

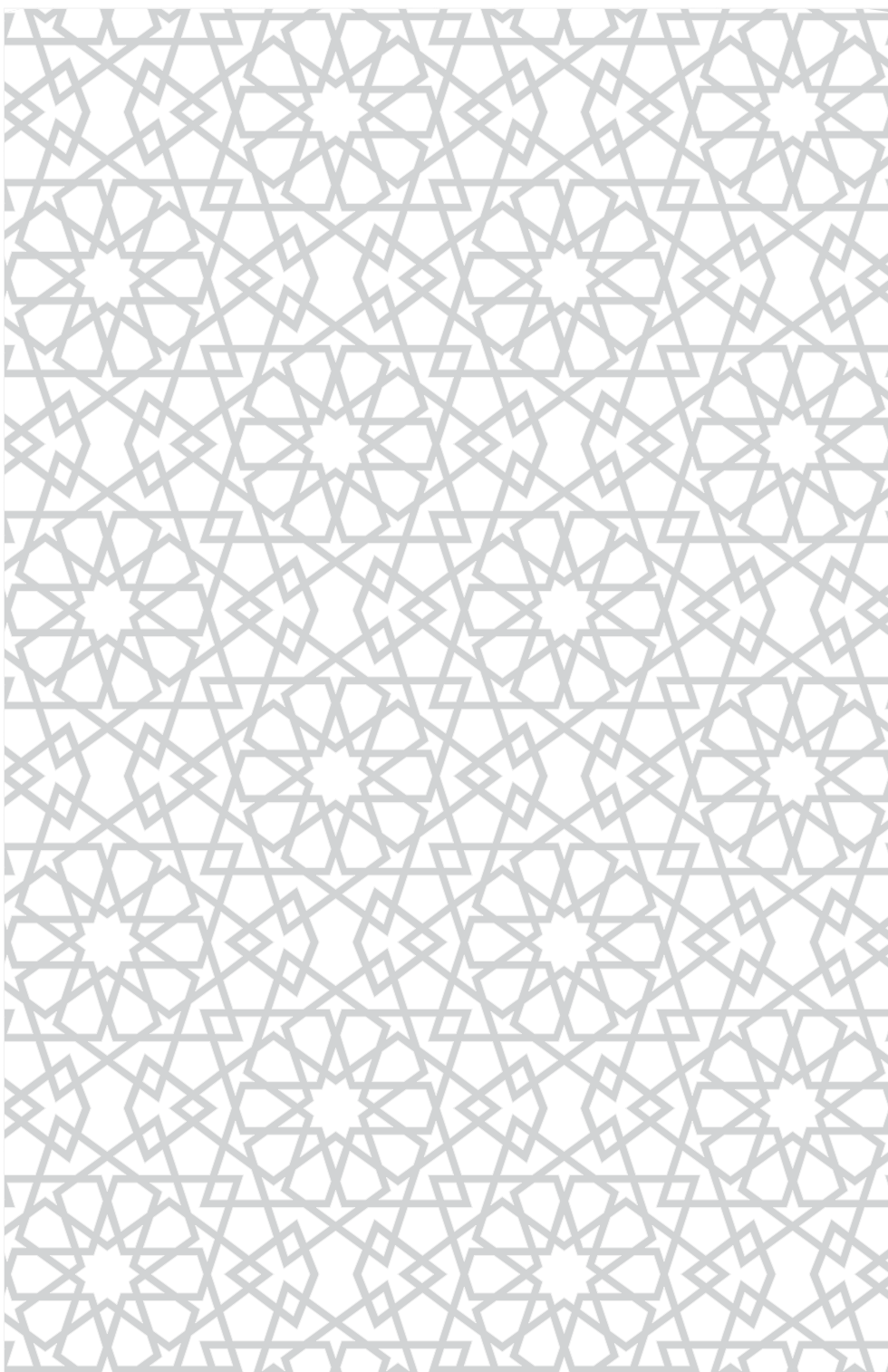
Shari'ah Standard No. (22)

Concession Contracts



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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

The purpose of this Standard is to indicate the rules that govern Concession Contracts for utilization of minerals, water and the likes (Utilization Concession), or construction of projects (Construction Concession), or management of government facilities and projects that provide services to the public (Management Concession). The Standard also highlights the Shari'ah adaptation of such contracts, as well as their underlying procedures, rights and duties. Moreover, it portrays application of Concession Contracts by Islamic financial Institutions (the Institution 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 the basic Shari'ah rulings relating to Concession Contracts for utilization, construction or management of projects, and provides guidance to Institutions on application of such contracts. It does not cover legal or consensual concession rights, which are subsidiary rights. This standard does not cover franchises as it should be dealt with by a separate standard.

