2012), in addition to mere economic duress. Economic duress consists of using superior power in an 'illegitimate' way in order to coerce the other contracting party to agree to a particular set of terms (Mckendrick, 2010). Furthermore, the focus of the doctrine has turned to the

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wrongfulness of the threatened conduct rather than the consequences to the coerced party (Halson, 1991). It includes unlawful threats and lawful threats which are used to support unlawful demands (Mckendrick, 2010). However, the rough and tumble of the pressures of normal commercial bargaining does not amount to illegitimate pressure (Poole, 2012).

A second doctrine of procedural justice is undue influence. Under the English law the equitable doctrine of undue influence operates to release parties from contracts that they have entered into as a result of being influenced by the other party. Undue influence is presumed where there is a trust relationship between the parties. Generally, it seems that the court would allow release based on undue influence if the claimant's decision was made by excessive reliance or dependence on the defendant (Peel, 2011). The modern approach to undue influence in English law requires wrongful conduct on the part of the defendant. Generally, it is observed that most cases of undue influence contain such an element of 'wrongful' conduct, in the form of an act of exploitation or taking advantage of the claimant's vulnerability (Mckendrick, 2010). Transactions that amount to undue influence are the kind of transaction that claimants would not have entered into under normal circumstances. In other words, it is when the victim receives no benefit from entering into such a transaction (*Bank of Credit and Commerce International SA v Aboody* [1990] 1 QB 923).

The two procedural doctrines of fairness have been developed in modern times to create more limitations within the law of contract. The development of the two doctrines represents the main modern changes in the acknowledgment of contractual fairness in English law. Contractual freedom is restricted by the relatively new development of the doctrine of economic duress and the stress on 'wrong doing' as the basis for the two doctrines. This involves restriction of the substance of the contract since the two doctrines are invoked when there is imbalance between the counter-values of contract (Stone and Devenney, 2015). Nevertheless, the basis of the two doctrines remains procedural since it cannot be invoked unless there is something wrong with the process by which the contract was concluded. As a result, it intervenes into the substantive fairness of the contract in a very limited sense.

ENGLISH LAW AND SUBSTANTIVE FAIRNESS

The way the English law regulates substantive fairness is not as certain or direct as procedural fairness is regulated due to the ongoing ideological battle. Classical law of contract is based on the assumption that free dealing is fair dealing. Justice is enforced in a contract by ensuring that the process by which the contract was concluded has been freely agreed upon (Devlin, 1965). A transformation is said to have taken place in the late nineteenth century with the doctrine of *laissez-faire* falling out of favour (Epstein, 1975). The alleged transformation of the law is understood to have been reflected in the adoption of values of fairness and cooperation. Notions of inequality of bargaining power, unconscionability, reasonableness and good faith were thus introduced to the law of contract (Brownsword, 2006).

The inequality of bargaining powers is invoked as a starting point for the differentiation between consumer and commercial transactions (Brownsword, 2006). Furthermore, the idea of relative bargaining powers is employed in the statutory regimes which regulate exclusion clauses under the test of reasonableness of the Unfair Contract Terms Act 1977.

The notion of reasonableness seems to stand at the core of modern law of contract (Brownsword, 2006). Reasonableness is widely employed in the contemporary law of contract. It is imposed by legislation on several occasions and has a great effect in the rules and doctrinal formation of the modern law. The most obvious example is the test of reasonableness imposed by legislation in the Unfair Contract Terms Act 1977 (Coote, 1978).

In recent years, good faith has been frequently invoked and wide range of literature is devoted to discussion of the principle of good faith. The English court has shown some willingness to acknowledge the principle of good faith by the law of contract (Paterson, 2015;

Summers, 1968; Zhou, 2014). Furthermore, the notion of good faith is employed in the statutory regimes.[2] A contract can be ruled out based on unconscionability if there is evidence of 'taking advantage' of a disadvantageous party. Yet, the courts' requirement of unconscionability is difficult to satisfy and there is hardly ever a successful claim on unconscionability grounds alone (Poole, 2012).

Nevertheless, these notions of substantive fairness are best described as supplementary rather than limiting notions, which soften the rigidity of the law. Despite the alleged transformation of the law, intervention into the substance of contract to fix the balance of the contractual relation remains minimal. Intervention is mainly limited to procedural doctrines of undue influence and duress, and the intervention by the reasonableness test is limited to exclusion clauses. This indicates that the sanctity freedom of contract is softened but still dominant. Although there is a movement towards the creation of a general doctrine of fairness by English common law, such movement has been hampered. At one point, the idea that fairness should be a condition of the validity of the contract prevailed in the courts. This was later on dismissed by liberal ideas and more precisely by the notion of freedom of contract.

The current state of the English law of contract in relation to substantive fairness brings about the next question: does the rejection of a general doctrine of substantive fairness (outside consumer transactions) by the English courts negate the idea that fairness is relevant to contract validity? This question is addressed next.

THE EFFECT OF THE REJECTION OF A GENERAL DOCTRINE OF SUBSTANTIVE FAIRNESS IN ENGLISH LAW

We have seen that the English law of contract has rejected the development of a general doctrine of substantive fairness. By contrast, substantive fairness is promoted and protected under the consumer theory. One might question why the English law would accept that contract fairness is relevant in one case (consumer transactions) but not relevant in the other case (commercial transactions). Obviously, the law is based on the assumption that commercial contractors are always contracting at arm's length and of equal bargaining positions. But what if this proves not to be the case? For example, when a small and newly established company is contracting with a large powerful company, it would be hard to imagine that they are contracting from equal positions. Why would make the law ignore such inequality whilst acknowledging it in relation to consumers? In other words, how does the law ensure that contracting commercial parties are equal?

It is observed that English courts in fact only reject the name of doctrine but not contractual fairness itself (McKendrick, 1999). Even though courts avoid the admission that fairness is a relevant consideration within contract validation, fairness is still evaluated under the guise of other doctrines (Thal, 1988).[3] McKendrick (1999) indicates that as easy as it seems for an English judge to rule against common principles of fairness, a judge will "think hard and long before ruling against principles of good faith and fair dealing" (p. 46). Waddams (1976) observes that even though courts try to show commitment to the freedom of contract, relief is everyday given against agreements that are unfair, inequitable, unreasonable or oppressive.[4] Atiyah (1985) has rejected the idea that contract regulation is still concerned only with procedural unfairness or the bargaining process and not with the substance of the contract. He

[2] For example the duty to act in good faith under the Commercial Agents (Council Directive) Regulations 1993 (SI 1993/3053) and Unfair Terms in Consumer Contracts Regulations 1999 (SI 1999/2083).

[3] Thal (1988) observes that considerations of fairness have often been determined by the court under the doctrines of duress and undue influence. He cites the courts' decisions in the North Ocean Shipping v Hyundai Construction, The Atlantic Baron [1979] QB 705 (duress) and Allcard v Skinner (1887) 36 Ch D 145 (undue influence) in support for his argument.

[4] Waddams (1976) observes that consideration of substantive fairness is viewed by the court in relation to: penalties, deposits, exemption clauses, incorporation of documents, documents and consents, interpretation, duress, protection of weaker parties, withholding discretionary remedies, consideration, and restraint of trade.

says that fairness is protected by courts even without the assistance of statute. It is also widely acknowledged that judges tend to give effect to their sense of justice through constructing contracts or implying terms.[5] Paterson explains that the fairness notions without doubt will continue to be implied into the law of contract regardless of whether the court is prepared or not to recognise a general duty of fairness. This includes the promotion of duties of loyalty to the contract by precluding parties from engaging in dishonest, uncooperative, opportunistic or irrational behaviour that would undermine their commitment to the contract relationship (Paterson, 2015).[6]

At this point one may be confused as to the approach of the modern law of contract towards fairness of exchange. On one hand, fairness and cooperation are important values that are indicative of the modern transformation of the law of contract. On the other hand, the law seems reluctant to adopt a general doctrine that protects the fairness of deals. The tendency of the English law of contract to shy away from commitments to explicit principles of fairness raises questions about its commitment to protecting the fairness of contract. How do the English courts respond to the adversarial values of the law of contract? Or more precisely how do they respond to inequality of bargaining power and unfairness in contracts?

ENGLISH LAW APPROACH TO PROTECTING CONTRACTUAL FAIRNESS

The modern law of contract acknowledges the fact that contractors hardly negotiate from even bargaining positions. To respond to this fact without causing the contract institution to collapse, a corrective approach has been followed. For example, situational monopoly is regulated by the doctrine of economic duress to protect commercial contractors who are being put under pressure to renegotiate a contract (Brownsword, 2006).

As long as the measures employed are taken to be corrective, the institution of contract will remain based on free and informed consent. Modern corrective intervention is taken to be a restatement of classical contract law and the freedom of contract. Brownsword (2006) explains this point in relation to the doctrine of inequality of bargaining power, which could read either as plaintiff-sided or defendant-sided. It could be defendant-sided in the sense that the stronger party has taken unfair advantage of the weaker party and plaintiff-sided in the sense that the weaker party has not given a free and informed consent to the transaction. As long as the measures taken are understood to be plaintiff-sided, the doctrine could be viewed as a restatement of the ideal of freedom of contract. By contrast, if it were to be defendant-sided, it would mean that it is concerned with fairness and militating against unconscionable advantage-taking. The modern law then, according to him, "is taking on a major reconstruction of institution of contract" (pp. 88-92).

In order to respond to these demonstrated problems of unfairness, Sir Thomas Bingham explains that the English law of contract has "developed piecemeal solutions" (*Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] QB 433, p. 439) Honest behaviour in contract is achieved without adopting a general doctrine but rather through "the adaptation of specific rules that, in particular context, make honesty the best policy" (Waddams 1999, p. 237-56). To some, the English approach serves well enough the way it is. McKendrick (1999)

[5] Atiyah suggests that 'it is no longer possible to accept without serious qualification the idea that law is today solely concerned with the bargaining process and not with the result' (procedural fairness but not substantive fairness). He argues that the English court has over the years expressed real concern with substantive fairness. He cites in this regard the decisions of the English Court of Appeal in Staffordshire Area Health Authority v South Staffordshire Waterworks [1978] 1 WLR 1387 and Tito v Waddell [1977] Ch. 106. He adds that even in cases that are based on traditional procedural doctrines such as undue influence and duress, substantive fairness considerations were taken into acknowledgment by the court, in this regard he cites the English court decisions in Lloyds Bank Ltd v Bundy [1975] QB 326, Cresswell v Potter [1978] 1 WLR 255 and Backhouse v Backhouse [1978] 1 WLR 24.

[6] Paterson made this opinion in relation to the principle of good faith in the light of Yam Seng Pte Limited v International Trade Corporation Limited [2013] EWHC 111 (QB).

points out that the refusal to adopt a general doctrine could be taken as evidence of strength in the law. According to him, the English law manages to serve in other ways what different legal systems pursue through a general doctrine of morality. For example, in dealing with the events occurring after the formation of the contract that have the effect of rendering the performance of a contract impossible, illegal or impracticable, English law responds through the distinct doctrine of frustration. By contrast, German law has to resort to the doctrine of good faith to regulate the matter. Thus, it does not make sense to McKendrick (1999) to abandon a clearly-focused doctrine such as frustration in favour of the more amorphous doctrine of good faith.[7]

IS IT TIME FOR RECONSTRUCTION?

Atiyah (1990) has argued that the 'basic conceptual apparatus' of the English law reflects the situation in the nineteenth century rather than the contemporary moment. These values reflect liberal traditions of belief in the value of the rights of the individual. Nonetheless, he argues that current values of society contradict what used to be admirable in the nineteenth century. Therefore, it is the time to revise the concepts to reflect current societal values.

It is preferable that fairness is dealt with directly by a doctrine that makes an explicit ground for it, rather than covertly through the manipulation of technical rules. Indeed, trying to achieve fairness in the absence of a general doctrine produces incoherent outcomes, leaving judges unable in some situations to achieve justice. The answer could be to adopt a general doctrine of morality which would provide coherent regime that enables judges to deal effectively with unfairness (Powell, 1956).

Dealing with the matter explicitly by adopting a general principle (or principles), according to Trebilcock (1976), would serve the ends of constructive judicial law-making as well as rational independent analysis and the evaluation of the aptness of legal rules. He argues that it would even be cost efficient, because it gives guidance to other parties in their actions, through rules that have some generality of application. He explains that "decisions that are ostensibly confined in their application to narrow technical or factual circumstances only relevant to the case under adjudication" (Trebilcock, 1976, p. 384).

