

## **THE NATURE AND SCOPE OF LIABILITY OF RABB-AL-MAL AND MUDARIB IN CONTRACT OF MODARABA: THE PERCEPTION OF MUSLIM JURISTS**

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The concept of Limited liability is well known for the corporations and limited partnerships however in contrary to it in Islamic law creditors have full access to the personal wealth of the debtors or towards the wealth that have not been contributed towards the capital. In the contract of Modarabah loss is always transferred/born by the investor (Rabbul Mall) however there may be a case where a Mudarib exceeds from the limits of his lawful authority and so held liable for the debts of Modarabah. This study aims to discuss the nature and scope of the liability arises on both ends Rabbulmaal and Mudarib The right and power to make purchase on credit beyond the limit of the employed capital as per the perceptions of the Muslim Jursits.

**Keywords:** Limited liability, Istidanah, Istiqrad (raising a cash loan), credit purchase.

### **Introduction**

Liability of a partner usually arises due to loan and credit purchases. In modern law the concept of limited liability is well known for the corporations and for limited partnerships. This concept demonstrates that creditors have no access to the personal wealth of the debtors or towards the wealth that have not been contributed towards the capital. In contrast, according to the Islamic law there is only a single form of liability (unlimited liability) there is no concept of limited liability as in modern law<sup>1</sup>. Thus the creditors have full access to the personal wealth of the debtors, for the satisfactions of the debts other than the assets of the business the personal wealth of debtor i.e. House, personal land, ornaments etc. can also be liquidized for the recovery of debts.

### **Liability of Rabbul mall and Mudarib**

After discussing the concept of limited and unlimited liability we are in a position to discuss the liability of Rabbul Mall and Mudarib for the debts of a Modarabah.

It is clear that in the contract of Modarabah loss is always transfered/born by the investor (Rabbul Mall) however there may be a case where a Mudarib exceeds from the limits of his lawful authority and so held liable for the debts of Modarabah.

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A Mudarib has a right and power to buy and sell on credit by virtue of the contract however his right to purchase on credit cannot go beyond the amount of capital employed in Modarabah. His right to buy on credit by virtue of contract belongs to him only when his purchases are not beyond the amount of capital employed in Modarabah and if in a case he plans to exceed the limit of the capital amount, he has to take special permission of Rabbul Mall for doing so. On acquiring permission from Rabbul mall to exceed the limit of the capital if Rabbul mall permits him to make purchase on credit beyond the limit of the capital, his permission will be termed as "Wilayat al-istidanah".

Wilayat al-istidanah is a term used for the authority given by the investor to Mudarib for raising debts beyond the limit of the capital invested in the Modarabah.

Explaining the distinction between *Istidanah* and *Istiqrad* (raising a cash loan) al-Sarakhsi states<sup>2</sup>:

"If he authorizes him to raise money against the capital of the firm (istidanah) or to raise it against the (credit-worthiness of the) rabbal-mal, and he purchases a slave girl for the Modarabah and thereafter the mudarib raises 1000 against the (assets of the) Modarabah and purchases (another) slave girl with this, This second purchase is deemed to be for his personal account and he is personally liable for qard. Among the jurists are those who say that istidanah pertains to purchase on credit, and raising of loans (qard) is something different. It therefore, is not included in an unqualified authority of istidanah. The correct view is to say that granting the authority to raise loans is batil."

The Sarakhsi's statement demonstrates two main points one is that a mudarib (working partner) have no right to raise loans (debt financing) thus he cannot make liable to the investor (Rabbul mall) for the amount of loan he has raised for the firm through debt financing.

The second important point is that any authority granted for raising loans is in itself a null and void. Nyazee describes the reason why al-Sarakhsi say this? Are business loans not allowed in Islamic law? The answer is yes, they are not allowed, but this statement has to be qualified. Raising of loans with a fixed period of repayment are not permitted in Islamic law even when there is no interest

(riba) involved. The only loan acknowledged by Islamic law is called a qard. h.asan, which is a loan that resembles a gift or charity. The reason is that the use of the amount of money is gifted to the beneficiary for an undetermined period. It is not permitted to fix the period or repayment in such a loan, and it is preferred that the lender wait till the beneficiary enjoys a period of financial ease. The lender, however, has the legal right to recall the loan any time he likes<sup>3</sup>.

Thus the liability of Rabbulmaal and Mudarib raised by the credit purchase offers us two situations for analysis.

1. Liability before wilayat al-istidanah
2. Liability after wilayat al-istidanah

#### **Liability before wilayat al-istidanah**

Liability of Rabbulmaal and Mudarib before wilayat al-istidanah offers us two further situations for analysis.