2. Definition of Concession

Concession in this context refers to the act of an authorized party granting another party the right of utilizing, constructing or managing a project for agreed upon consideration.

3. Permissibility of Concession Contracts

3/1 The concession contracts described in this Standard are permissible, as set out in the Shari'ah rulings, unless those contracts comprise an element that does not conform to the rules and principles of Islamic Shari'ah. Such contracts are considered to be among the devices that facilitate realization of public interest or the interests pursued by the two contracting parties.

3/2 There is no Shari'ah objection to taking on the procedures required to the offering of concession rights against specific fees or any compensation stipulated in the contract, unless the deal constitutes an element of Riba (usury), Gharar (uncertainty), or any other Shari'ah-banned practices.

4. Offering the Concession Right

When offering concession rights, due consideration should be given to justice, equality of chances, and realization of public interest.

5. Concession Contracts for Utilization of Minerals, Water and the Like (Utilization Concession):

5/1 Definition of utilization concession contracts

A Utilization Concession contract is an agreement between the State and a natural or legal person (Institution) according to which the latter becomes the sole owner of the right of extracting and producing the minerals, water or any other object in question against a specific remuneration, as is shown in item 5/3 below.

5/2 Formal procedures of utilization concession

5/2/1 Granting a survey license

The State has the right to require natural or legal persons to obtain permission (license) before conducting survey in a certain area against payment of a specific amount of fee or rent to the State. Such a license does not grant its holder the right of the sole surveyor in that area nor does it grant him the right to conduct works relating to extraction through mining and construction of the required facilities.

5/2/2 Granting exploration licenses

The State has the right to require natural or legal persons to obtain permission (license) before conducting exploration in a certain area for a certain period against payment of a specific amount of fee or rent to the State. Such exploration license may entitle its holder the right to become the sole explorer in that area and the right of conducting the works required for exploration.

5/2/3 Obtaining utilization concession

The exploration licensee, after discovering the minerals, water or any object in question, becomes eligible for the exclusive right of obtaining the utilization concession in the area specified in the license, unless the license stipulates otherwise.

5/2/4 If until the end of the exploration period, the holder of the exploration license (the licensee) does not discover the minerals, water or for whatever the license has been obtained then the licensee is not entitled to utilization concession at the end of that period.

5/2/5 Notwithstanding the procedural order stated in preceding paragraphs, the State may offer exploration or utilization concessions directly, and without resorting to the above-mentioned procedures.

5/2/6 When the State requests a specialized body to conduct survey or exploration on its behalf, the contractual relationship becomes subject to the rulings of "Ijarah" and "Ju'alah". In this case Shari'ah Standard No. (9) on Ijarah and Ijarah Muntahia Bittamleek, as well as Shari'ah Standard No. (15) on Ju'alah, should be referred to.

5/3 Shari'ah perspective on utilization concession contracts

Utilization of minerals, water resources and the likes cannot take place without exploration, which entails an unknown amount of effort. Whereas the remuneration to which the holder of concession is entitled, is usually a well-defined lump sum amount or percentage share of the output. The Shari'ah classifies such contracts as a form of Ju'alah, where the State is the "*Ja'il*" (*Ju'alah initiator*), the licensee Institution is the "*'Amil*" (hired party) and the specific amount to be received by the latter is the "*Ju'l*" (compensation amount). [see Shari'ah Standard No. (15) on Ju'alah]

5/4 Scope of utilization concession contracts

Since utilization concession contracts are concluded between the State on the one hand and natural or legal persons on the other, the following should be observed:

5/4/1 When adopting the Fiqh viewpoint that considers minerals to be the property of the State, whether such mineral have been extracted from a State-owned or a privately-owned land,

concession contracts may be applied to all types of lands, whether State- or privately-owned.

5/4/2 When adopting the Fiqh viewpoint that gives the right of utilization of minerals to the owner of the land or its usufruct against a fee payable to the State, the following types of lands should not become subject to concession contracts:

5/4/2/1 Privately-owned lands whether vacant or built on.

5/4/2/2 Wastelands that have been contracted for development according to the relevant Shari'ah stipulations and legal rulings.

5/4/2/3 Lands allotted by the State to natural or legal persons, whether through change of ownership title or for temporary utilization.

