

## Contracting with *Gharar* (Uncertainty) in Forward Contract: What Does Islam Says?

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### Abstract

The forward contract is one of derivative instruments. The value of this contract is derived from the values of underlying assets such as commodities, equities, and currencies. Muslim scholars differ on the permissibility of forward contracts. Among the key issues raised in the forward contract is the issue of *gharar*. In general, *gharar* means an excessive uncertainty and risk. However, not all contracts containing the element of *gharar* void the contract. This article attempts to formulate a parameter for *gharar* that voids the contract based on the opinions of classical and current scholars. It also analyses the elements of *gharar* that exist in forward contracts of crude palm oil in Malaysia. This study uses a thematic analysis approach to explain the data collected through secondary sources and interviews with few individuals involved in this industry. Based on the analysis of forward contracts on the parameter of *gharar*, the finding of this research indicates that the issue of *gharar* exists in forward contracts does not void the contracts.

**Keywords:** Parameter, *gharar*, derivatives, forward, crude palm oil

### 1. Introduction

Forward contracts are the production of financial innovation created from the increasing need of a business world that is becoming more complex and challenging. This contract is used in conventional finance for the purpose of hedging and speculation. The objective of hedging is permissible in Islam, so how to achieve the objective of the hedge has been refined so that the uses of forward contracts are not open for speculators dominate the market by doing gambling on prices (Azlin, 2014). This implies the need to ensure that the contract is free from *riba*, *gharar*, speculation and *maysir* (gambling). Some scholars rejected the idea of forward contracts due to issues of *gharar* in these contracts. However, not all contracts containing the element of *gharar* nullify the contracts. Therefore, it is important to formulate a parameter of *gharar* to determine whether the element of *gharar* in the forward contract voids the contract or not.

Forward contract is as an agreement to buy or sell an underlying asset at a certain future time for a certain price. Therefore, the contract is simply amounts to setting a price today for a trade that will occur in the future. The detailing in regards to the price such as goods specification, price, quantity and quality are determined. In this matter, the agreed price will not change regardless to whatever happens to the price when the transaction takes place (Hull, 2006). The value of this contract is derived from the values of underlying assets such as commodities, equities, and currencies. For underlying commodity asset, usually the parties involved in purchasing and selling at large scale. An example for this contract is crude palm oil producers and margarine manufacturers signing a forward contract to avoid the risk of uncertain fluctuation of price in the cash market and the risk of supply scarcity. The crude palm oil will be produced in the next six months and the margarine manufacturers also need the crude palm oil in the next six months. The producer of crude palm oil is exposed to the slump of palm oil price in that period of six months and the possibility of no demand. The margarine manufacturer on the other hand is exposed to the increase of palm oil price and the probability of supply shortage. The forward contract helps in assisting both sides to hedge the value and plan the business activities of their own (Nik Mohamed Ruslin, 1998). Diagram 1 illustrates the mechanics of a forward contract:

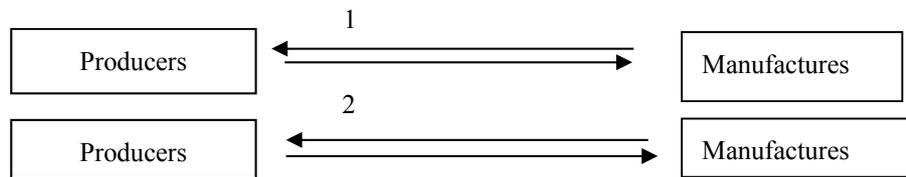


Figure 1. Commodity forward

1. On 1<sup>st</sup> January 2013, the buyer (manufactures) of a forward contract agrees to take delivery of crude palm oil at a future time (1<sup>st</sup> June 2013), at a price agreed upon today. The seller (producers) agrees to deliver the crude palm oil at a future time, at a price agreed upon today.

2. On 1<sup>st</sup> June 2013, the buyer (manufactures) takes delivery of crude palm oil and pay the seller, regardless of the market price at the point of exchange. The seller (producers) delivers the crude palm oil regardless of the market price at the point of exchange.