So, what would it take for the English law to adopt a general doctrine of fairness? Perhaps the first obstacle to the creation of a doctrine is the question of defining the idea of fairness of exchange and indeed whether the idea of fairness in exchange itself is a theoretically defensible idea (Atiyah, 1985). Moreover, the issue of how to define the limitation on the freedom of contract doctrine is the most difficult to resolve (Thal, 1988). The problem has been raised both by judges and legal scholars.[8] The issue was concisely stated by Treitel, who explains that the alleged principle is very wide and not well defined (as quoted in Peel, 2011). According to him, English courts, unlike American courts, have no intention of taking the matter far to give clarity to the law. Thus, the matter is better left to Parliament (as quoted in Peel, 2011).

Different approaches have been suggested in this regard. Trebilcock (1976) takes the position that in order to have an effective instrument that tackles contractual unfairness, the adopted doctrine "needs to be sharp in its focus, conceptually sound and explicit in its policy underpinnings, and operational in terms of both the process of judicial inquiry it envisages and the remedial instruments available to a court to abate objectionable phenomena" (p. 385). Treitel on the other hand, focuses only on the substantive side of the matter, suggesting that to

[7]McKendrick (2010) failed in making a sensible argument first, because he did not make good bases for his claim that the adaptation of a good faith doctrine requires abounding the doctrine of frustration. Second, he mentioned that German law deals with issues of impossibility, illegality and impracticability in contract formation by referring to the doctrine of good faith whereas in fact these issues are dealt with by legislation through the German Civil Code; illegality is dealt with in section 134, impossibility 275 (1); impracticability 275 (2).

[8] Some of the best discussions of this problem are found in Tiplady (1983); Beale (1986); National Westminster Bank plc v Morgan [1985] AC 686.

have a sufficiently formalised doctrine we need to define what amounts to an unfair outcome (as quoted in Peel, 2011). Thal (1988) rejects Treitel's proposal, and instead proposes a procedural approach. His view is that the only way to define unfairness is by focusing on the bargaining process and not the outcome.

Brownsword (2006) emphasises the importance of having a specific moral reference point. According to him there are two principle options for such a reference point: (1) the standards of fair dealing recognised by the community of which contracts are most proximately a part; (2) the standards of fair dealing that would be prescribed by the 'best'. Though, the latter option looks difficult to justify either in terms of the practical legitimacy of judicial decisions or in terms of their theoretical justification. He sees a tendency in the English law of contract towards adopting morality doctrines to reflect the expectations associated with good practice in both the field of consumer and of commercial contracting.

Atiyah (1985) on the other hand, acknowledges the fact that courts are giving effect to their sense of justice in construing contracts or implying terms. He rightly explains that ideas of fairness and customary behaviour interact. When a judge implies a term to give effect to his sense of justice rather than the intention of the parties, his sense of justice derives in part from patterns of customary behaviour.

This research upholds the conclusion that the English law of contract should deal with substantive fairness of contract directly and clearly through the adoption of a general principle. The fear that the institution of contract would collapse and the uncertainty regarding a moral reference point should not be an excuse to remain bound by values that no longer reflect society. Continuing to serve justice disguisedly and indirectly in addition to being costly and lacking clarity restricts proper development of the law. It would be much more efficient, clear and simple to militate against unconscionable advantage-taking rather than correcting the wrongdoing when it occurs. Furthermore, when the issue is dealt with directly and clearly through an accepted doctrine mentoring the judicial practice will become more practicable. A sense of justice is always derived from customary behaviour. Thus, allowing judicial intervention both in relation to the process and substance of the contractual relation is likely to reflect societal values.

CONCLUSION

The modern law of English contract rejects a general doctrine of substantive fairness but not the idea that fairness is a relevant consideration for contract validity. As a result, fairness is dealt with by indirectly and covertly through doctrinal manipulation. This causes issues of inconsistency and stands against the development of the law. It seems to be primarily the fear that the contract institution would collapse without it that makes the law keen to preserve a liberal ideology that does not reflect current values. However, as Lord Devilin states, "the true nature of common law is to override theoretical distinctions when they stand in the way of doing practical justice" (*Ingram v Little* [1961] 1 QB 31, p. 66). Thus, any obstacle in front of the application of practical fairness should be removed. The English law should respond to modern social and economic developments by adopting a general doctrine of substantive fairness. It should be recognised in the law of contract that liberalisation is no longer the best way to achieve justice. The creation of a doctrine of substantive fairness is a necessary development of the law. The introduction of a substantive doctrine would serve the consistency, efficiency and clarity of the law. Achieving practical justice requires intervention into the process as well as the substance of the contract. Being focused on one aspect of fairness rather than the other is likely to produce unjust outcomes. Furthermore, ignoring contemporary economic and social developments and needs is likely to produce injustice. This is because fairness is a relevant phenomenon that changes with time and circumstances. This is the main issue facing the development of the English law of contract. It struggles in dealing with

perceived injustice as a result of the determination to remain bound by liberal theory while ignoring changes in economic and social factors.

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AL-QISAS: THE PRINCIPLE OF LIFE FOR LIFE AND LIMB FOR LIMB IN ISLAMIC LAW

NADA BALTO[1]

ABSTRACT

This paper analyses retaliation law (*Qisas*) and examines its history, aims, definitions and conditions, including how the commencement of Islam affected communal laws of revenge in the Arabian Peninsula societies, converting them into illicit norms and practices, and what amendments were required to regulate the justice system in relation to homicide cases. A brief history of these unlawful practices clarifies why intermediation became mandatory, and provides insight into the social, moral, legal and political obligations imposed on Muslims. The paper examines certain conditions prescribed in the *Quran*, which ensure the smooth delivery of justice in *Qisas* cases, and the objectives that were sought through *Qisas* law. This paper also discusses the admissibility of pardon in *Qisas* cases, and other practices alien to the Western justice system. The aims of *Qisas* law are analysed, both as rules of law and as a sacred phenomenon designed to uphold the supremacy of God.

Keywords: *Al-Qisas*, Revenge, Homicide, Intermediation, Pardon.

INTRODUCTION

In ancient Arab traditions, the involvement of the victim, his or her family, and the community in sentencing for crimes committed against them was minimal. The justice system was primarily comprised of decisions made by powerful tribe members, and included violent punishment inflicted on victims' families (Kariem, 1999). The inception of Islam in the Arabian Peninsula resulted in a restoration of the justice system and a destabilisation of this well-established and unlawful practice. Divine intervention in the form of *Qisas* law transformed society by reorganising the criminal justice system, increasing the direct involvement of all stakeholders, and denouncing all other illegal practices and customs (Kalf, 2008).

Muslims believe that God revealed *Qisas* law through the Holy *Quran* and *Sunna*, and that it was imposed to replace man-made rules and regulations (Henaiss, 2005). Divine law restricted old practices and introduced new norms that demanded the fulfilment of certain conditions and the ultimate application of justice. *Qisas* rejected unlawful punishment, favoured forgiving the accused over punishing them, dictated the terms and appropriate execution of punishments, and enlightened society as to how restitution could be divided between both parties (Al-Ashquer, 2002). *Qisas* law characterised punishments for homicide cases as inhumane and primitive, and tended to humanise both the perpetrator and the victim of the crime (Al-Sakeir, 2015). It enriched the criminal justice system with a refined mode of punishment designed to provide both retribution and absolution, to the extent that it soon superseded pre-Islamic laws (Shafey, 2003). Placing homicide cases into the *Qisas* category restored justice for victims and their families, requiring victims to instigate both prosecution and punishment to return justice to the hands of victims and their families (Jafer, 2008).

This fresh emphasis on the participation of victims in the sentencing process required the fulfilment of certain conditions that were primarily designed to encourage reconciliation and forgiveness, and to avoid corporal punishment (Al-Najar, 2008). Victims were expected to

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forgive culprits without demanding prosecution, or to request financial compensation (*Diya*). These predetermined conditions were an effort by Islam to seek other punishments and discourage corporal ones (Mansour, 1996). However, *Qisas* did not prohibit jurists or victims from imposing bodily harm on criminals. On the contrary, the law of exactitude is central to *Qisas* cases: 'a limb for a limb' justice requires that the punishment inflicted on the victim must be imposed on the perpetrator (Fahmi, 1995). Islamic justice is characterised by an emphasis on redemption through the noble act of forgiveness rather than punishment, and the evaluation of all relevant circumstances before deciding upon punishment (Al-Elwani, 2001).

THE HISTORY OF *AL-QISAS* PUNISHMENTS

Revenge was the pre-Islamic punishment for homicide. Pre-Islamic Arabia was filled with tribal hostility and aggression. Friendly cooperation was rare and only existed among members of the same tribe, and hostility was a compelling motive for revenge (Ouda, 1998). As a result, both the offender and the offender's tribe could be subject to revenge, especially in cases of homicide. In ancient Arabia, it didn't matter if the crime was committed by one offender alone; his or her whole tribe could undergo a chain reaction of revenge. Trivial "disputes could result in bloodshed, and it could take years to end such disputes" (Kariem, 1999, pp. 56-61). Tribe members associated such matters with their prestige and honour and would go to any extent to regain their social status (Ez-Aldien, 1996). Ultimately, these practices created an extremely violent atmosphere in which revenge was common between tribes and no consideration was given to peace or forgiveness (Kariem, 1999). However, ancient Arabs did consider peaceful alternatives in some cases, including blood money (*Diya*). The status of the perpetrator and his or her tribe defined the amount to be paid.

The inception of Islam led to rapid social development and significant improvements regarding the legal position of individuals (Al-Elwani, 2001). Islam reorganised the Arab region to establish strong and stable roots for human interactions and relationships (Al-Malky, 2013). Islamic societies replaced the ancient tribal social order with the newly established Islamic legal system under the authority of God (Al-Alwiet, 2015). After Islam triumphed in Arabia, the area witnessed a drastic transition from the custom of revenge to *Qisas* law, under which injury could be inflicted on the perpetrator without reference to the tribal status of the murderer or victim (Kalf, 2008). Legal scholars, including Mohammed Fahmi, argue that *Sharia* law's punishment for homicide (*Qisas*, or capital punishment) has a dual nature: as well as acting as a deterrent, it also benefits the victim in that punishment is imposed and compensation is provided (Shafey, 2003; Fahmi, 1995). This notion was also supported by ancient Arabs who believed that *Qisas* was an Islamic innovation which required the state to inflict punishment for homicide cases (Fahmi, 1995).

Islam gave decisive rights to all individuals, and crimes which nullified those rights resulted in retaliation (Al-Ashquer, 2002). Islam provided the option of either demanding punishment or pardoning culprits and claiming blood money. *Qisas* punishments are applied in cases of bodily harm or killing (Kalf, 2008). According to *Qisas* law, as defined by the *Quran* and *Sunna*, if someone killed another person, the victim's family could demand that the culprit be killed, or forgive the culprit and settle for blood money (Abu-Rakiea, 2010). The victim's family should decide the amount of blood money according to the nature of the crime (Jafer, 2008).

AIMS OF *AL-QISAS* PUNISHMENTS

Al-Qisas punishments are characterised by two common elements: imposing the same harm on defendants that they inflicted on victims, which discourages and limits crimes like homicide (Jaradat, 2012); and an emphasis on the process of establishing guilt, which protects the accused party and reduces the chance of unfair punishments (Fahmi, 1995). Islam

established the practice of waiving punishment in the presence of uncertainty and introduced the principle that the accused party should always enjoy the benefit of the doubt (Shafey, 2003). A strict procedure regarding the reporting of crime is stipulated, and punishments cannot be awarded unless reliable witnesses prove the crime in court (Hussny, 2006). *Al-Qisas* punishments are also designed to allow pardon, which is not considered in the modern legal systems. Pardon according to Islamic law may result in repentance (Fahmi, 1995).

Laws such as those regarding homicide drastically changed the concept of revenge that was common in the pre-Islamic era (Al-Katieb, 2009). Islam restricted the punishment to the accused person alone rather than including his or her family and tribe and introduced the concepts of *Diya* and the victim's right to pardon. These revisions were enacted to uphold the supremacy of God, justice, and peace (Al-Sadlan, 1997).

