

Shari'ah Standard No. (49)

Unilateral and Bilateral Promise



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IN THE NAME OF ALLAH, THE ALL-MERCIFUL, THE MOST MERCIFUL

All praise be to Allah, the Lord of all the worlds, and blessings and peace be upon our master, Muhammad, and his household and all his companions

Preface

This Standard aims to explain the concepts of unilateral promise/undertaking (promise) and bilateral promise/undertaking (bilateral promise); their various types and the enforceability of each type; the Shari'ah rules that govern them and the most important contemporary applications of each type in the activities of Islamic financial institutions.⁽¹⁾

(1) The word (Institution/Institutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

Statement of the Standard

1. Scope of the Standard

This Standard covers promises (unilateral and bilateral) given by certain parties for the purpose of concluding a contract or effecting a disposal, and explains when such instruments are binding and when they are not, the jurisprudential rules that govern them, and the most important contemporary applications of each type in the activities of Islamic financial institutions.

2. Definitions of Unilateral and Bilateral Promises

2/1 For the purpose of this Standard, a unilateral promise is given when a party informs another of its resolute intention (undertaking) to act in the future in the interest of the other, with the other having the option to avail itself of the promise. The party undertaking the promise is called the 'promisor', the party receiving the promise is called the 'promisee' (the beneficiary of the promise) and the action is called the 'promised action'.

2/2 Bilateral promise in this Standard refers to the exchange of two back-to-back promises between two parties, each promising to perform an act in the future relating to the same subject matter.

3. Types of Promises and the Shari'ah Rules Applicable to Them

3/1 Promising to perform an act that impermissible by the Shari'ah is prohibited, and fulfilling such a promise is also prohibited. Examples of such promises are those intended to be a ruse to circumvent the prohibition of interest-bearing (Riba) transactions.

3/2 Any promise in a loan contract that procures benefit for the lender, over and above the repayment of the debt, is prohibited by the Shari'ah even if the promise is granted in a document separate from the loan contract.

- 3/3 Any promise in a sale contract made by the buyer or the seller that results in a repurchase contract ('Inah) is prohibited by the Shari'ah, whether the promise is part of the sale contract or is given prior or subsequent to it, such as purchasing an item on credit and promising to sell it back on spot for a lower price or selling an item on credit and promising to buy it back on spot for a lower price (reverse 'Inah). The same prohibition applies if the parties collude with a third party to act as an intermediary in the repurchase.
- 3/4 It is permissible to promise to perform an action or a financial transaction and it is then a religious obligation to fulfill it, meaning that breaking a promise without an excuse is a sin. However, a promise is not legally binding except when there is a real need for it to be enforced, such as when the promisor causes the promisee to incur a liability as a result of the promise. For example, if a person instructs a merchant to purchase a specific item and then resolutely promises the merchant that he will buy this item from him. If the merchant purchases the item solely in reliance on the promise, the promisor is legally bound to purchase the item from him, failing which the promisor is required to indemnify the promisee (merchant/seller) for any actual loss suffered such that if the merchant is unable to sell the item for a price that covers the cost of the item, the promisor is required to make up the difference between the cost of the item and the price obtained by the merchant for it. Actual loss does not include opportunity cost.
- 3/5 A legally binding promise, as explained in item 3/4 above, is enforceable only against the promisor and is not enforceable against the promisee who has the option either to demand performance from the promisor or to waive it.
- 3/6 Fulfilling a benevolent promise (such as a promise to make a gift or lend an item) is a religious obligation but is not binding legally, except if the promise is conditional upon the promisee performing an action that causes the promisee to incur a liability, in which case it is legally binding. For example, if the promisor says to the promisee: "If you

buy this item from me, I will give you a gift of another specified item”, fulfilling such a promise is a religious obligation and is legally binding.

- 3/7 It is permissible for a party to promise to enter into a commutative contract in the future and for the promisee to promise the first party to enter into a separate commutative contract with a different subject matter from that of the first promise. For example, the first party says, “I promise to sell you this item”, and the other party says, “I promise to lease to you such and such property”, neither of the two promises is legally binding except if a promisor causes a promisee to incur a liability, in which case such promise is binding. [see item 3/5]
- 3/8 When a promise is made to enter into a contract in the future, such contract is not effected automatically. The contract must be entered into at the relevant time by the exchange of offer and acceptance. Where the promise is legally binding, if the offer is made by the promisee, the promisor is bound religiously and legally to accept it. And if the offer is made by the promisor, the promisee has the option to accept or reject it.

4. Types of Bilateral Promise and the Rules Applicable to Them

- 4/1 A bilateral promise to perform an act that is prohibited by the Shari'ah is itself prohibited such as a bilateral promise to enter into one or more contracts with the intention to circumvent the prohibition of interest (Riba); e.g., a bilateral promise to enter into a sale and repurchase ('Inah) contract and a bilateral promise to enter into a sale and a loan.
- 4/2 Fulfilling a bilateral promise to perform an act that is permitted but not binding under the Shari'ah is a religious obligation on both parties but is not legally binding except in situations where an actual commercial transaction is not possible without a binding bilateral promise owing either to legal requirements or to general commercial custom, and the objective is not merely to provide financing, such as:
- 4/2/1 Bilateral promises in international trade conducted by means of documentary credits.
- 4/2/2 Bilateral promises in supply agreements.