Forward contracts are traded over the counter and between the two parties. Risk of default is real when there is no delivery or payment involved at the commencement of the contract. If the underlying asset price rises, the contract buyer gains on the contract, and will be exposed to the credit risk that the seller will default on forward contract delivery obligations, when the underlying asset can be sold for more on the spot market. This is because there has been no delivery at the initial stage of the agreement. Likewise, if the underlying asset can be bought at a lower price than the forward price, the contract seller is exposed to the credit risk that the buyer will default on the forward contract payment obligations (Jarrow & Tunrball, 1996). For this reason, a forward contract is rejected by some Muslim scholars due to *gharar* issues. *Gharar* sales are considered invalid precisely because of the excessive uncertainty and risks involved (Sherin & Balachandran, 2010; Tamer, 2005; Obaidullah, 2001).

This parameter will be the benchmarking to determine the effect of *gharar* element to the forward contract. This is because not all contracts that have the element of *gharar* void the contract. The element of *gharar* that gives effect are prohibited and included in the *ghararfahish*. Then, due to the need for risk management tools, an Islamic forward contract has to be created, so that risk can be mitigated effectively and at the same time preserving *maqāṣid al-shari'ah*. The writing begins with the literature review on *gharar* and parameter of *gharar*. The next section discusses the parameter of *gharar* and the third section is on the analysis of forward contracts based on the established parameter of *gharar*.

## 2. Literature Review

There are various definitions of *gharar* given by scholars. This disagreement arisen when there is no direct prohibition in the Qur'an and the hadith of the Prophet are in the form of examples of transactions that contain elements of *gharar* (Ahmad Hidayat, 2004; Siti Salwani, 2009). The definitions given by the classical jurists, are summarized based on the classification described by Al-Darir (2004). He divides the definitions given by scholars to the three main streams. Firstly, the group that defines *gharar* as doubt or uncertainty as to whether the transaction occurs or not. The second stream refers *gharar* to the *jahalah* (ignorance) of the object. The third stream which is held by most of the scholars, states that *gharar* is an unknown and doubtful. The first group was namely Ibn 'Abidin, the second group comprised of Mazhab Zahirī such as Ibnu Hazm, the third group was Sarakhsī. The differences of opinion show no consensus of the classical jurists in defining *gharar*. Differences in the definition can also be seen in the definition given by the current scholars. There is also an approach taken by the current scholars which is relatively similar to the definition of the classical jurists in the past, such as Al-Zuhayli (2004) and Al-Darir (2004) associated *gharar* with the danger posed by uncertainty and ambiguity of goods, in term of existence, quantity, and delivery characteristics of a product. Some scholars related the element of *gharar* to the element of risk. For instance, Al-Zarqa (1994) referred *bay'al-gharar* as the sale and purchase of goods which its existence and criteria are ambiguous because of the risk element in it. Saleh (1992) opined that *bay'al-gharar* is a risky transaction that contains uncertainty and speculation. The element of risk and uncertainty were also mentioned by Obaidullah (1998) and Kamali (2002) in defining *gharar*.

The objective of this article is to formulate a parameter for *gharar* that voids the contract. The formulation of the *gharar* parameter is based on classical jurist's opinion. Further research is required to draw a line between *gharar* that voids the contract and *gharar* that is not, especially to measure the degree of *gharar* element in the contract. This measurement is essential for reference in a forward contract, especially to measure whether the element of *gharar* in the forward contract gives effect or not. Based on our research, Al-Darir (2004) has put the parameter (*dawabit*) for *gharar*. He specified 4 parameters for *gharar* that give effect to *aqad* (contract). These

parameters or *dawabit* are: the element of *gharar* is too abundant, unwanted contracts, an element of *gharar* in the contract of exchange (*uqud mua'awadat*) and elements of *gharar* in the substance *ma'qud alayh*, not in the subsequence (*tabi'*). The four parameters were also made as a resolution by the Accounting and Auditing Organization for Islamic Financial Institutions (2010).

Besides Al-Darir, the classification of *gharar* was also discussed by Atikullah (2007). He, however, placed the parameter measurement in situations that cause the element of *gharar* not giving any effects to the contract. According to the article the existence of *gharar* in these situations does not affect the contract, namely: element of *gharar* in the contract of *tabarru'*, the *gharar* element is minor (*yasir*), the element of *gharar* is on *tabi'* and there is a need for the contract. The parameter is similar to the *gharar* measurement discussed indirectly by the classical jurists in their treaties such as Al-Nawawi (n.d), Al-Baji (1999), Al-Dusuqi (1996), Ibnu Rushd (2003) and Ibn Taimiyah (1997).