Since Islam stipulates equality between all members of society, it tends to diminish differentiation between rich and poor by awarding equal punishments (Al-Elwani, 2001).The Islamic legal system does not include pecuniary punishments; for example, it lacks the imposition of penalties or monetary fines, with the exception of *Diya* (Al-Katieb, 2009). However, blood money in Islam is fixed and can only be imposed if the injured party wishes to accept it (Shafey, 2003). Islam also discourages exaggeration in stipulating the amount of *Diya,* encourages a moderate *Diya* that is appropriate to the perpetrator's social status, and rejects the conversion of punishment into blood money until the victim or the victim's family approve this course of action (Karieb, 2012). The aim of *Qisas* is thus to give culprits a chance to redeem themselves, rather than to act as a licence to avoid punishment.

Any punishment in Islamic criminal law, including *Qisas* punishments, is prescribed in divine revelation by God and granted to Muslims by the prophet Muhammad. These punishments are thus considered to be sacred phenomena that serve the sacred purposes of restoring social justice, protecting religious interests, and providing protection for possessions and morals (Abdullah, 2006). Islamic criminal law determines the relationship between the members of Islamic societies, defines the connection between Muslims with their God, and defines the rule of law (Hussny, 2006).

Since *Qisas* punishments are prescribed in both the *Quran* and *Sunna*, they may be considered as the cornerstones of Islamic criminal law (Mentawi, 2015). The preventive function of these severe punishments, as they have been incorporated into the Islamic legal system, should be considered in a positive light. Islam does not advocate punishment unless it can serve as a deterrent (Al-Beisher, 2001). The *Quran* and *Sunna*, the main sources of Islamic law, provide stable, steady provisions for the Islamic legal system (Fahmi, 1995).

The most important aims of *Al-Qisas* punishments are to correct criminal activity, prevent future crime, and enforce Islamic values (Jaradat, 2012). Punishment should therefore be considered as corrective measure which imposes criminal liability on culprits by depriving them of their freedoms and rights. Punishment can only be administered after the crime has been committed, or when it is predicted, if the crime is retaliatory (Karieb, 2012).

THE DEFINITION OF THE *AL-QISAS* PRINCIPLE

Qisas can be defined as a noble principle: the principle of life for life and limb for limb (Fahmi, 1995). This principle gives injured parties and their heirs the absolute right to impose the same injuries on offenders. It applies to all killings and certain kinds of serious wounds or damages (Kalf, 2008). Islam provides the family of the victims of murders or bodily injury a right to apply *Qisas* against the convicted party after a fair trial (Al-Fasy, 2012). For bodily injuries, *Qisas* allows victims and their families the right to execute the same type of injury suffered at the hands of the perpetrator, on the perpetrator themselves. For example, if a victim of a crime loses his or her eye during an attack, he or she can retaliate by inserting a sharp, red-hot needle into the attacker's eye once they have been found guilty (Karieb, 2012).

Qisas and *Diya* are prescribed punishments under Islamic law for murder and bodily injuries. The *Quran* and the *Sunna* dictate two specific conditions regarding *Qisas* for body parts and wounds, about which there is a consensus among notable Muslim scholars: the punishment must not result in injustice or transgression, and the body parts must be equivalent in both name and location. Retaliation must be accomplished by cutting off the same body part from the same specific joint. If there is no clear specification of the extent of the retaliatory injury required, retaliation cannot be granted (Kutb, About Islam, 2005). For example, if a perpetrator breaks someone's tooth, his or her tooth must be removed just as violently to fulfil the condition of *Qisas*. Amputating an offender's right arm does not fulfil the conditions of *Qisas* if the victim's left arm was amputated. Similarly, a ring finger cannot be amputated in retaliation for the amputation of a little finger. This condition applies to all body parts, including the hands, eyes, legs, and ears (Abu-Rakiea, 2010).

The rule of exactitude applies strictly here. If a victim accidently inflicts more damage to the perpetrator, he or she is also in violation of the law, and therefore subject to punishment (Al-Fasy, 2012). The Ministry of Interior is responsible for the execution of *Al-Qisas* punishments. Because this rule of exactitude discourages the victim's retaliation, Islam introduced the concept of compensation. Offenders and victims can agree on blood money to settle their disputes instead (Al-Najar, 2008). *Qisas* punishments in cases of murder and bodily harm therefore range from inflicting the same injury to the payment of financial reparations (Al-Katieb, 2009).

Importantly, blood money varies in accordance with the nature of the crime. For example, more money is owed in cases of intentional murder than in those of manslaughter (Karieb, 2012). According to the Prophet Muhammad, "Whosoever kills a believer unjustly will suffer retaliation for what his hand has done unless the relatives of the murdered man consent otherwise. And therein it was: A man shall be killed for the murder of a woman. And therein it was: For the murder of a life, there is blood wit of 100 camels" (Abdullah, 2006, pp. 36-41).

CATEGORIES OF *AL-QISAS*

Qisas can be further divided into two broad categories: homicide and bodily harm. *Qisas* enables defendants to be liable for compensating victims and their families for wounds they have inflicted or murders they have committed in the form of *Diya* (Kalf, 2008), and enables victims and their families to inflict identical injuries on perpetrators (Peters, 2005, pp. 54-58). Islam gives equal rights to all Muslims, and this egalitarianism extends to the right of *Qisas*. With respect to physical harm, the *Quran* maintains, "Remember that the recompense of an injury is an injury the like thereof; but whoso forgives and thereby brings about an improvement, his reward is with Allah. Surely, He loves not the wrongdoers" [042:040]. According to the Islamic penal code, therefore, an equal requital is given to the injured person (Hub-Allah, 2005). Mohammed Al-Mashehadany criticises this requital as uncivilised and primitive (Al-Mashehadany, 2006), but others such as Mohammed Kutb argue that because divine guidance, human inclination, and nature remain the same, primitive rules do not necessarily require updating (Kutb, Implementation of Sharia, 1998). According to the *Quran*, individuals' rights to retribution transcend those of the state or community, and individuals can never take the law into their own hands. Islamic law also suggests that individuals try settlement first to avoid the irreversible procedure of trials and punishments, which involves time, effort, expense, and the interference of government (Jafer, 2008).

CONDITIONS NECESSARY FOR *AL-QISAS* PUNISHMENTS

The first and most important condition of *Qisas* punishments is that they only apply in cases of deliberate murder or wounding, and are not valid punishments for accidental killings or

injuries (Shafey, 2003), offenders in these cases are responsible for paying *Diya* (Karieb, 2012). Retribution only applies in intentional murder or injury because God says in the *Quran*, "O you who believe, retribution is prescribed for you in the case of murder" [2:175]. Another vital element of *Qisas* punishment is that the retaliation must be clear, and there must be enough evidence to support its execution on the perpetrator. In other words, if Muslim jurists cannot exactly determine the appropriate retaliation for injuries due to lack of evidence, *Qisas* cannot be executed (Abu-Rakiea, 2010).

One example of an injury case is that of 24-year-old Ali al-Khawahir, who allegedly stabbed his childhood friend and was punished under *Qisas*. The stabbing had occurred ten years previously during a heated dispute between the two, and al-Khawahir left his friend paralysed from the waist down. The *Sharia* law, which is imposed in Saudi Arabia, dictated that al-Khawahir's punishment be based on the 'eye-for-an-eye' principle. However, there was the option of pardon if both parties agreed to legal compensation. The court sentenced al-Khawahir to pay one million riyals to the victim or be surgically paralysed. If al-Khawahir failed to provide financial compensation for his offense, he would be paralysed from the waist down for the rest of his life (Al-Essamy, 2014).

The second condition of *Qisas* punishments is that the rights of the victim must be fulfilled. The victim (or his or her family) has the freedom to decide whether a defendant should be punished. The judge hearing a case must therefore inquire of the victim (or his or her family) about their right to pardon the offender (Jafer, 2008). The *Quran* says, '"if anyone waives the right to retaliation out of charity, it shall be an expiation for him" [5:45]. In this way, Islam encourages the victim to pardon the criminal by promising rewards in the afterlife. However, this infrequently occurs in contemporary Islamic legal proceedings. Pardon can be granted with or without financial compensation (Hussny, 2006).

The third condition of *Qisas* punishments is that the state or government must carry out the pronounced punishment. The victim (or his or her family) cannot take the law into their own hands and carry out the punishment themselves (Al-Elwani, 2001). The punishment should be implemented publicly by the Ministry of Interior.

CONCLUSION

This paper has thoroughly assessed the law, history, objectives, definitions, categories, and conditions of *Qisas*. It explains why it was necessary to formulate a justice system that combats social ills and extends justice to all stakeholders and demonstrates the necessity of divine intervention in regulating crimes and punishments to increase stability, promote peace within Islamic societies, provide justice, and halt the victimisation of individuals. *Qisas* eliminated unlawful practices and provided Muslims with just discourse (Al-Katieb, 2009). It is necessary to thoroughly define the law and the principle of retribution it codifies to form a better understanding of its characteristics, principles, and prescribed punishments (Al-Zehaily, 2013). This examination of *Qisas* further demonstrates that it is based on noble principles. Strictly applying the law of exactitude eliminates discrimination and transgression and encourages forgiveness and financial restitution.

These legal practices are still alien to many Western legal systems and often carry negative connotations, because the concept of blood money has been overlooked in Western discourse about restorative justice. However, Islam made blood money a fundamental part of *Qisas* law because it offers much-needed solutions to *Qisas* crimes (Fahmi, 1995). *Qisas* law is designed to comfort victims and their families rather than benefit guilty parties. A murder or injury can have severe repercussions for victims and their families. When they are given the choice to settle for money, it can save them significant trouble, and may encourage them to forgive the murderer (Al-Saqier, 2015). This emphasis on forgiveness encourages the promotion of equal rights and maintains a focus on promised rewards and advancement towards

an impartial and healthy society. *Qisas* law has immense potential to support Muslim morality and foster harmony within Muslim societies by eliminating disparities between the rich and the poor, the dominant and the weak, and the resourceful and the uncompetitive (Hussny, 2006).

This paper has also discussed the role of the judiciary and state in *Qisas* cases. While victims must instigate punishment for *Al-Qisas* crimes, judges and policy-makers must ensure that all of the necessary conditions are met and that the chosen punishments are carried out (Abu-Rakiea, 2010). The implementation of preferable or excessive punishments by victims or their families would certainly lead to unlawful activity; victims thus do not have the right to take the law into their own hands, and authorities must be responsible for penalising the accused in public (Kalf, 2008). This paper also provides an example that illustrates Saudi Arabian application of *Qisas* law, because Saudi Arabia is one of the few countries that strictly enforces *Sharia* law (Mentawi, 2015). There have been instances when victims have forgiven culprits, instances when they have settled cases by accepting financial compensation, and instances when victims' families have demanded that murderers be executed. In all three types of cases, the Kingdom ensures the provision of justice based on *Qisas* principles as defined in the *Quran* and *Sunna* (Al-Essamy, 2014).

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LEGAL FRAMEWORK OF CORPORATION AND SHIRKAH AL-INAN: A COMPARISON

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ABSTRACT

Under the civil law, the metaphor of corporate personality is used to justify the existence of the corporation as a legal person. As a creature of the statute, the existence, opertation and dissolution of a company is governed by the Companies Act. Such a principle is not found to be applicable to *Shirkah al-Inan*, which has been assumed by many *Shariah* scholars to be similar to a civil corporation. With the recent vast and rapid development in *Shariah* compliance businesses such as Islamic banking and finance and halal products, it is important to study whether *Shariah* businesses could be carried out inside a civil law business structure. This paper analyses the legal framework of civil corporations and compares them with *Shirkah al-Inan* to highlight the misconception of many scholars that *Shirkah al-Inan* is similar to a civil law corporation.

Keywords: Corporation, *Shirkah 'inan*, Juristic person.

INTRODUCTION

In Malaysia, there are four types of business entities, namely sole proprietorship, partnership, company, and limited liability partnership. All these entities were established under specific legislation. It is interesting that all Shari'ah compliant corporations in Malaysia, such as the Islamic Bank (BIMB), are registered under the Companies Act which was based upon the English and Australian Companies Act. BIMB is essentially an *'inan* company; a separate legal entity based on the concept of *al-musyarakah*. The issue arise is whether the concept of the body corporate is comparable with the concept of partnership or *sharikah* in Islam. This paper discusses and compares the concept of the corporation with *Shirkah al-Inan*. The main objective of this paper is to highlight the misconception of many scholars that *Shirkah al-Inan* is similar to a civil law corporation. This paper also seeks to propose a basic legal framework of *Shariah* compliant companies which adhere to the *Shariah* principles.