5/5 Requirements of obtaining the utilization concession

A holder of a utilization concession is entitled to undertake all the activities required for utilization, such as establishing refineries and treatment laboratories, acquiring transportation devices and facilities, etc. The holder becomes the sole owner of such rights throughout the period of the concession license thereof.

5/6 Continuity of utilization

Concession contracts usually indicate the commitment of the licensee to continue utilization as per contract or the prevailing customary practices. In case the licensee ceases utilization without a reasonable excuse, the licensee may be given a reasonable grace period to restart again and preserve utilization, otherwise the State has the right to cancel the license thereof.

5/7 Product pricing and purchase by the State

5/7/1 The State has the right to determine in advance the way in which the licensee should dispose of his share of the extracted products and the value to be paid to him taking into account public interest

5/7/2 In addition to its own share in the product, the State has also the preemptory right of purchasing the quantities it needs from the output, according to the prevailing prices and contractual terms.

5/8 Expiry of utilization concession contracts

A utilization concession contract expires at the end of its specified period, or when the two parties agree to prematurely cancel it. The contract can also be cancelled when there remains no more output to be utilized. Moreover, each of the two parties has the right to revoke the contract when the other party breaches a contractual condition or commitment. In this case the breaching party has to compensate the other party for any consequent actual damages.

6. Concession Contracts for Construction of Projects (Construction Concession)

6/1 Definition and forms of a construction concession contract

6/1/1 Definition of a construction concession contract

A Construction concession contract is a contract between the State and another party according to which the latter constructs a specifically defined project usually related to public utilities.

6/1/2 Forms of construction concession contracts:

Construction concession contracts may take several forms including the following:

6/1/2/1 When the licensee constructs the project according to certain specifications, on a piece of land owned by the State, and the State becomes the owner of the project, while the licensee is entitled to the usufruct of the project for a specific period. After this period, the ownership of the usufruct is transferred to the State.

6/1/2/2 When the licensee constructs the project according to certain specifications on a piece of land owned by the State, and the project and its usufructs become

the property of the licensee for a specific period after which the ownership of the project (and its usufruct) goes to the State.

6/1/2/3 When the licensee constructs the project according to certain specifications on a piece of land owned by the State, and the project becomes a property of the State, while the two parties agree to share the revenue for a specific period after which the project belongs to the licensee.

6/1/3 In all three cases set out in 6/1/2, the licensee becomes entitled to collection of fees or rent for provision of services to the public.

6/2 Shari'ah perspective on construction concession contracts:

Construction concession contracts vary with regard to their Shari'ah adaptation, according to the following conditions:

6/2/1 If the commitment of the licensee includes construction works as well as provision of materials, which is the predominant case, the contract is that of "Istisna'a". The value of the contract is the right which enables the licensee to utilize the project for one's own benefit for a specific period before handing it over to the State.

6/2/2 If the project is constructed on a piece of land that the licensee obtained on lease from the State against handing over the project thereto after a specific period, the contract is that of "Ijarah" and the rent is the project itself which will be handed over to the State at the end of the contractual period.

6/3 Remuneration for construction concession contracts

6/3/1 When the remuneration for construction of the project is determined in terms of the right to utilize the project for a specific period, the contract is considered as "Istisna'a" against a price determinable in terms of utilizing the constructed facility for a specific period before handing it over to "al-Mustasni".

6/3/2 If the remuneration for the construction of a project is determined in terms of a certain amount of money, the licensee retains the ownership of the project to ascertain one's right to get the price through utilization of the project. Licensee has also the right of arranging a clearance deal with the licensor so that the licensee can receive the full price and hand over the project to the licensor before the end of the contract period. Otherwise, the licensee keeps on utilizing the project until the receipt of the full amount agreed upon.

7. Application of Utilization Concession Contracts by Institutions

Institutions can apply utilization concession contracts either through direct relationship with the State, or by playing an intermediary role in the contract between the State and the licensee. Application of such contracts may take place in one of the following forms:

7/1 Ju'alah

It is possible to apply Ju'alah or Parallel Ju'alah where the licensee receives a specific share of the output as remuneration.

7/2 Ijarah

Ijarah contract may be applied where the State gives the land on lease to the licensee for a rent payable as a predetermined share of the output. The licensee may, in turn, give the land on lease to a third party to establish the project thereon (sub-contracting).

7/3 Mudarabah

Mudarabah may be applied where the State provides the land to the licensee to utilize it on the basis of a predetermined rate of profit sharing. The Institutions may either implement the project directly or through two-steps Mudarabah.