##### **I. Before the commencement of the transactions**

There could be a situation that after entering in contract of Modarabah as soon as the RabbulMaal hands over the entire capital to Mudarib, before that Mudarib commence the business and invests the capital amount to purchase goods for Modarabah unfortunately he lost entire capital. In such a case the contract of Modarabah becomes void because of the loss of capital as it was the subject matter of the contract and in the absence of the subject matter a contract becomes void. Explaining the above situation al-sarakhsi states<sup>4</sup>:

“If the investor gives him a thousand dirhams by way of Modarabah, concluded on half profits, and this capital is lost before he could buy anything with it, the Modarabah becomes void, because of the loss of its subject-matter.”

Mudarib will not be held liable for the loss of capital if negligence is not found on his end and it will be treated as a loss of the Rabbul mall.

##### **II. After the commencement of the transactions.**

It is clear that a Mudarib has a right and power to buy and sell on credit by virtue of the contract. However, his right to buy on credit cannot exceed beyond the limit of the capital employed in Modarabah. It means that at any moment the entire accounts payable should not exceed from the capital of Modarabah. Thus the liability raised by the credit purchase up to the extent of the capital has two cases for analysis. The first case of liability is

concerned with a state where after the commencement of the business no profit has been realized. For instance, there may be a case that for the commencement of Modarabah, Rabbulmaal hands over the entire capital 1000 dirhams to Mudarib. Mudarib plans to invest the amount so he buys goods on credit up to the limit of the capital but unfortunately he lost the entire amount of capital 1000 dirhams before he could make payment to the seller. This situation arises prior to the emergence of the profit from the purchase, he has made on credit and all the goods were in the possession of the Mudarib. In this scenario, the Rabbulmaal has total and unlimited liability as the working partner has followed the restrictions to purchase on credit to the extent of the capital as should be in the state before the authority of wilayat al-istidana. The loss of capital was due to unforeseen circumstances like fire etc. and there is no negligence of Mudarib. Al-Sarakhsi describes this as follows<sup>5</sup>:

“If a person gives to another a thousand dirhams by way of Modarabah on a 50:50 ratio, and he (the mudarib) buys something with this amount, but the thousand are lost before the mudarib could pay the seller. The mudarib will have a right to recover this (lost) amount from the rabb al-mal . . . . If he takes them (a second time) from the rabb al- mal and he has not made payment to the seller when the amount is lost (again), he is to recover the same amount (again). . . . He is to have recourse (to the rabb al-mal ) again and again till the amount reaches the seller.”

It is obvious that the liability of Rabbulmaal is unlimited and in this case Mudarib has a right to go back to the rabbulmaal and claim for a similar amount. This right of Mudarib to go back to the rabbulmaal and claim for a similar amount extends further until he makes the payment to the seller.

To settle the claims of the seller whatever the amount is received by Mudarib from Rabbulmaal is added towards the capital, as much as money will be taken by the Mudarib to settle the claims of seller the capital of Modarabah will be increased to that extent and thus the emergence of Net profit and loss of Modarabah will also be affected.

Nyazee explains it as<sup>6</sup>:

“Whatever the mudarib receives this way is added to the capital. Thus, if the mudarib takes another

thousand to pay the seller, the capital increases to 2000 and so on. If the mudarib sells the thing purchased for 1500, there is no profit, even though it was bought for 1000. The net profit and loss will be taken into account here.”

The second case is concerned with a state where after the commencement of business the profit has been realized and re-employed in Modarabah. Thus in this case liability rose after the emergence of profit. For instance, there may be a case that Rabbulmaal hands over 1000 dirhams to Mudarib by way of Modarabah on a 50:50 ratio. Mudarib invests the amount to buy goods valued 2000 dirhams. (Thus he violates his authority to buy goods up to the limit of the capital so the excessive purchase is from his personal account). After taking possession of these goods, he sells these for 3000 dirhams and thus earns a profit of 1000 dirhams. He then purchases some other goods valued 2000 dirhams on credit but unfortunately he lost it before he could make payment to the seller. Here in order to settle the claim of the seller the Mudarib has a right to claim an amount up to the extent of his share capital which is now 1500 Dirhams whereas remaining 500 dirhams will be compensated from the personal wealth of the Mudarib.

From the above discussion, we cannot say that it is likely to yield the concept of limited liability, this is unlimited liability and in no way liability of Rabbulmaal is being limited. The liability of Rabbulmaal is not limited to the extent of his capital; it remains unlimited till the settlement of all the claims. Same position will remain with Mudarib, His liability is also unlimited to the extent of this share in profit re-employed in the business.