CORPORATIONS IN MALAYSIA

In Malaysia, all companies must be registered under Companies Act 1965 which accords them the status and attributes of a body corporate. The legal effect is a body corporate shall be an entity separated from its incorporator. The doctrine of separate legal entity was introduced by English common law through the decision made by the court in the Solomon's case[3]. This doctrine has received its application in Malaysia via the Companies Act 1965 (Act 125). Section 16(5) laid down the effect of its incorporation, namely:

> *A company shall be regarded as a body corporate, capable of exercising all the functions of an incorporated company.*

The term 'body corporate' is not defined under the Companies Act 1965. However, generally it covers both 'companies' and 'corporation'. Both of these terms are defined under Section 4 of Companies Act 1965: a corporation can be defined as anybody corporate formed or

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[3] *Salomon v Salomon & Co Ltd* [1897] AC 22.

incorporated or existing within Malaysia or outside Malaysia and includes any foreign company. 'Corporation' is one of an artificial legal person. In the case of *Tan Lai v. Mohamed Bin Mahmud*[4], Salleh Abas FJ,held that it is a "body corporate" as a result of statutory acts of the Registrar of Companies for which it is capable of exercising the functions of an incorporated. In addition to that, Zakaria Yatim, J in *People's Insurance Co (M) Sdn Bhd v. People's Insurance Co Ltd & Ors*[5] [1986] held that under the ordinary rules of law, a parent company and its subsidiary company, even a wholly owned subsidiary company, are distinct legal entities.

A company will have the right of suing and being sued.

In the case of *Foss v. Harbottle*[6], the court had established the rule which is known as the 'proper plaintiff rule' whereby in this case, the court held that, A member of the company cannot sue on the company's behalf to enforce a company's rights. If a director breaches his duty to the company, it is the company who has the right to sue him. A member cannot sue the director on the company's behalf. Similarly, if a contracting party breaches his contract with the company, it is the company who has the right to sue the contractor. In the case of *Lee Eng Eow (as director of Lee Guat Cheow & Co Sdn Bhd) v Mary Lee (as executrix of the estate of Low Ai Lian) & Ors*[7], the Court of Appeal had laid down the statutory effects of an incorporation, whereby an incorporated association has a legal personality of its own apart from the persons who comprise it; even though it is not specifically provided in the Companies Act 1965.

A company will have perpetual succession.

To illustrate this point, in the case of *Abdul Aziz Bin Atan v. Ladang Rengo Malay Estate Sdn. Bhd.*[8], despite changes in the membership, the corporate entity continues unchanged as decided in *Re Noel Tedman Holdings Pty Ltd*[9], the company may even continue to exist despite the death of all its shareholders and directors.

A company will have the power to hold land and other property.

Article 9 of the Third Schedule to the Companies Act 1965 provides that a company possesses the power to purchase, take on leases or exchange, hire and otherwise acquire any movable or immovable property. Besides, such rights are also conferred onto states by the National Land Code (Act 56 of 1965), where section 43(b) conferred on the State Authority with the power to dispose the land to the corporations.

Even though section 16(5) of Companies Act 1956 only mentions the right to own land, a company also possesses the right to own other sort of property (Han, 2005). The property will be treated as the company's own and not the shareholders' (Zuryati et al., 2009; Hassan, Abd Ghadas and Abd Rahman, 2012). Therefore, even if a person owns all the shares in the company, he does not own the company's property, nor does he have any legal or equitable interest therein (*Macaura v. Northern Assurance Co. Ltd.*[10]).

The liability on the part of the members to contribute to the assets of the company in the event of its being wound up are provided by the Companies Act 1965.

For example, according to s. 214(1)(d) of Companies Act 1965, in the case of a company limited by shares, the liability of its members is limited to the amount unpaid on his or her shares in the company. This was noted as one of the benefits enjoyed by the members of the limited company (Rachagan et al., 2005). The above discussion clearly highlights that the

[4] [1982] 1 MLJ 338
[5] [1986] 1 MLJ 68
[6] (1843) 67 ER 189
[7] [1999] 3 MLJ 481
[8] (1985) 2 MLJ 165
[9] (1967) QdR 561
[10] [1925] AC 619

Companies Act 1965 adopted the English principle of corporate entity, which give rise to all the statutory attributes of a corporation.

Therefore, we may conclude that there are two types of person recognised by the law. The first one is the natural person or human beings; and the second is the artificial person (*Tan Lai v. Mohamed Bin Mahmud*[11]), which includes any being other than human beings which the law recognises as having duties and rights. One of the most recognised artificial persons is the corporation. Thus, we can see that the doctrine of separate legal entity is a fundamental legal principle which draws a distinction between an incorporated company and those people who have a control over it. A company will continue unchanged even if the identity of the participants in it changes.

THE CONCEPT OF SHIRKAH IN ISLAM

Shirkah (or *sharikah*) refers to partnership between two or more persons. Literally, *Shirkah* means a mixing of shares (*khalat*) until it could not be distinguished from the other while according to *Syara'*, *shirkah* is a transaction between two or more people which have agreed to perform some work for the purpose of profit (Susamto, 2014). According to Ibn-e-'Abidin, *Shirkah* has also been defined as a contract between two or more people for participation in a capital and its profit (Hafeez, 2013).

THE LEGALITY OF SHIRKAH IN ISLAM

In *surah an-Nisa*: 12, Allah swt stated:

> *And for you is half of what your wives leave if they have no child. But if they have a child, for you is one fourth of what they leave, after any bequest they [may have] made or debt. And for the wives is one fourth if you leave no child. But if you leave a child, then for them is an eighth of what you leave, after any bequest you [may have] made or debt. And if a man or woman leaves neither ascendants nor descendants but has a brother or a sister, then for each one of them is a sixth. But if they are more than two, they share a third, after any bequest which was made or debt, as long as there is no detriment [caused]. [This is] an ordinance from Allah, and Allah is Knowing and Forbearing.*

In another verse, Allah said:

> *[David] said, "He has certainly wronged you in demanding your ewe [in addition] to his ewes. And indeed, many associates oppress one another, except for those who believe and do righteous deeds - and few are they." And David became certain that We had tried him, and he asked forgiveness of his Lord and fell down bowing [in prostration] and turned in repentance [to Allah].* (*As-shod*, 24)

TYPES OF *SHIRKAH*

Muslim jurists have unanimously agreed that *shirkah* is permissible in Islam but they dispute the division of it. According to Abdurraham Al-Jaziri in *Kitâb al-Fiqh 'alâ al-Mazâhib al-Arba'ah*, Hanafiyah, divided *shirkah* into two types i.e. *shirkah al-milk* (non-contractual partnership) and *shirkah al-uqud* (contractual partnership).

Shirkah al-milk (non-contractual partnership) implies co-ownership and comes into existence when two or more persons have joint-ownership of an asset without having entered into a formal partnership agreement, for example, two persons receiving an inheritance or gift of land or property which may or may not be divisible. The partners have to share the gift, or inherited property or its income, in accordance with their share in it until they decide to divide it (if it is divisible, e.g., land) or sell it (if it is indivisible, e.g., a house or a ship).The *shirkah al-milk* can be divided into *shirkah al-milk ikhtiyariyyah* for which the partners still decide to

[11] [1982] 1 MLJ 338

stick together even the property is divisible and, if it is indivisible it will be characterised as *shirkah al milk jabariyyah* ((involuntary). The essence of *Shirkah al-milk* is common ownership of property and it will not be considered as a partnership in a strict sense so long there is no mutual agreement with regards to sharing profits and risk.

However, according to Sayid Sabiq in *Fiqh Sunnah*, *shirkah al-milk* is not allowed because each partner has a right to deal with their portion of property without the need of authorisation from the other counterparty. While according to Wahbah Zuhaily in *Al-Fiqh al-Islâmī wa Adilatuhu*, each partner should be treated as separate entity and was not allowed to deal with the shared property without authorisation from other partners**.**

Shirkat al-'Uqud means two of more people coming together making a contract for the investment of their profit. According to Hanabilah, *shirkah* comprising of five types; shirkah 'inân, mufâwadhah, abdân, wujûh dan mudhârabah. While, according to Hanafiyah, *shirkah* is divided into *syirkah amwâl, a'mâl, dan wujûh* and each type was further divided into mufâwadhah dan 'inân. Referring to *Mâlikiyah dan Syâfi''iyah*, *syirkah* is divided into four types; *shirkah*, *'inân*, *mufâwadhah*, and *abdân dan wujûh*. The differences in these categorisations will lead to different rulings. However, the Muslim jurists unanimously agree on the permissibility of *shirkah inan*, but they have some disagreement on other types of *shirkah*. Syafi"iyah, Zahiriyah dan Imamiyah consider all types of *shirkah* as void except *'inân* and *mudhârabah*, while Hanabilah recognised all types of *shirkah* except *shirkah mufâwadhah*. Malikiyah recognised all types of *shirkah* except *shirkah wujûh*. Hanafiyah and Zaidiyah prefer to recognise all types of *shirkah* as long as its formation is not contrary to the injuction of Islam (Susamto, 2014).

According to Chapra, *Shirkah al-'uqud* (contractual partnership) can, however, be considered a proper partnership because the parties concerned have willingly entered into a contractual agreement for the joint investment and sharing of profits and risks. The agreement can be done orally and informally. However, it would be preferable if the *shirkah al-'uqud* is formalised by a written agreement with proper witnesses, specifically stating the agreed terms and conditions in conformity with the *Qur'anic* teachings about loans and important business transactions (al-*Qur'an*, 2: 282-3). Just as in *mudarabah*, the profits can be shared in any equitably agreed proportion. Losses must, however, be shared in proportion to capital contributions. For *mazhab Shaf'i*, profits should be divided in proportion to capital contributions. This is because the contribution of labour (or skill and management) is difficult to measure and it is assumed that labour will be contributed equally. Profits, like losses, should also be in proportion to the risk shared. However, if two partners contribute to the capital and only one of them works, then even according to the *Shaf'i* school, the working partner's share in the profit should be higher.

Shirkah al-abdan is where the partners contribute their skills and effort to the management of the business without contributing to the capital.[12] In *shirkah al-wujuh* the partners use their goodwill, their credit-worthiness and their contacts for promoting their business without contributing to the capital.[13] Both these forms of partnership, where the partners do not contribute any capital, would tend to remain confined primarily to small-scale businesses.

[12]This is also called *Shirkah al-a'mal* (partnership in labour or management), *shirkah al-sana'ah* (partnership in crafts or art) and *shirkah al-taqabbul* (partnership in contracting) ; *Shirkah al-abdan* is not recognised by al-Shaf'i, according to whom *shirkah* arises from the pooling of only financial resources because, as indicated above, the contribution of work and skills cannot be measured precisely and it is assumed that all partners will contribute these equally to the partnership (Ibn Rushd, 1960) .

[13]*Wujuh* is the plural of *wajh*, which means face, and refers here to the strengths associated with a person's own reputation, goodwill and credit-worthiness. *Shirkah al-wujuh* or credit partnership is not recognised by the Maliki and Shafi'i schools (Ibn Rushd, 1960).

In the case of *al-mufawadah*, the partners are adults, equal in their capital contribution, their ability to undertake responsibility and their share of profits and losses, have full authority to act on behalf of the others and are jointly and severally responsible for the liabilities of their partnership business, provided that such liabilities have been incurred in the ordinary course of business. Thus each partner can act as an agent (*wakil*) for the partnership business and stand as surety or guarantor (*kafil*) for the other partners.[14]

Al-'Inan on the other hand does not require all partners to be adults or have an equal share in the capital. They need not be equally responsible for the management of the business. Accordingly, their share in profits may be unequal, but this must be clearly specified in the partnership contract. Their share in losses would of course be in accordance with their capital contributions. Thus, in *shirkah al-'inan* the partners act as agents but not as sureties for their colleague.

Hence their liability towards third parties is several but not joint.