Based on the observation by the researchers, the parameter proposed by by Al-Darir (2004) still requires expanded elaboration to be applicable to the current contracts. We try to elaborate and add a new element to make it more applicable to audit *gharar* element in the current financial instrument. For example, for the *gharar* element that is too abundant, there is no specific measure prescribed to measure or to know whether the element is much or less. On the contrary, Al-Darir suggested the measurement of *gharar*, its amount depends on the local situation and condition that differs according to respective periods. The parameter proposed by Atikullah also not much different with the one suggested by Al-Darir. Thus, the stated parameter still needs detailing and further elaboration.

### 3. Research Methodology

Data Collection for this study was collected from various sources namely classical books, hadith, contemporary books and article journals. We also use an interview method to understand the real *modus operandi* of forward contracts and to what extent the element of *gharar* exists in the forward contract. The key persons that we have interviewed are an expert in the Islamic Jurisprudence, Shariah Advisor and the practitioners in the Islamic Banking and Finance in Malaysia. They are Nurdin Ngadimon (Assistant General Manager, Securities Commission), Zaharuddin Ab Rahman (Lecturer of Economics and Managerial Science Faculty, International Islamic Universiti of Malaysia), Ahmad Suhaimi Yahya (Head of Shariah, Kuwait Finance House (Malaysia) Berhad), Aznan Hassan (Shariah Advisor of Malaysian Exchange), Teoh Beng Chuan (Assistant CEO, The Palm Oil Refiners Association of Malaysia (PORAM) and Hassan Zainal Mohamed (Senior Executive Sales And Logistic Felda Palm Industries Sdn. Bhd). The interviews have been conducted within one-two hours and has been transcribed. We analyse the interview data using analytical analysis by searching what is common, difference and compare the data obtained. We then coded the data into specific themes as described below.

### 4. Theoretical Framework

#### 4.1 Parameter of *Gharar* that Gives Effect to the Contract

There are five parameters formed to be indicators of *gharar* element in derivative contracts. If the elements of *gharar* in derivative instruments meet these parameters, then the contract is considered as voided or prohibited. If the elements of *gharar* in derivative instruments do not meet these parameters, thus the contract does not contain the element of *gharar* that nullifies the contract.

##### 1) Element of *Gharar* in Contracts of Exchange (*uqud mua'awadat*).

Muslim scholars unanimously opined that *gharar* gives effect to the contracts either in gratuitous (*tabarru'*) or exchange contract (*mu'awadat*) except in the will contract (*wasiah*) (Al-Kasānī, 2000; Al-Sharbīnī, 1998; Mardawi, 1990; Al-'Asqalani, 2000). On the contrary, Maliki viewed *gharar* as only giving effect to the contract *mu'awadat* or in other words *gharar* gives effect to contracts that purposefully for gaining profit or obtaining income. Whereas for contracts that are non-profitable such as nuptial contract and contracts of *tabarru'*, such as hibah or donation, *gharar* will never give effect (Al-Zuhaylī, 2001; Sinyan, 2003; Ju'ani, 2005; Ibnu Rush, 2003). This opinion was also held by Ibnu Taimiyah (1997) and Ibnu Qayyim (1993)

Maliki jurists stipulated that exchange contracts are contracts where the contracting parties will receive the reciprocal as the outcome of the exchange from the sealed contract. The reciprocal exchange happens in the form of property and assets such as in the contract of sale and purchase whereby the seller will get money from the buyer and the buyer gets the goods from the seller. Reciprocal exchange also happens in the form of asset and benefit such as in the contract of rental whereby the landlord will get money and the tenant will get benefit from the rented goods (al-Masrī, 2011). In the contract of *tabarru'*, the purpose of this contract also does not involve the exchange of assets. For example, contract of *hibah*, will, *waqf* (endowment), and donation. *Gharar* gives

effect in the contract of sale and purchase because it involves falsehood in devouring human wealth and hazard that will be arisen because of the *gharar* element. This is in line with the wisdom of *gharar* prohibition, that is to prevent argumentation and hostility and to prohibit human from taking another man's wealth falseness, which is different with contracts of *tabarru'* that do not involve the exchange of assets (Al-Qarafi, 2001).