7/4 Musharakah

In utilization concession contracts, Musharakah - whether fixed or diminishing - may be applied as follows:

7/4/1 In fixed Musharakah, the Institution contributes a share in the required capital besides the State or the party that executes the

concession license, and the Musharakah continues up to the end of the contract's period.

7/4/2 In diminishing Musharakah, the Institution contributes a share in the required capital, and undertakes (the Institution or the party that executes the concession license) to sell its share in the project gradually to the State.

8. Application of Construction Concession Contracts by Institutions

Institutions may apply construction concession contracts whether through direct relationship with the State, or by entering as an intermediary party in the contract between the State and the licensee. Application of such contracts may take place in one of the following forms:

8/1 Ijarah and Ijarah Muntahia Bittamleek

In this case, the licensee hires the land from the State with the aim of constructing the project thereon and presenting the project back to the State based on Ijarah Muntahia Bittamleek. The licensee may, use a sub-contract of operating or diminishing Ijarah, to rent out the land to another party to construct the project thereon.

8/2 Istisna'a

Istisna'a and Parallel Istisna'a contracts may be applied where the State is "al-Mustasni" and the Institution becomes "al-Sani" (the licensee is a parallel Mustasni)" and the price of the product is the income generated from the fee or rent collected from the public for provision of the services.

8/3 Musharakah

In construction concession contracts Musharakah, whether fixed or diminishing, may be applied as follows:

8/3/1 In fixed Musharakah, the Institution contributes a share in the required capital besides the State or the party that executes the concession license, and the Musharakah continues up to the end of the contract's period.

8/3/2 In diminishing Musharakah, the Institution contributes a share in the required capital, and undertakes (the Institution or the party that executes the concession license) to sell its share in the project gradually to the State.

9. Disposing of the Concession License

Since the concession license is a financial right, its owner may dispose it of through selling, leasing, mortgaging, partnership or securitization according to Shari'ah rulings, as well as the conditions imposed by the licensor.

10. Management Concession Contracts

10/1 Definition of management concession contracts

These are contracts between the State and other parties according to which the right of managing public utilities and providing services to the public is given against a specific price.

10/2 Shari'ah perspective on management concession contracts

10/2/1 When the price for offering management concession is determined as a lump sum amount of money or a percentage of total income, the contract between the State and the licensee is that of Ijarah. The licensor in this case has the right to receive rent for offering the concession license, in addition to the amount/percentage of income the licensor deserves during the period of the contract. If the price of the management concession is a percentage of the profit (net income after expenses and allocations), the contract between the State and the licensee becomes Mudarabah wherein the capital is the original facility or the project itself.

10/2/2 In both cases mentioned in item (10/2/1) above, the contract between the State and the project's utilizer is either that of Ijarah or *Bay'* (sale) contract, as per the nature of the activity in question.

10/3 Cancellation of the management concession contract

Management concession contract is a fixed-term contract. It may be rescinded by the State when the licensee breaches a condition or fails to meet one's contractual obligations. The licensee may also rescind the contract on condition that the licensee takes the measures that ascertain the provision of the services to the public.

10/4 Pricing of services

It is permissible for the licensor to fix or adjust the price of the services to be delivered by the licensee in a way that leads to establishing justice and preservation of the interests of both the licensee and the beneficiaries.

10/5 Observation of the contract's conditions

The licensor has the right to perform (directly or through deputation) monitoring and inspection to ascertain observation of the conditions and specifications stipulated in the contract. It has also the right to impose penalties stipulated in the contract, in case of breach of contractual obligations on the part of the licensee.

11. Date of Issuance of the Standard

This Standard was issued on 22 Rabi' I, 1426 A.H., corresponding to 2 May 2005 A.D.

Adoption of the Standard

The Shari'ah Board has adopted the Standard on Concession Contracts in its meeting No. (14) held in Dubai on 21–22 Rabi' I, 1426 A.H., corresponding to 30 April – 2 May 2005 A.D.

Appendix (A)

Brief History of the Preparation of the Standard

The Shari'ah Board decided in its meeting No. (7) held on 9–13 Ramadan 1422 A.H., corresponding to 24–28 November 2001 A.D., in Makkah Al-Mukarramah to issue a Shari'ah Standard on Concession Contracts.

On 12 Jumada I 1423 A.H., corresponding to 22 July 2002 A.D., the Shari'ah Standards Committee decided to commission a Shari'ah consultant to prepare a draft standard on concession contracts.