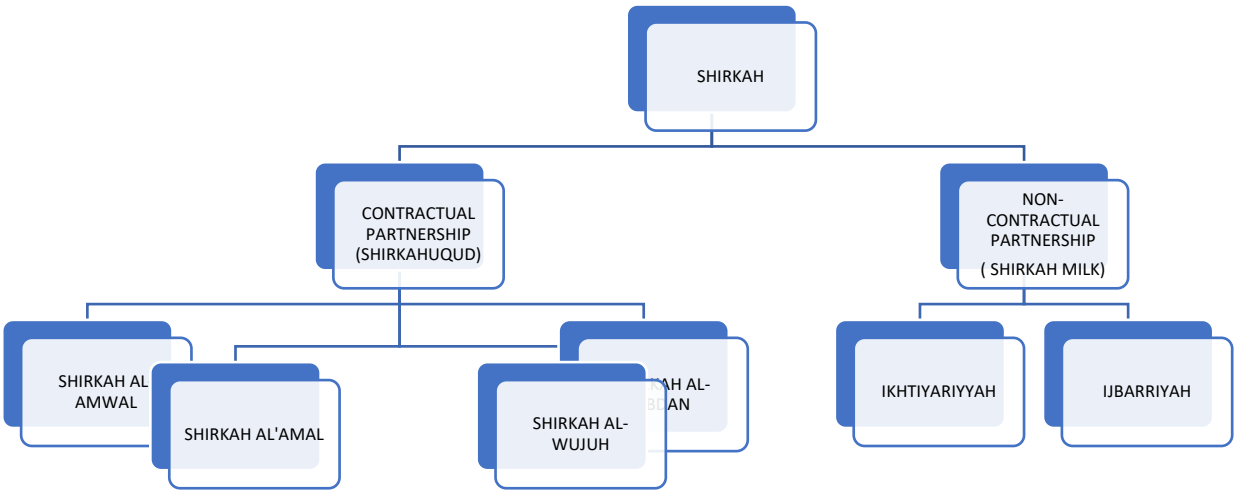
To summarise, below is the table on differences opinion of four *mazhab* regarding the types of *shirkah*.

Table 1. Differences opinion among four *Mazhab* regarding recognition of types of *Shirkah*

Mazhab	Inan	Mufawadah	Abdan	Wujuh
Malikiyah	/	/	/	
Syafiiyah	/	X	X	X
Hanabilah	/	X	/	/
Hanafiyah	/	/	/	/

Figure 1 is a diagram on the types of *shirkah* according to majority jurist and each type of them was further divided into *mufâwadhah dan 'inân*.

Figure 1. Types of *Shirkah*



Practically, the partners may contribute not only finance but also labour, management and skills, credit worthiness and goodwill, and may not necessarily provide these equally. The most popular and widely-used form of partnership is the *shirkah* '*inan*, which implies unequal shares and is recognised by all schools since it is more practical. In the case of *Inan*, the profits may be divided in accordance with a contractually agreed proportion, since the *Shari'ah* admits an

[14]The Hanafi, the Maliki and the Hanbali schools, all recognize *mufawadah* partnership, with some differences. The Hanafis require that there be equality of the partners in net wealth and that the entire net wealth should enter the partnership business. The Malikis do not consider this to be necessary. They require only the equality of capital contributions (Ibn Rushd, 1960; Al-Sarakhsi, 1978).

entitlement to profit arising from a partner's contribution to any one of these three business assets. However, the *Shari'ah* makes it absolutely imperative that losses should be shared in proportion to the contribution made to capital. This is because losses, as already indicated, constitute an erosion in equity according to the *ijma'* (consensus) of the jurists and must be charged to the capital. If a loss has been incurred in one period, it must be offset against profits in the subsequent periods until the entire loss has been written off and the capital sum has been restored to its original level. This may be done in one stroke or in instalments depending upon circumstances and the understanding of the partners. However, until the total loss has been written off, any distribution of 'profits' will be considered as an advance to the partners. Accordingly, it would be desirable to build reserves from profits to offset automatically any losses that may be incurred in future (Chapra, 1998).

Contractual principles in *Shirkah*

The existence and validity of *shariah* business structure is mainly based upon contractual principles. Apart from the main contract such as *mudharabah* and *musharakah*, there are specific underlying contract as basic rules that govern relationship between partners, their various right and liabilities and even the right owed to the third parties. There are four basic contracts that can operate on a partnership. All four contracts however do not exist simultaneously in one partnership contract. These contracts are the contract of *amanah* (trust), the contract of *wakalah* (agency), the contract of *kafalah* (surety) and the contract of *ijarah* (hire).

The contract of *kafalah* does not operate in *Muzaraah*, *Mudharabah* and *Musaqah*[15] . While a contract for *ijarah* does not have any role in *inan* and *mufawadah* and thus, it will not be discussed further here. The underlying contracts for *shirkah inan* are the contract of *amanah* and *wakalah*.

OBSERVATIONS

The concept of *shirkah* '*inan* has been used to define companies in many Islamic countries and by Shariah scholars. Various types of *Shirkah* are reflected under common law such as *syarikah al-tawsiyyah al-basitah* for a company limited by guarantee, *syarikah al-musahamah*, *al-tawsiyyah bil-asham* and *zatul mas'uliyyah al-mahdudah* for a company limited by share. The various names of the *sharikah*/companies limited by shares are due to the flexibility and compatibility of Islam, based on the principle of *'urf'* (custom), to suit the changing nature of modern world of trade and business. The shareholders of these companies have limited liabilities according to the portion of shares held (al-Zuhayli, 1995). However, Zuhayli does not specifically state the principle of neither separate legal entity nor juristic person (*syakhsiyah maknawiyah*) on the nature of these companies.

According to Zuhaily (1995) referring to Ibn al-Mundhir,'*inan'* is a form of partnership where the partners share the capital, as well as profits and losses, is approved by consensus (1995). These partners in a *sharikah 'inan* need not be equal in their contributions to capital, nor equal in their legal rights for using the property. Thus, one party may contribute more than another to the partnership, and one of the partners may have the exclusive right to run the affairs of the partnership. Given this potential for great variation in legal rights of dealing in the joint property, each party is only responsible for dealings that he himself performed. Thus, while they share the profits according to any rule they agreed upon in the contract, the only share losses in proportion to their contributions to the partnership's capital. The general rule is

[15] *Muzaraah* is an agreement in which one party agrees to allow a portion of his land to be used by the other in return for a part of the produce of the land; while *Musaqah* is a contract in which the owner of agricultural land shares its produce with another person in return for his services in irrigating the garden; and *Mudharabah* means a type of partnership for profit which is structured so that one partner provides capital and the other provides labour and expertise. Source; www.islamicfinancenews.com/glossary retrieved on 26th February 2017

summarized thus: "profits are shared according to the parties' conditions, but losses are shared according to their shares in the capital" (Al-Zuhayli, 2003, p. 452).

The Joint Stock Company business is regarded as akin to the contract of *Shirkah* in Islamic legal system by the Islamic jurists. They considered that the incorporation of company having the status of distinct legal personality is permissible in *Shari'ah* (Islamic law). They argued that:

> *The limited liability of the master of a slave who carries on business on behalf of his master was also cited. In such a case the initial capital for the purpose of trade was provided by his master, but the slave was free to enter into all the commercial transactions. The income would also vest in him, and whatever the slave earned would go to the master as his exclusive property. If in the course of trade, the slave incurred debts, the same would be set off against cash and the stock in the hands of the slave. But if the amount of such cash and stock would not be sufficient to set off the debts, the creditors had a right to sell the slave and settle their claims out of his bid price. However, if their claims still remained due even after selling the slave, or the slave would die in that state of indebtedness, the creditors shall not approach his master for the rest of their claims. Here, the master was actually the owner of the whole business, the slave being merely an intermediary tool to carry out the business transactions. The slave owned nothing from the business. Still, the liability of the master was limited to the capital he invested including the value of the slave. After the death of the slave, the creditors could not have a claim over the personal assets of the master. This business practice was followed in the days of Holy Prophet (P.B.U.H)* (as quoted in Hafeez, 2013, p. 105).

The above statement mirrored limited liability of shareholders in a conventional company. Generally, Islam recognised the existence of body corporate as mentioned earlier; however, the corporate form of business organisation, with a separate legal entity, does not appear directly in the classical *fiqh* discussions. However, in Islam, *Shirkah* does not separate the entity from its partners, for they are treated as one unit. This is because, life and *dhimmah* (i.e. liability) can only be attributable to human being to which they are granted with rights and are capable of performing their responsibilities. Dhimmah are not something which can be transferred to a non- living entity. Islam treats human beings at the highest level. They are endowed with '*aql* and the power of disposition, to which they have the will of their own in performing their duties and obligations.(Azrae, Yusoff and Ayub, 2009)

Imran (2003) further opposed the existence of separate legal entity in *Syariah* law, and termed it as fictitious or artificial person. The concept of separate legal entity that a company is a fictitious person, which is relied upon on the instances of *waqf* and *baitul mal* and the estate of deceased, has been regarded as misplaced assertions by modern Muslim jurists. According to Imran (2003) the concept of *syarikah* will lose its significance if the concept of separate legal entity is acknowledged in *Syariah* law. In consequence, the acceptance of the principle will shatter the whole structure and violates the fundamental principles of Syariah law, particularly law of contract. Hence, there is a strong opposition to the concept of legal persona for a corporation (Zuryati, Yusoff and Azrae, 2009).

Another point which is of concern is the fact of absolution of debt arising from 'limited liability' which is designed to avoid and deny payment of debt. It is the position in Islam that the liabilities will hang on the necks of debtors even on the day of *Qiyamah*. Human beings are the only entity endowed with the life in this world and in the hereafter. Their actions in their lifetime will be carried forward to the Judgment Day. The individuals who have incurred any liability have to pay it: the claims shall remain here and will remain in the day of *Qiyamah*. A

partner's liability will not be limited to the amount they have put in. Whilst the profit distribution ratio is decided according to what is agreed, the loss is distributed relative to the amount or shares each partner invests in the business. Thus, there is no limited liability in Islam. Taqi Usmani (2006) is known as a supporter of separate legal entity, however, he himself has some reservation on its application. The concern is that the company, while the liability of the shareholders are limited, being exploited as a vehicle of fraud. This is also the basis for the adversaries that the principle is incompatible with *Syariah* law. On the other hand, on the apprehension of the company being utilised for avoidance of law or fraudulent purposes, though understandable, may be dealt with the application of exception to principle of separate legal entity that is, lifting the corporate veil. Though the exception only exposes the 'real' person behind a company, the liability is still limited to the portion of his shares without extending to his personal properties. In other words, the exception to the principle of separate legal entity does not fully solve the problem of companies being used for fraudulent purposes.

Obviously, there is a misconception about the application of *shirkah inan* in a body corporate. As mentioned by Hafeez (2013), some of the jurists argued the concept of corporate entity and limited liability does not breach the ruling of Islam by giving an example of master and slave in the trading. According to them, the master was actually the owner of the whole business, the slave being merely an intermediary tool to carry out the business transactions and therefore the liability of the master was limited to capital that he invested. This is a clear misunderstanding in the concept of *sharikah* in Islam. In Islam, the underlying contract of *shirkah* or partnership is based on *wakalah* for which the principal and agents was treated as one entity. Even, if the underlying contract is based on *amanah* and *kafalah*, still, there is no room for limited liability of the owner. Thus, according to (Alkhamees n.d.) , The doctrine of limited liability is seen as a breach of the *Shariah* prohibition on *Gharar* (uncertainty or excessive risk). This is based on many prophetic Hadiths such as "The delay (in paying a debt) of a person who is able to pay is oppression", and "Whosoever takes from the wealth of a Muslim person with a transgressing hand then let him make a house as an abode in the Fire of Hell", as well as the legal maxim Al Kharaju Bi Al-daman ("entitlement to profit or gain depends upon the corresponding liability for loss").

CONCLUSION

There are many differences between a company and a *Shirkah al-inan*, mainly based on the legal status of the latter which is not separated from the partners and does not exempt liability of the partners. The doctrine of corporate personality also cannot be explicitly applied in *Shirkah al-Inan*; thus reaching the conclusion that to define companies as *Shirkah al-Inan* is incorrect and misleading.