Maliki jurists also argued with the hadith by Rasulullah s.a.w. that prohibited the *gharar* sale. Thus, *gharar* affects only the sale contract. The original argument in this contract is *mubah* (permissible), as long as there is no evidence that forbids it. Muslim scholars debated with this hadith. Nevertheless, they suggested that this prohibition includes the contracts of *tabarru'* which is to preserve one of the *maqasid al-shari'ah* in order to protect the wealth of assets (Al-Qarafi, 2001).

Therefore, whatever that is not permissible in the contracts of sale and purchase, such as *jahalah*, will also not be permissible in the contracts of *hibah* because the purpose of the contract is to own assets. However, the element of *jahalah* in the will is permitted (Al-Shīrazī, 1995). Thus, views from the scholars of Maliki are closer to the purpose of *aqad* prescription. The arguments presented are also stronger compared to the arguments of the consensus scholars.

### 2) Element of *Gharar* in the *Asl (Original)*, not in the Subsequences (*Tabi'*).

The scholars were unanimous when saying that *gharar* in the subsequence (*tabi'*) will never give effect to the contract (Ibn Qudāmah, 1996). Therefore, the *gharar* element in its original *ma'qud alayh* is forbidden. The scholars gave the example of *gharar* in the subsequence (*tabi'*) such as sale and purchase of the calf in the womb and milk in the udder. If the *gharar* element is in the fetus or milk, it will not void the contract because they are only of the importance of both sold goods. The scholars were in consensus to say that the sale and purchase of the fetus in the womb are illegal, but the sale and purchase of conceiving cattle are legal. Likewise, the sale and purchase of milk in the udder are forbidden, but to buy a kettle that has milk in its udder, is legal despite the buyer does not know the condition of the milk, because it follows the cattle, it is also sold in the sale of the original (Al-Nawawī, 1992; Ibn Taymiyah, 1997).

Similarly, in the purchase of a house on the land that is unknown of its condition. If it is sold together with the original object, it will come along with things that follow it; as such, it will eliminate the *gharar* element which probably found in the land. It is also permissible to the sale and purchase of fruits with the tree because it no longer contains the element of *gharar*, and some scholars stipulated that this contract is permissible because it contains *gharar yasir* (Ibn Qudāmah, 1996). Another example is the sale and purchase of plants that are still planted in the ground. According to Hanafi jurists, it is valid to sell what lies in the grounds if the existing part is more than the non-existing part because the latter is then a subsidiary (*tabi'*) to the former (*asl*). This kind of uncertainty will never nullify the contract (al-Kasānī, 2000).

### 3) The Contract does not Reach the Level of Need (*Hajah*).

Islamic law looks at *hajah* or public need as one of the measurements in determining the legality of sale and purchase contracts. For instance, the *gharar* contract done without intention such as selling fish in a pool of water, selling milk that is still in its udder and selling the fetus in the womb. If there is a need and *hajah* toward the contract that has the element of *gharar*, this contract is permissible. Because of this, the scholars are unanimous to say that it is permissible to sell a lined overcoat, though the lining is not seen (Al-Jundi, 2005). Ibn Taimiyah (1957) also permitted the sale of tubers that is still planted in the ground, base on *maslahah* and *uruf*. In fact, Al-Darir (2004) stressed that when there is *hajah* toward the contract, thus it is permissible regardless the degree of *gharar* element in it. This is because the contract is prescribed for human need and eliminates the hardships and difficulties of human beings. He argued by the word of Allah s.w.t in Surah Al-Haj (22): 78 'And He has imposed no difficulties on you in religion'.