In its meeting No. (5) the Shari'ah Standards Committee (2) held on 1 Rajab 1423 A.H., corresponding to 8 September 2002 A.D., in the Kingdom of Bahrain, the committee discussed the Shari'ah study and advised the consultant to introduce the necessary amendments, in light of the discussions and observations of its members.

In the joint meeting of the Shari'ah Standards Committees (1) and (2) on 21 January 2004 A.D., held for discussing the observations made in the public hearing that had been convened on the same day in the Kingdom of Bahrain, the committee discussed the draft standard on concession contracts and introduced necessary changes. The committee also requested the consultant to review the document in light of the discussion and comments of its members.

The committee once again discussed the draft standard in its meeting in Dubai on 28 Rabi' I, 1425 A.H., corresponding to 16 June 2004 A.D., and made further changes therein.

The revised draft of the standard was then submitted to the Shari'ah Board in its meeting No. (3) held in Makkah Al-Mukarramah on 26–30 Sha'ban 1425 A.H., corresponding to 10–14 October 2004 A.D. The Board

made some changes on the document and decided to present it to some experts for their comments before discussing it later in the public hearing.

A public hearing was held in the Kingdom of Bahrain on 15 Safar 1426 A.H., corresponding to 25 March 2005 A.D. and attended by more than 35 participants representing central banks, Institutions, accounting firms, Shari'ah scholars academics and other concerned parties. Several comments were made before and after the public hearing. Some members of the Shari'ah Standards Committees (1) and (2) responded to the queries raised during the session.

In the meeting of the Shari'ah Standards Committees (1) and (2), held in the Kingdom of Bahrain on 15-16 Safar 1426 A.H., corresponding to 25-26 March 2005 A.D., the comments made during the public hearing were discussed and some appropriate changes were made.

The Shari'ah Board convened its meeting No. (14) on 21-23 Rabi' I, 1426 A.H., corresponding to 30 April – 2 May 2005 A.D., in Dubai (U. A. E) and adopted the Standard.

Appendix (B)

The Shari'ah Basis for the Standard

Concession for Utilization of Minerals

- The right of the State to regulate survey or exploration of minerals, water and the like by offering exclusive rights of utilization, stems from the fact that such an act by the State leads to realization of public interest and prevention of disputes. This reasoning is adopted by the fuqhaa who argue that development of wasteland requires State permission. The basic assumption here, knowingly, is that when the State disposes of public property, its act is supposed to be that of serving the cause of public interest, which should always surpass private interest.
- The distinction between survey on the one hand, and exploration and concession on the other, and the fact that only the latter two can enable the licensee to have the exclusive status as a contractor, stems from the fact that survey is based on mere expectation, while exploration is like *Tahjir* (retention) in wasteland development, which usually precedes utilization. Thus, offering the exclusive right to the explorer can be based on the saying of the Prophet (peace be upon him): "*Whom who develops a piece of wasteland shall become its owner.*"⁽²⁾
- The ruling that gives the one who discovers the minerals the priority in utilizing them is extracted from the fact that exploration resembles wasteland development, which entitles to ownership of the developed land.
- The alternate viewpoint of the Maliki School, which considers minerals as the property of *Bayt al-Mal* (treasury) even when discovered in a private land, leans towards the fact that no body, the landlord included, can claim the honor of bringing these minerals into being. Putting the mi-

(2) This Hadith has been Related by Al-Bukhari in his "*Sahih*" [3: 139], Al-Shaab Publications, 1378 A.H.

nerals at the disposal of the State, therefore, does not leave any room for dispute between the property owner and the one who discovers the minerals.

- The viewpoint of the majority of the Fuqaha, including the Maliki School, that the minerals are the property of the landowner, focuses on their perspective that deems land ownership as underground resources. Moreover, the fact that the *Kharaj* imposed on land is one fifth indicates that the remaining four fifths are the property of the landowner.
- Eligibility of the holder of the concession for utilization of minerals to other rights pertaining to production and transportation devices is due to the fact that such rights constitute the complementary requirements. This reasoning also holds true for eligibility of the licensee to the easement rights pertinent to one's license.
- The condition that the licensee should sustain the activity in question originates from the Shari'ah ruling on the case of a person who retains a piece of wasteland for a period of time without developing it. In this connection it has been narrated that Caliphate Umar Ibn Al-Khattab said: "When somebody develops a piece of wasteland that had been left for three years undeveloped by its original owner, the land becomes the property of the developer"⁽³⁾
- Eligibility of the State to purchase the quantity it requires from the output of the project is justifiable by the need to realize public interest without harming the licensee, since purchasing takes place according to the procedures and conditions available to other clients. With regard to the right of the State to fix the price of the product, the justification is hinged on the need to prevent social injury that could result from charging unduly high prices by licensee.
- The State is given the right of amending concession contracts for minerals when necessary, because the acts of the State are normally considered to be in pursuance of public interest, which should always surpass private interest.