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APPRAISING THE ROLE OF LENDER OF LAST RESORT: A COMPREHENSIVE STUDY OF FEDERAL RESERVES, BANK OF ENGLAND AND STATE BANK OF PAKISTAN

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ABSTRACT

This research enunciates the functions and the significance of the lender of last resort (LOLR) with reference to contemporary financial issues. Primarily, the research provides the conceptual underpinning of the doctrine of LOLR and divulges that the ambit of the role of LOLR was nothing more than liquidity; hence, it could not get attention by the policy makers until the recent global financial crisis of 2007-08. It further explores the progression in the responsibilities of the Central Banks (CBs) after the financial crisis of 2007-08. Equivocal financial challenges eroded the contentions and paved the way for the LOLR and made it an inevitable part of the functions of CBs. Qualitative study is applied to carry out this research. It appraises the operations of LOLR during the crisis and highlights the lacunas of current legislation regarding it. The present research explains the emergence of Federal Reserves as a CB for the United States and unfolds its rescue operations to strengthen the financial institutions during crises. It also evaluates the gaps of the Federal Reserve's Act, 1913 and extensively explains the significance of Dodd-Frank Act, 2010. Additionally, it studies the financial challenges of the United Kingdom and the operations of the Bank of England as LOLR. In the current hour, the financial system of Pakistan is enduring numerous financial challenges; nonetheless, there is not much scholarly work done in this context. This research highlights regulatory problems and suggests reform proposals, therefore, it will immensely contribute to the literature and benefit the concerned researchers of this area. The laws which legitimate the powers of CBs as LOLR are also studied. Finally, it provides a comprehensive discussion regarding the moral hazard problems which are inseparable in the presence of LOLR and argues that how effacing these problems could be for the system.

INTRODUCTION

This research critically evaluates the role of LOLR played by the Federal Reserves, The Bank of England and the State Bank of Pakistan. It is divided into six parts which appraises the role of domestic and international LOLR. First part enunciates the functions of LOLR and their significance in the modern economic system. Second part explains its nature before the financial crisis of 2007-2008. It further unfolds how it has been emerged after the financial crisis. Third part is further divided into three parts, its first part explains the operations of Federal Reserve's second part explains the role of Bank of England and the final part divulges the role of State Bank of Pakistan as LOLR. Fourth part unfolds the laws of the US, UK and Pakistan which legalize the functions of LOLR in their countries. Fifth Part provides the opinion of the scholars who have criticized this role and are against its presence in the financial systems. Final part of this chapter extensively evaluates the moral hazard problems pertaining to it.

FUNCTIONS AND SIGNIFICANCE OF LENDER OF LAST RESORT

In the modern economic system, it is a common fact that financial institutions can face liquidity shortage and it is only the CB of the state which is empowered to generate liquidity to fulfill

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its demand. There is no separate institution which is authorized to exercise the powers of LOLR. It is a vigorous part of the duties of CBs at domestic level and IMF which is a branch of World's bank performs the duties of international LOLR (Wallich, 1987). Usually, the understanding of LOLR is that the CBs intervene by lending liquidity to the financial institutions which need liquidity. The uncertain situation of the financial system and surging panic among investors invoke the operations of LOLR to enhance the resistance of the financial institutions against crisis (Giannini, 1999). However, impartation of the liquidity by private individuals or the institutions to the financial markets cannot attribute the role of LOLR to them because it is a part but not the entire function of this role. This role is not limited only to provide liquidity but has several functions. The stability of the financial system lies on trust of the depositors however; ups and downs are part of its activities (Fischer, 2016). In the modern financial systems, the institutions are working with each other hence they provide loans to the financial institutions which are facing problems. However, in some circumstance when they are unable to handle the issue and CB realizes that it could be detrimental for the system it operates as a LOLR (Humphrey, 2010).

Sir Francis Baring (1797) argued that the Bank of England holds this power to lend liquidity when all other financial institutions failed to do so. Henry Thornton and Walter Bagehot has designed the characteristics of LOLR and explained the insight behind its operations (Fischer, 2016). The impartation of liquidity in the apprehension of a financial crisis is different from lending a loan. The CBs have responsibility to govern the system not to protect individual institutions. Therefore, the liquidity assistance in the operations of LOLR can only be granted to solvent institutions. The core function of the CBs as a LOLR is not to intervene during special circumstance but it is obligated to take all necessary steps to make an indomitable system. The dread of a crisis is more annihilating for the survival of the system than the shortage of liquidity. It is a vital part of the functions of the LOLR to ensure the trust of the stakeholder on the system. The reason behind establishing a CB is to have an institution which can regulate the financial system and have the powers to implement its policies (Bordo, 2014).

The functions of LOLR are enhanced and it is no more merely a facility of liquidity during crisis. It is regarded as a tool to govern the economic system. Thus, to give the monitoring and financial policy of the state is also an important part of this role. It must have an accurate check and balance of the system and diverge the insolvent financial institutions. The regulations regarding the functions of LOLR must be well clear that in which circumstance and on which grounds its assistance can be availed. It also ensures the trust of the domestic and foreign investors on the system by taking all necessary steps. According to the needs of the system, it provides opportunities to the financial systems to excel their businesses. Finally, if the financial institutions start facing liquidity shortage and are unable to overcome the problem by the normal loan facilities of the market. (Tucker, 2014). The CB extends its support of liquidity as a LOLR to abolish the problem of liquidity and curtail the panic of a crisis. The mandate of the role of LOLR is not limited to impart liquidity but it can also purchase the illiquid assets of the financial institutions which are in trouble (Tucker, 2014). Normally, to fulfill the demand of liquidity the financial institutions start selling their illiquid assets and a rapid sale always deteriorate the value of the assets and make the situation worse for the institutions to handle. Therefore, the functions of LOLR are not limited to certain operations, it can go to any limit for the survival of the system (Obstfeld, 2009).

The functions of an international LOLR are limited as compare to those of the domestic one. It is no more a contention if the modern global economic system requires an international LOLR or not. The failure of domestic system has effacing effects on the world's economy (Truman, 2010). Financial institutions seek help from the CBs when they face difficulties and

the CBs in their difficult times ask the IMF to rescue them which is currently working as an ILOLR. (Landau, 2014). It can ask foreign investors to invest in the country which is facing liquidity problems or ensuring the existing investors that it will rescue the CB when it will be needed which eliminates the panic and allows the system to stabilize itself. The ILOLR can play a role of a consultant however; it cannot give the financial policy of the states. Like the domestic LOLR, the IMF cannot purchase the assets of the CB which requires its assistance. It can make its support conditional that the CB which needs its help must provide a viable financial policy that it will be able to return the money (Truman, 2010).

In the modern economic era, the significance of LOLR cannot be denied. Its salient functions and successful role in the recent financial crisis make it an inseparable part of the functions of the CBs at domestic and IMF at international level. Liquidity shortage and minor financial panics are common in the current financial systems which can be converted into a large financial crisis if there is no institution which can lend liquidity to address such problems. A trivial liquidity issue can escalate the apprehensions of crisis and make it difficult for even a solvent institution to survive. Large financial institutions in the absence of a LOLR will be mighty in the financial system and will make the conditions of loan facility unapproachable for small institutions. The rationale behind having a LOLR on domestic and international level is not merely to have an institution which will provide liquidity in difficult times but to make such an effective and efficient system where all institutions enjoy the same rights and can excel. However, to achieve this goal it requires a proper legislation to regulate this role according to the insights of having it. (Landau, 2014).

FEDERAL RESERVES AS LENDER OF LAST RESORT

Every financial system strives to maintain the stability of the system and back the financial institutions in tough economic conditions which requires a CB. The first CB for the United States was created in 1791 and it is known as the Bank of the United States. It was established to fulfill the traditional duties of a CB to assist the federal government in its financial matters. It was authorized to emit notes which were accepted by the federal government in making financial payments. Though, it was not well accepted unanimously by the inhabitants of the USA and particularly its private ownership allows it to work as an independent institution rather as a government institution. Hence, even after 20 years, it was unable to get approval from the congress to continue working as a CB. In 1836, President Andrew Jackson used his powers and rejected the bill of the extension of the second CB of the US (Powell, 2017). Absence of a CB was causing harm to the system and country had faced many financial crises in 1839, 1857, 1873, 1893 and in 1907. It was realized that the presence of an institution which can give monetary policy and help the financial institutions when they face liquidity problem the happening of these crises can be curbed. Minor financial institutions can create panic among the creditors and create a situation when the financial institutions will be unable to address it. The CBs are designed to help the financial institutions when the demand of liquidity rises and prevent the financial crisis. The CBs were collaterals hence, they were lending liquidity to the solvent institutions and allowed them to fulfill the demand of liquidity without selling of their assets. In the outset of 20th century, the US didn't have a CB hence; it had faced many crises one after another. Finally, the financial crisis of 1907 paved the way for the establishment of Federal Reserves though many economists were still opposing the idea of having a CB and were arguing that the powers should be granted to the regional bodies (Oganesyan, 2013).

The Federal Reserve Act (FRA) 1913 empowered the Federal Reserve to play the role of LOLR and lend liquidity to the financial institutions which were facing liquidity shortage. In the recent global crisis, the role of Federal Reserves is commendable as it took a radical approach to deter the crisis. It did not rely on the traditional lending policies and took unconventional step to prevent the financial institutions from collapsing which also played an

important role to extend the conception of LOLR. Sections 10-B, 13 and 14 of FRA 1913 legalized the operations of Federal Reserve as LOLR. In the starting of 2007 the Federal Reserve lent liquidity to the financial markets to enable them to resist the crisis. Although Bagehot emphasized that high interest rate should be charged to curtail moral hazard problems, but it was reduced to encourage the banking sector to lend each other which worked well to stabilize the system (Herr, Rüdiger and Wu, 2016). Federal Reserve's completely ignored the principles of Bagehot and directly lent to the insolvent institutions. Basically, it lent freely to nationalize AIG company which worked well to stabilize it. The Federal Reserve also followed the parable of the Bank of England and purchased the illiquid assets of the financial institutions which were forced to sale them rapidly because of the liquidity demand. This step provided liquidity to the financial institutions and prevented the depreciation of their assets (Dobler, 2016).

The role of LOLR is regarded as a vital part of the modern economic system however; it was not warmly accepted by many economists because of the moral hazard problems. In the case of Lehman Brothers when the Federal Reserve refused to lend liquidity it was badly criticized by the economists. It was perhaps the biggest bankruptcy in the history of United States and left many lessons for the financial institution to be learnt. The presence of LOLR allows the financial institutions to ignore the consequences of risky investment because they believe that they will eventually be rescued if there will be a panic which creates moral hazard problems. To address the issue of moral hazard problems Federal Reserve has set an apt precedent in the case of Lehman brothers. Although, the Federal Reserve has played a very effective role to resist against the financial crisis, even then it was observed that there are many lacunas in the legislation and this significant role cannot be left on the discretion of Federal Reserve therefore; it needs to be legislated. (Tucker, 2014). The United States which was struggling to have a CB which can play a role of LOLR when the financial institutions need liquidity is now leading in expanding the doctrine of LOLR. After the recent financial crisis to address the loopholes of the existing laws and fixing the moral hazard problems United States has enforced Dodd-Frank Act 2010. It provides principles on which the financial institutions will be provided with liquidity (Judge, 2016).

BANK OF ENGLAND AS LENDER OF LAST RESORT

This part of the research explains how the Bank of England (BOE) adhered itself with the insights of Sir Francis Baring and played the role of LOLR for the financial institutions during crisis. It is important to appraise the operations of LOLR in previous crisis to get guidance. As Lord Mervyn King (2016) said, "During the crisis, I found that the study of earlier periods was more illuminating than any amount of econometric modelling" (p. 90). The evolution of the LOLR is extensively described that although the BOE had lent liquidity in Eighteenth century but lending liquidity to the financial institutions when they need it, is a duty of the CB which was established in the last quarter of Nineteenth century. It is important to evaluate if the BOE has altered its policies after accepting the role of LOLR or not. There is no evidence which can enunciate that there was an empirical change in the policies of BOE henceforth. It was criticized because of having the primary aims of profit maximization that there is a conflict of interest and it cannot hold the position of CB (Anson et al., 2017).