In this regard Al-Sarakhsi states as follows<sup>7</sup>:

“He gives to a person one thousand dirhams as Modarabah for half profits and this worker buys a slave with them whose value is two thousand (dirhams). He then takes possession and sells him for two thousand. With the two thousand he purchases a slave girl, but has not paid the amount of two thousand when it is lost. The mudarib has recourse to the rabb al-mal for one thousand five hundred and compensates from his personal wealth the remaining five hundred. The reason is that the mudarib is acting for himself in the purchase of one-

fourth of the slave girl in consideration of his share of the profits. He, therefore, has no recourse to the rabbal-mal for the part of the agreement that pertains to him with respect to this fourth. For the remaining three-fourths he is still working for the rabb al-mal according to the agreement.”

### **Liability after Wilayat al-istidanah**

Wilayat al-istidanah is a term used for the authority given by the investor to Mudarib for raising debts beyond the limit of the capital invested in Modarabah. Thus istidanah is the process of raising credit (not loans) during trading. In the contract of Modarabah when Rabbulmaal grants wilayat al-istidanah to the Mudarib, it gives birth to a new contract of Sharikat al-wujuh based on the inan form, thus the new contract is one layer above the existing Modarabah contract. However this new contract remains dependent upon the underlying contract of Modarabah. Shirkat al-wujuh has its own rules which are different from the contract of Modarabah. It is a form of partnership where profit is earned on the basis of credit worthiness and not on the basis of the capital contributed or on the basis of work. Granting wilayat al-istidanah to Mudarib is quite similar to the case where profits are reinvested in the Modarabah. Thus it would lead to combine two separate yet related contracts. Here, both of the partners will be held liable for the credit purchase to the extent of their ownership in the goods purchased. Their liability in credit purchases is of several types and is joint as both have equal shares in the ownership of goods and in profits. This condition has been stated also by Malikies in the following words<sup>8</sup> :

“If they got together for a bargain and purchase a slave against their credit worthiness, without having capital, it is permissible and the slave is jointly owned by the two partners. This is what Imam Malik, has said. The reason is that in the example in question both the partners are together and stand sureties to each other before the seller.”

The credit purchases through istidanah require sharing of profit on equal basis between the partners. Al-Sarakhsi explains it as follows<sup>9</sup>:

“The rest is shared by them in equal ratios, because the authority of istidanah is absolute, and the commodity

purchased on credit is owned (jointly and) equally by them. This equality between them, with respect to the purchased item, does not permit an inequality of profit.”

Profit sharing on equal basis is in a case when their ownership in credit purchase is not specific. In such a case, their ownership will be treated as equal. However if the ratio of their ownership is specific, profit will be shared accordingly<sup>10</sup>.

The liability of both partners is unlimited however for settlements of the credit claims transacting partner will be asked or will be subjected to ‘mutalabah’. It is because the rights of the transaction are reverted to him. Transacting partner has a right to call upon the principal partner (Rabbulmaal) to share in his liability<sup>11</sup>. If the transacting partner fails to settle the claims of the creditors, they cannot file a suit against the principal for the settlement of their claims<sup>12</sup>.

#### REFERENCES & NOTES

<sup>1</sup>Nyazee, Islamic law of business organization partnership, p.81.

<sup>2</sup> Al-Sarkhst, al-Mabsut., vol. 22, p. 180

<sup>3</sup>Nyazee, Islamic law of business organization partnership, p.100.

<sup>4</sup>Al-Sarakhst, al-Mabsut, vol. 22, p.169.

<sup>5</sup>Al-Sarakhst, al-Mabsut., vol. 22, p. 169.

<sup>6</sup>Nyazee, Islamic law of business organization partnership, pp.267-268.

<sup>7</sup>Al-Sarakhst, al-Mabsut., vol. 22, p. 169.

<sup>8</sup>Sahnun, Al-Mudawwanah al-kubralil Imam Malik vol 5.pp.41-42

<sup>9</sup>Al-Sarakhsi, al-Mabsut, vol.22, pp.178-179.

<sup>10</sup>Nyazee, Islamic law of business organization partnership, p.272.

<sup>11</sup>Hasanuzzaman, S.M., The liability of partners in an Islamic shirkah, Islamic Studies, vol.10, No. 4 (December 1971), p.332, Islamic research institute, International Islamic University, Islamabad.

<sup>12</sup>Nyazee, Islamic law of business organization partnership, p.86.