(3) Related by Abu Yusuf in "*Al-Kharaj*" (P. 61), Dar Al-Ma'arif edition. Al-Hafiz said in "*Al-Dirayah*" that this Hadith has been narrated by reliable people.

Concession for Construction of Projects

- Project construction contracts are permissible because they come under commitments that should be honored by virtue of the divine ordain of Allah, Exalted be He, Who says: {**“fulfill (all) obligations”**}⁽⁴⁾ and also the Hadith of the Prophet (peace be upon him): *“Muslims honor all their obligations except those which permit prohibited deeds or prohibit permitted deeds”*⁽⁵⁾
- Permissibility of remunerating the licensee by allowing him to benefit from the project before handing it over to the licensor, relates to the fact that in Istisna'a, temporary benefiting from the product may constitute the price of its production. That is to say, the price can be either money or usufruct including that of the product in question. This viewpoint has been confirmed by a similar resolution of the Al Baraka Seminar.⁽⁶⁾ The other viewpoint referred to in this Standard is that the price should be fixed first, and then the licensee is given the chance to utilize the project until he gets the remuneration agreed upon, regardless of any specific period of time. The basis for this viewpoint is that a predetermined period may not be sufficient for getting the full price. This viewpoint, therefore, seems to visualize the relationship between the State and the Institution as a management relationship, as well as a clearance arrangement with regard to the price to be paid and the period of utilization.
- Permissibility for Institutions to enter into concession contracts with the State directly or as intermediaries is clear because they do this in a permissible contractual form such as Ju'alah, Mudarabah, Musharakah, Istisna'a and Ijarah. All these contractual forms are permissible whether performed directly or through entering as an intermediary between the State and the other original party to the contract.

(4) [Al-Ma'idah (The Table): 1]

(5) Narrated by several companions of the Prophet (peace be upon him) and quoted by: Ahmad [1: 312], Ibn Majah [2: 784], Mustafa Al-Babi Al-Halabi, Cairo, 1372 A.H./1952 A.D.); Al-Hakim (Hyderabad Publications, India, 1355 A.H.); Al-Bayhaqi [6: 70 and 156], [10: 133], Hyderabad Publications, India, 1355 A.H.); Al-Daraqatni [4: 228], [3: 77], Dar Al-Mahasin, Cairo, 1372 A.H./ 1952 A.D.).

(6) Resolutions and Recommendations of the 17th Seminar of Al Baraka, Resolution No. 13/2, (P. 220).

Management Contracts

- Permissibility for the State to offer concession licenses for management of public utilities is justified by the fact that the State has the right of regulating such facilities and collecting fees, and therefore it can transfer this right to a second party. The management contract in this case is Ijarah and the government has the right of identifying the lessee on the ground of common interest.
- Permissibility of fixing the contract's value in terms of money is that the deal is considered as Ijarah, and determination of the contract's value as a specific share of the project's income could embody uncertainty (*Jahalah*) pertaining to the possibility of realizing the agreed upon amount during the contract's period. The relationship between the State and the licensee, in this sense, is considered as an Ijarah deal. If such relationship is considered as Mudarabah, the basis for determination of the contract's value will become a given share of the project's profit, which can be determined only after preservation of the project's capital, which is the managed asset in this case. The Hanbalis permit Mudarabah on income-generating assets like animals. The reason behind the justification for sharing the net profit after allocations is the preservation of the project's capital.
- Permissibility for licensor to rescind the contract when the other party breaches a condition or fails to fulfill an obligation is derived from the commitment of Muslims to honor contractual obligations according to the Hadith of the Prophet (peace be upon him) stating: "*Muslims shall honor their obligations*"⁽⁷⁾



(7) Narrated by several companions of the Prophet (peace be upon him) and quoted by: Ahmad [1: 312], Ibn Majah [2: 784], Mustafa Al-Babi Al-Halabi, Cairo, 1372 A.H./1952 A.D.; Al-Hakim (Hyderabad Publications, India, 1355 A.H.); Al-Daraqatni [4: 228] and [3: 77], Dar Al-Mahasin, Cairo, 1372 A.H./ 1952 A.D.).