The BOE has played the role of LOLR in the crisis of 1847, 1857 and 1866. Bagehot (1873) described the rules for LOLR which were followed by the CBs around the world. Bagehot's doctrine has three main principles of lending i) the CB must lend freely ii) it must lend at a high interest rate iii) its lending must be against worthy collaterals. Although, it can be evinced by the operations of the BOE as LOLR that it has freely lent liquidity, but it was lent only to few institutions. Like the other CBs there were no regulations regarding LOLR. Thus, BOE has also used its discretionary powers and lent three-fourth of the total amount of

liquidity to the top five borrowers. The principle of charging high interest rate was strictly followed in the crisis of 1857 and 1866. The interest rate was more than the commonly practiced rate. Nonetheless, in the crisis of 1847 the interest rate on the lending of BOE was even below than the normal market rates. Therefore, it can be argued that there was no absolute condition for the lending of liquidity in the operations of LOLR that it cannot be lent on the interest rate less than the normal rate. Finally, the principle of lending against worthy collaterals was also practiced but the BOE has again used its discretionary powers to evaluation the collaterals and did not follow the same rules for all enterprises (Anson et al., 2017).

The principle behind the operations of LOLR is that it will only intervene and lend liquidity to the financial institutions which are experiencing liquidity problems but are not insolvent. In the cases of Barings and Yorkshire Penny Bank (YPB) when both were unable to fulfill the demand of liquidity sought assistance from the BOE were recused because they were illiquid not insolvent. However, in 1878 the City of Glasgow Bank (CGB) were refused to get liquidity support because the collaterals which were produced by the CGB were not accepted as a good security. It is however, an unaddressed issue that how the CB will determine if the financial institution is illiquid or insolvent (Anson et al., 2017). Baring was rescued and had established an argument that it was merely illiquid, but it took four years to settle its liabilities. Many institutions were declared insolvent and could not get the support of LOLR would be able to settle their liabilities if were granted several years like other institutions. In the case of Northern Rocks, the BOE has used an entirely different approach and instead of lending liquidity the BOE decided to nationalize it because it was not befitting for the system to let it fall on the grounds of not having good securities.

Tucker (2014) expressed his views that it was a tragedy that the role of LOLR was neglected in the major policy debates of central banking and no effects have been made to legislate on it. Albeit, the significance of the LOLR in modern financial system cannot be denied but leaving its functions on the discretion of CB will be fatal. The role of BOE as a LOLR during the financial crisis was well regarded by many economists however; it is also emphasized by all the policy-makers that like the issue of moral hazard problem it is also important to frame a regulatory frame-work for the functions of LOLR. The absence of an effective regulation will continue to allow the BOE to use its discretionary powers to judge if the financial institution is insolvent or merely illiquid. Hence, this role will remain controversial and it will not be possible to achieve the desired goals (Tomasic, 2009).

STATE BANK OF PAKISTAN AS LENDER OF LAST RESORT

Pakistan is among the developing countries and its banking sector is still evolving. State Bank of Pakistan (SBP) holds the gold resources of the country and has power to emit notes. It is the only institution which can lend liquidity to the financial institutions when no other institution is capable of lending (Raja, 2009). The SBP plays the role of LOLR to strengthen the financial institutions against crisis. However, its functions as being a LOLR are equivocal and still emerging. The State Bank of Pakistan Act 1956 legalize the LOLR operations of SBP. Due to unprogressive financial policies and unproficiency in the operations of LOLR, Pakistan has faced sever financial crisis. In this modern era the role of LOLR is not merely to lend liquidity in crisis, it has several functions to protect the system from recession as it was described. (Altaf, 2016). The panic among the creditors is the most annihilating factor for the financial system which the CB should eliminate while performing the role of LOLR. The SBP lent liquidity to many financial institutions to stabilize the system and issued many new notes to fulfill the demand. However, the emittance of new notes rapidly deteriorated value of the currency and caused inflation. Therefore, Pakistan sought the assistance from IMF which is playing the role of international LOLR.

The role of LOLR has been emerged swiftly after the recent financial crisis in developed countries especially in UK and USA. Nonetheless, it is still not the part of major financial debates of the financial and economic forums of Pakistan. The Islamic Banking is an emerging sector in Pakistan however; there is no legislation and clear policy of the SBP that in case if this sector faces the liquidity crisis who will play the role of LOLR (Umer, 2015). There are no set principles for providing liquidity support and it will not be befitting to adopt the principles of the UK or USA because each system has different needs and dimensions (Altaf, 2016). The banking sector is not the only one getting liquidity support from the SBP but it also lends to the government institutions like Pakistan International Airlines (PIA), Pakistan Steel Mill and Pakistan Railways etc. Most of the financial and governmental institutions are unable to return the money to the SBP. Absence of a strong regulation to curtail moral hazard problems is hauling the system towards crisis. Public money is going in vain and due to moral hazard problems the LOLR itself is becoming the cause of recession. Thus, the SBP had no other option but to seek assistance from IMF. Notwithstanding, it is a dilemma that Pakistan's economy is standing at the verge of destruction and miserably depending on the aid of IMF but still there are no financial regulations which can address these issues. Although, IMF is working as an ILOLR, but it is alleged that it is influencing the economic systems of the countries and its stipulations are fair with the developing countries. This research aims to propose a regulatory frame work for the functions of LOLR in Pakistan.

LAWS RELATING TO LOLR IN US, UK AND PAK

The benefits of the role of LOLR in the recent financial has emerged it conception swiftly. There are no more contentions whether the modern financial systems at domestic and international need a LOLR or not. In the recent financial crisis, the CBs took unconventional measures to protect the system which worked well for the extension of the functions of LOLR. Federal Reserves unfolded all possible measures to address the crisis which is extensively discussed in this research. However, the role of LOLR in the crisis highlighted the moral hazard problems and lacunas of the current regulations regarding LOLR. The Federal Reserve Act 1913 legalizes its operations as LOLR, section 10, 13 and 14 of the Federal Reserve Act 1913 empowers it to play the role of LOLR. Nonetheless, it does not regulate its functions of LOLR. There are several principles to perform this role but still the Federal Reserve has many discretionary powers in this regard. The United States is the first one to regulate the functions of LOLR immediately after the financial crisis. Dodd-Frank Act 2010 describes all the functions of Federal Reserves as LOLR and provides the stipulations on which it can refuse to rescue a financial institution.

The Bank of England Act 1988 has legalized the operations of BOE as LOLR. It has played an important role to strengthen the financial institutions against crisis. It can be observed in the operations of BOE as LOLR that it followed the principles of Bagehot for operating as LOLR. The principles of Bagehot regarding the LOLR are extensively described. However, it can also be observed that these principles were not followed by the BOE as a hard and fast rule while acting as LOLR. There are several cases where the BOE has used its discretionary powers which was castigated by many economists. It was argued that to avoid this role from being politicized, it must be regulated.

In Pakistan, the State Bank of Pakistan (SBP) is empowered to play the role of LOLR for the domestic financial system. Section 17, 18 and 19 of the State Bank of Pakistan Act 1956 legalize the operations of SBP as LOLR. There is no regulation regarding the functions of LOLR and it is badly politicized. The domestic system enjoys the liquidity support of LOLR but does not return the loans, which is a big threat to the financial stability of Pakistan. Although, many developed countries have no regulations of LOLR but still they are following certain principles to carry out these operations and the current financial situation of Pakistan

cannot sustain against a financial crisis without the help of IMF. Thus, it must regulate the functions of LOLR otherwise it cannot attain any benefit from this role.

CONCLUSION

This research has provided a critical evaluation of the role of LOLR. It has discussed the functions of LOLR and explained that if there will be no institution which will play the role of LOLR for the financial system in this modern system, the entire system can collapse because of a minor liquidity problem. The LOLR can address the liquidity problem and eliminate pain among the investors. It had discussed the role of Federal Reserve, the Bank of England and the State Bank of Pakistan as LOLR. It had also explained the laws of all three countries relating to the role of LOLR. Finally, it has explained the moral hazard problems and criticism on this role.

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A CRITICAL ANALYSIS OF DUTY BETWEEN STRANGERS IN DUTY TO RESCUE

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ABSTRACT

Traditionally, the courts have not imposed a duty to rescue those in grave peril. According to common law, there is no duty imposed upon a bystander to rescue a stranger who is in need of assistance in an emergency even if the rescue could be done easily and without any risk to the rescuer. Proponents for duty to rescue have illustrated the horrific result of the 'no duty to rescue' rule that a baby can be left drowning, or a blind man may be hit by an oncoming train without warning given by the public as no one can be legally obligated to provide any level of help to another in need. This paper explores the basis for the absence of the duty to rescue in tort law. It also analyses the arguments for and against duty to rescue and how this implicates the duty between strangers.

Keywords: Duty, Rescue, Socio-legal, Tort.

INTRODUCTION

Tort law traditionally focuses on the aspect of liability itself. Common questions include how and when a person would be held liable for his actions. In negligence law, the focus would always be on whether the elements of duty, breach, causation and damages are fulfilled. This paper, however, seeks to present a different perspective of tort law. It submits that rather than simply viewing tort law as determination of liability, tort law also signifies the duty that we owe to one another. Tort law sets up individual responsibilities and rights as well as the boundaries of how we should or are expected to behave. It outlines the duties between strangers.

Goldberg and Zipursky (1998, p. 1743) argue that negligence law embodies "moral principles that contemplate a set of civil obligations we owe one another" and that one central task of the courts is to "elaborate those obligations in a manner that meshes with modern understandings and modern problems; to articulate the set of obligations that matches, roughly, what citizens believe about the care they owe one another".

If a person is exposed to harm, and a bystander knows this and would be able to avert the harm, what would his obligations be? How far would a person be responsible for another's safety? How ought one to behave in such circumstances? This paper explores the principle of duty to rescue in common law by looking at case law for illustrations. It then provides an explanation for the absence of duty to rescue in common law by using landmark cases. Following this, the implications of the no duty to rescue rule is discussed, on which it is asserted that the effects of this rule are not hypothetical but that in reality they affect society at large. This paper then offers a different insight on tort law and urges for legal subjects to be viewed in their true form, as vulnerable subjects which are interdependant and interconnected with one another.

THE ABSENCE OF DUTY TO RESCUE IN COMMON LAW

The principle of no duty to rescue

There is no general duty to rescue in common law. The law has persistently refused to impose on a stranger the moral obligation to render assistance or go to the aid of another. The principle

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that there is no duty in law to aid a stranger is strongly established in case law. A clear illustration of this was given by Lord Atkin (*Donoghue v Stevenson*[2], p. 580) where he stated:

> *The priest and the Levite, when they saw the wounded man by the road, passed by on the other side. He obviously was a person whom they had in contemplation and who was closely and directly affected by their action. Yet the common law does not require a man to act as the Samaritan did.*

The illustration evoked by Lord Atkin was reiterated in the case of Lord Diplock in *Dorset Yacht Co. Ltd. v. Home Office*[3] of which he explains further that an omission to aid others incurs no liability in the English law:

> *…in the conduct of the priest and of the Levite who passed by on the other side, (is) an omission which was likely to have as its reasonable and probable consequence damage to the health of the victim of the thieves, but for which the priest and Levite would have incurred no civil liability in English law.*

It is clear that the position in the law is that there is no duty to aid others even if the harm is foreseeable and may be averted by the bystander. Lord Diplock highlighted that there is an abundance of instances of omissions which "give rise to no legal liability in the doer or omitter for loss or damage sustained by others as a consequence of the act or omission, however reasonably or probably that loss or damage might have been anticipated" (*Dorset Yacht Co. Ltd. v. Home Office*[4], p. 1060).