- 4/3 The binding bilateral promises referred to in item 4/2 are not future contracts, which means that the promised contract is not effected automatically upon the promised date. The contract must be entered into at the relevant time by exchanging notices of offer and acceptance. Since the bilateral promise is binding on both parties, if any party makes an offer, the other party is religiously and legally bound by it. If one party defaults in fulfilling the promise, the other party can obtain a court injunction requiring them to conclude the contract. If it is not possible to conclude the contract and the promisee needs to mitigate his loss by concluding the same contract with a third party but is not able to recover his cost by means of such contract, the defaulting party is liable to indemnify him for actual loss suffered (not to include opportunity cost) if the price obtained under the new contract (with the third party) is lower than price promised by the defaulting party.
- 4/4 It is permissible for the two parties to enter into a master agreement for future transactions where each party has the option whether or not to enter into the future transaction. If the parties enter into a transaction, then the terms and conditions agreed in the general framework (master agreement) apply. An agreement containing a general framework (a master agreement) is a bilateral promise that does not bind any of the parties to enter into those transactions. For example, an institution and a client wishing to enter into Murabahah transactions can agree on a general framework which explains the transaction process and the terms and conditions. A general framework (a master agreement) is not considered to be a concluded transaction and the client is not required upon signing the framework to enter into a Murabahah contract. Rather, each party has an option. When the parties enter into the Murabahah contract by exchanging notices of offer and acceptance, the contract becomes subject to all the terms and conditions agreed upon in the general framework (master agreement) which are expressly reconfirmed and incorporated in every contract. [see Shari'ah Standard No. (37) on Credit Agreement]

5. Permissible Applications of Promises and Bilateral Promises

5/1 The promise given by the client in the Murabahah transactions conducted by institutions is legally binding by virtue of item 3/5 of this Standard. [see Shari'ah Standard No. (8) on Murabahah]

5/2 The promise given by the institution in Ijarah Muntahia Bittamleek transactions to grant the leased asset to the lessee as a gift conditional on that he pays all the lease installments is legally binding as in item 3/6 of this Standard. [see Shari'ah Standard (9) on Ijarah Muntahia Bittamleek]

The promise given by the institution in diminishing Musharakah transactions that it will lease its share of the asset to the other co-owner is legally binding and the promise given by the client that he will buy units of the institution's share at stipulated intervals are legally binding by virtue of item 3/5 of this Standard. [see para 5 of Shari'ah Standard No. (12) on Sharikah (Musharakah) and Modern Corporations]

6. Impermissible Applications

It is impermissible to enter into back-to-back bilateral promises for the purpose of circumventing the prohibition by Shari'ah of certain transactions, such as back-to-back derivatives as in items 3/1 and 3/7 of this Standard. [see para 5 of Shari'ah Standard No. (20) on Sale of Commodities in Organized Markets]

7. Date of Issuance of the Standard

This Standard was issued on 21 Safar 1434 A.H., corresponding to 4 January 2013 A.D.

Adoption of the Standard

The Shari'ah Board adopted the Standard on Unilateral and Bilateral Promise in its meeting No. (34), held in the Kingdom of Bahrain, during the period of 20-21 Safar 1434 A.H., corresponding to 3-4 January 2013 A.D.

Appendix (A)

Brief History of the Preparation of the Standard

On 14 Jumada II, 1430 A.H., corresponding to 7 June 2009 A.D., the General Secretariat decided to commission a Shari'ah consultant to prepare a juristic study on Unilateral and Bilateral Promise.

In a joint meeting held in the Kingdom of Bahrain, on 18 Safar 1428 A.H., corresponding to 8 March 2007 A.D., the Shari'ah Standards committees (1) and (2) discussed the study, approved it and required the consultant to prepare the exposure draft of the Standard.

In a further joint meeting held in Manama, the Kingdom of Bahrain, on 15 Jumada I, 1428 A.H., corresponding to 31 May 2007 A.D., the Shari'ah Standards Committees (1) and (2) discussed the draft of the Standard and necessary amendments were made in the light of the discussions and observations of the meeting.

In its meeting No. (19) held in Makkah Al-Mukarramah, during the period of 26-30 Sha'ban 1428 A.H., corresponding to 8-12 September 2007 A.D., the Shari'ah Board discussed the draft of this Standard and made the amendments which it deemed necessary.

The General Secretariat held a public hearing in the Kingdom of Bahrain on 8 Jumada II, 1429 A.H., corresponding to 12 June 2008 A.D. The public hearing was attended by a number of representatives from central banks, institutions, accounting firms, Shari'ah scholars, academics and others interested in this field. The members of the Shari'ah Standards Committees (1) and (2) duly responded to several comments and observations that were made in the public hearing.

In its meeting No. (21) held in Al-Madinah Al-Munawwarah, during the period of 21-48 Jumada II, 1429 A.H., corresponding to 28 June -2 July

2008 A.D., the Shari'ah Board discussed the amendments proposed by the participants in the public hearing and incorporated the amendments that it considered suitable.

In its meeting No. (25) held in the Kingdom of Bahrain, during the period of 2-4 Dhul-Qadah 1430 A.H., corresponding to 21-23 October 2009 A.D., the Shari'ah Board discussed the draft of the Standard, incorporated the necessary amendments that it deemed appropriate, and adopted the Standard.

Appendix (B)

The Shari'ah Basis for the standard

The International Islamic Fiqh Academy resolved: "In situations where a sale contract cannot be concluded because the seller does not own the commodity and there is a public interest in obligating both parties to sign a contract in the future by virtue of law or otherwise, or according to international norms and customs, as in the case of opening letters of credit for importing goods, bilateral promise can be made binding to the two parties". [Resolution No. (157) 6/17 on Bilateral Promise and Collusion in Contracts (Islamic Fiqh Academy Magazine), Issue No. (17), Vol. 3, (P. 681)]

Appendix (C)

Definitions

General Framework (Master Agreement)

An agreement representing mutual understanding and the exchange of non-binding bilateral promises to enter into transactions.