He provided several examples of which there would be no liability for omission should there be no special relationship between the parties including in matters of trade and land. This position stands regardless of the harm that might befall the other party due to the omission. A powerful example of this was given by him in which:

> *…you need not warn him of a risk of physical danger to which he is about to expose himself unless there is some special relationship between the two of you such as that of occupier of land and visitor; you may watch your neighbour's goods being ruined by a thunderstorm though the slightest effort on your part could protect them from the rain and you may do so with impunity unless there is some special relationship between you such as that of bailor and bailee.* (*Dorset Yacht Co. Ltd. v. Home Office*[5], p. 1060)

Lord Nicholls in the case of *Stovin v Wise*[6] had further illustrated how there is no duty to rescue owed by a bystander even if the rescue is an easy one. The circumstances may be such, that there is an opportunity to rescue easily and without any inconvenience or exposure to harm for the rescuer, yet he is not obligated to help. Lord Nicholls provided two examples of the absence of a legal duty to take position action, of which the first situation is where a grown person stands by while a young child drowns in a shallow pool. Another example is where a person watches a nearby pedestrian stroll into the path of an oncoming vehicle. Following this, he further stated that:

> *In both instances the callous bystander can foresee serious injury if he does nothing. He does not control the source of the danger, but he has control of the means to avert a dreadful accident. The child or pedestrian is dependent on the bystander: the child is unable to save himself, and the pedestrian is unaware of his danger. The prospective injury is out of all proportion to the burden imposed by having to take preventive steps. All that would be called for is the simplest exertion or a warning shout. Despite this, the recognised legal position is that the bystander does not owe the drowning child or the heedless pedestrian a duty to take steps to save him. Something more is required*

[2] [1932] A.C. 562
[3] [1970] A.C. 1004
[4] [1970] A.C. 1004
[5] [1970] A.C. 1004
[6] [1996] AC 923

> *than being a bystander. There must be some additional reason why it is fair and reasonable that one person should be regarded as his brother's keeper and have legal obligations in that regard.* (*Stovin v Wise* [1996] AC 923, p. 931)

Nonfeasance: basis for no duty to rescue

Courts' reluctance to recognise duty to aid is based on the common belief that legal liability could only be enforced in cases involving misfeasance, where there existed the doing or causing of harm. Duties of care that arise in negligence are duties not to cause harm to others through positive actions. Radcliffe (1986) attributes this to the historical origins of the common law rule which embodies distinction between misfeasance (the causing of harm) and nonfeasance (merely allowing harm to take place through inaction).

The distinction embedded in common law is emphasised by Bohlen (1908) as follows:

> *There is no distinction more deeply rooted in the common law and more fundamental than that between misfeasance and nonfeasance, between active misconduct working positive injury to others and passive in action, a failure to take positive steps to benefit others, or to protect them from harm not created by any wrongful act of the defendant. This distinction is founded on that attitude of extreme individualism so typical of Anglo-Saxon legal thought*. (Bohlen, 1908, pp. 219-220)

Nonfeasance will not give rise to liability as liability was found to exist only when an individual in some way caused harm to another. Hence, imposing a legal duty to rescue was not considered enforceable because it involved an omission to act. The courts did not consider nonfeasance to amount to causation. According to Radcliffe (1986), this notion is based on the theory that nonfeasance left the plaintiff in no worse position than he was in previously. It is also centred on the idea that individual liberty is violated when someone is forced to prevent harm that he has not caused.

The common law does not impose liability on the pure omissions of those who have no special relationship between them. Hence, should harm befall a stranger, omission to help would incur no liability to the bystander as an active or positive duty to help others is not required in tort law when there is a lack of special relationship. As put forward by Lord Hoffman in the case of *Stovin v Wise* [1996] AC 923 (p. 943):

> *There are sound reasons why omissions require different treatment from positive conduct. It is one thing for the law to say that a person who undertakes some activity shall take reasonable care not to cause damage to others. It is another thing for the law to require that a person who is doing nothing in particular shall take steps to prevent another from suffering harm from the acts of third parties (like Mrs. Wise) or natural causes.*

In this case, Lord Hoffman provided political, moral and economic reasons as to why there is no duty owed in such circumstances, specifically on the rule against liability in the context of pure omission. According to him, the political reason is that "it is less an invasion of an individual's freedom for the law to require him to consider the safety of others in his actions than to impose upon him a duty to rescue or protect" (*Stovin v Wise*[7], p. 943).

He further elaborated on the moral reason that it is unfair to hold one liable over the other if the situation is such that there was a large and indeterminate class of people who happened to be able to do something to prevent harm to others or render assistance to a person in danger or distress. This is posed as the 'why pick on me?' argument.

It was also argued in economic terms that there is no similar justification to expect a person who is not doing anything to spend money on behalf of someone else. Lord Hoffman stated:

[7] [1996] AC 923

> *…the efficient allocation of resources usually requires an activity should bear its own costs… liability to pay compensation for loss caused by negligent conduct acts as a deterrent against increasing the cost of the activity to the community and reduces externalities… there must be some special reason why he should have to put his hand in his pocket.* (*Stovin v Wise*[8], p. 944)

Based on Radcliffe's observation and Lord Hoffman's justifications, it could be seen that the reluctance to impose a duty on individuals for an omission reflects the liberal philosophical perspective that embodies tort law, which prioritises individual responsibility over social or collective responsibility. The idea that a person should be responsible for the safety of another is looked upon as a violation of individual liberty.

Exceptions to no duty to rescue rule: special relationship

The principle in law that there is no duty to rescue does, however, contain exceptions in which duty to aid is imposed. The rule of no duty to act was premised upon the traditional misfeasance-nonfeasance distinction, and the recognition of a special relationship exception created a duty in the absence of misfeasance, or lack of causation.

Generally, only if there is a special relationship between the parties has a person a positive obligation to act upon another. Thus, outside specific pre-tort relationships, there are no positive duties generally present in tort law; this may be attributed to the fact that negligence law developed against a social and political landscape that favoured individualism over any kind of collective responsibility.

The importance of the existence of a special relationship in order to constitute an omission to act was laid down in the case of *Sutradhar v Natural Environment Research Council*[9]. In this case, the claimant alleged that the British Geological Survery (BGS) under the Natural Environment Research Council had been negligent by failing to issue a geological report on safety, which omission resulted in him suffering arsenic poisoning from the drinking water. It was claimed that the non-issuance of the report had lulled the Bangladesh public health authorities into a false sense of security and inhibited them from testing the water themselves and discovering its toxic properties.

In this case, Lord Hoffman ruled that where there is no prior relationship between parties, there is no actionable negligence for an omission to act. He stated that:

> *But the fact that one has expert knowledge does not in itself create a duty to the whole world to apply that knowledge in solving its problems… BGS therefore owed no positive duties to the government or people of Bangladesh to do anything. They can be liable only for the things they did and the statements they made, not for what they did not do.* (*Sutradhar v Natural Environment Research Council.* (para 27)

If having knowledge does not necessarily create a special relationship between you and the public, what are the criteria which creates a special relationship? A special relationship may exist if there is an undertaking or the creation of reliance upon the other. Lord Hoffman elaborated on this by stating that, "there may be a duty to act if one has undertaken to do so or induced a person to rely upon one doing so. Or the ownership or occupation of land may give rise to a duty to take positive steps for the benefit of those who come upon the land and sometimes for the benefit of neighbours" (2006, p.). He cited the case of *Hargrave v Goldman the High Court of Australia*[10] where Windeyer said, "the trend of judicial development in the law of negligence has been... to find a duty to take care either in some task undertaken, or in the ownership, occupation, or use of land or chattels" (p. 66).

[8] [1996] AC 923
[9] [2006] UKHL 33; [2006] 4 All ER 460
[10] (1963) 110 C.L.R. 40

Historically, courts have developed certain exceptions which justify the imposition of duty to aid and in early common law, the only special relationship falling into the exception to the rule were common carrier to passenger, innkeeper to guest, and shipmaster to seaman. Later, the list of special relationships was expanded to include: "employer to employee, shopkeeper to customer, host to guest, jailer to prisoner, school to student, and companion to companion" (Radcliffe, 1986, p. 396). It also covers "taverns and patrons", "residential rental property owners and tenants", "landowners and invitees" and "merchants and customers" (Brady, 1980, p. 553).

Although the rationale in these cases is not explicitly stated in terms of dependency, according to Brady (1980), dependency is a common denominator of these relationships. She submits that this is manifested by "how the defendant holds some power or control over the plaintiff, in that the defendant has the opportunity to take certain precautions to decrease the probability that harm will come to the plaintiff" (Brady, 1980, p. 533).

However, it is unclear if this is indeed the rationale, as a person who walks pass a drowning baby certainly creates a dependency upon that person to rescue the infant, yet the court does not regard them as having a 'special relationship'. The courts have been criticised for devising various 'special relationship' exceptions to the duty to rescue rule so that the "proliferation of these exceptions has not only threatened to swallow the rule itself but has created a situation where it is no longer possible to determine which relationships are 'special' and which are not" (Radcliffe, 1986, p.404).

The dependency on the definition of special relationship is weak as the law sends a message condoning uncaring behaviour; it is arguable that there need to be circumstances giving rise to a special relationship first, in order to help others. As reiterated by Bender (1988, p. 32), "the law should not permit us casually to cast aside another's safety, health, or interests because we do not personally know the random person who might be injured". Strangers are no less human because we do not know them.

IMPLICATIONS OF THE NO DUTY TO RESCUE RULE

The discussion on no duty to rescue rule in tort law is not new and has long been debated by scholars, both for and against. The stance of the courts in disregarding the harm that befalls the stranger in void of assistance has been regarded as disturbing and scholars have provided several hypothetical illustrations of this situation. For example, a person may be walking along the shore who sees a victim drowning, yet he has no legal duty to throw a rope, or reach a stick out to help that person (Kelley, 2000). This is the position of the law even if the rescue could be easily done with no inconvenience to the rescuer. Other examples given include failure to warn a blind man of an open manhole, letting a child play in the path of a train, or a baby drowning while others watch (Brady, 1980).

The consequence of the no duty to rescue rule, however, no longer becomes hypothetical as the harm can be seen manifested in real-life situations. In particular, the case of Kitty Genovese in the early sixties where the victim was attacked over a period of thirty-five minutes but none of her neighbours summoned help (Kelley, 2000). According to Radcliffe (1986), the assailant stabbed her, then fled when she screamed for help. But when her screams went unanswered, he returned and struck again before he drove away. He then came back the third time and repeated his attack, killing her. Although thirty-eight of her neighbours either heard or saw from their apartment windows the assault and her screaming for help, no one called the police until she died (Crettez and Deloche, 2011). The one who finally made the call stated that he waited because "he didn't want to get involved" (Radcliffe, 1986, p. 387). This is now known as the Kitty Genovese effect, where many people observe a person in peril but do not act in anticipation of some other bystander stepping in and taking action.

A more recent incident which happened in 2011 was a two year old girl, Yue Yue, was hit by a van and at least eighteen people passed by indifferently, leaving her lying on the ground seriously injured (Tang, 2014). Later, a second van struck her and she died the next morning. The indifference of the bystanders shocked the public and a subsequent study discovered that several sensational lawsuits had actually "embittered the public toward performing heroic deeds for strangers" (Tang, 2014, p. 206).

These incidents, despite happening in New York and Guongdong respectively, have certain similarities which are: firstly, they use a common law tort system; and secondly, they exhibit the reality of failure to rescue and why it is important to discuss the duty to rescue considering the implications to the individual and society at large. The no duty to rescue rule is "a dilemma which not only involves the particular bystander but affects all of the society. It focus on the very essence of society in both the formation and reflection of mankind's true nature and general quality of life" (Radcliffe, 1986, p. 404) .

CONCLUSION

Tort law sets the expectation upon individuals to live as an autonomous, self-reliant and independent adults akin to the liberal legal subject. The asocial view of individual responsibility can be seen expressed by Lord Denning in *Spartan Steel v Martin*[11]:

> *Most people are content to take the risk on themselves… they do not go running around to their solicitors. They do not try to find out whether it was anyone's fault. They just put up with it. They try to make up the… loss by doing more work next day. This is a healthy attitude which the law should encourage* (, p. 38E-G)

Individuals are expected not to interfere with each others' affairs and to be self-sufficient without such assistance even in the face of danger. But the reality is, as suggested by vulnerability theory, we are always exposed to constant and inherent risks of harm. We are far from self-reliant; we are interconnected and dependant to one another. As Fineman (2015, p. 2091) posits:

> *A vulnerability approach disrupts the mantra of "personal responsibility, autonomy, and self-sufficiency" so prevalent in current neoliberal discourse and so often directed at certain designated and stigmatized "vulnerable populations." As embodied and embedded beings, we are all constantly and universally vulnerable to forces beyond individual control.*

The individualistic notion embedded in the no duty to rescue rule becomes problematic once viewed in terms of duty between strangers. Duty to rescue, as put forward by Brady (1980), "presents in dramatic form the fundamental question of duty to others that underlies all of tort law" (p. 551). A central question that the paper seeks to raise is: has tort law through the mechanics of no duty to rescue rule failed to consider the aspects of social dimension that governs individuals, i.e., interconnectedness, caring and dependency?

Furthermore, it also raises the question of whether protection of individual autonomy is more pertinent than the protection of life. As Bender (1988, p. 34) stated, "if we think about the stranger as a human being for a moment, we may realise that much more is involved than balancing one person's interest in having his life saved and another's interest in not having affirmative duties imposed upon him in the absence of a special relationship".

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