Shatibi (1999) defined *hajah* as something needed by man to avoid *masyaqqah* (difficulty) and obviate hardship, however it does not reach the stage of endangering a soul. (Ibnu Nujaym, 1969). Without *hajah*, man will face life hardship, although his life is not perished. For example, *hawalah* is permissible although it's against the *qiyas* because there is man's *hajah* toward it (Al-Suyuti, 1994; 'Ali Haydar, 1991). Other examples of contracts containing the element of *gharar*, yet permissible due to *hajah* or human need for it are *bay' salam*, *bay' istisna'*, *bay' wafa'*, *ijarah*, *khiyar al-syart*, *khiyar al-ta'yin*. These contracts such as *bay' salam*, *bay' istisna'* have the element of *gharar* because of *bay' ma'dum* and its permissibility is based on human need, though it contradicts the *qiyas* ('Azam, 2005; Zarqā', 1994). There are evidences showing that leniency is given due to *hajah* in Surah Al-Baqarah (2):185 'Allah intends every facility for you, He does not want to put to difficulties'.

Generally, this proposition implies to the human *maslahah* (need) and eliminate *fasad* and danger. Although the scholars acknowledged *hajjah*, which is general or specific in the sense as one of the reasons that lightens the law, the *hajjah* is still subjected to specific parameters (*dawabit*) so that the *hajjah* conforms the dispensation granted by the *shara'*. The specific parameters for *hajjah* are as follows:

### 3.1) Hajjah parallel to *maqāṣid al-shari'ah*.

*Hajjah* is facilitated when it attains human interest and in line with *maqāṣid al-shari'ah* or *qasdshara'*. This *hajjah* must be suitable to the *maslahah* desired to be formed by the *shara'* because shariah is built for the wellbeing of *ummah* and rejecting harm. This matter was recognized by Shatibi (1900) and 'Izzu al-Din (1994). Protecting asset is one of the *maqāṣid al-shari'ah*. However, this does not include all contracts that contain elements prohibited from the *shara'*. For instance, *ijarah* is permitted because there is *hajjah*. Nevertheless, *ijarah* is not allowed for benefits against the *shara'*. Therefore, *hajjah* which is granted leniency is the *hajjah* that has decent purpose, not purposefully for conducting wrongdoings, and not the *huge* that is against the Islamic law (Shibir, 2001).

### 3.2) Leniency based on *hajjah* according to the permissible degree only.

Leniency based on *hajjah* toward a purchase contract also has its limitation and is allowed only according to its degree ('Abdul al-Aziz, 2005) as the Islamic legal maxim says that the condition of urgency is determined by the degree of the urgency (Ibn Nujaym, 1969; al-Fauzan, 2000). The position of *hajjah* is similar to *darurah* in the aspect of the required degree application. This condition is permitted only to its degree, without exaggeration (Shibir, 2001).

### 3.3) There is no other alternative than the contract.

*Hajjah* or need toward the contract must have no other solutions but only it. If there is another contract that has no *gharar* element can serve the purpose of the contract that has *gharar*, hence the *hajjah* towards the *gharar* contract is not acknowledged. For example, the illegality of the *ijarah contract* of the cattle for the purpose of milking, because the cattle can be purchased to get the milk (Al-Darir, 2004). Based on the aforementioned parameters, *hajjah* that is granted leniency is the *hajjah* that fulfils the above conditions and the leniency will not happen for the *hajjah* that does not meet these conditions.

### 4) The Element of *Gharar* is Easily Avoidable.

Al-Nawawi (1992), Ibn Qayyim (1993a), Shatibi (1913) and Al-Baji (1999) stated that there is a consensus when the *gharar* is inescapable, unless through hardship, thus it is permissible and categorized as *gharar yasir*. Therefore, the researchers suggested that the element of *gharar* that is easily removed by the contracting parties is considered as *gharar fahish* that gives effect to the contract, due to the fact that the classical jurists do not classify *gharar* into three categories which are done by the current scholars. This opinion was also acknowledged by Al-Misri (2009). Based on his review on the parameter specified by Al-Darir, he opined that this element is important to be treated as a benchmark, for when a matter is hardly avoidable, the *shara'* will grant leniency to it. Furthermore, he proposed that the parameter of *gharar* should be based on the degree of avoidance ability not by basing it on the degree of the *gharar* element.

The scholars also gave example of house sale and purchase that is unknown of its building condition and how it is built. The same goes to the purchase of conceiving animals, that is unknown whether the baby is female or male, is it going to survive the delivery or not or is it normal or abnormal. There is also a possibility that the number of babies is one or more. If to get information on the foundation of the house and the condition of the animal pregnancy, the buyer has to undergo difficulties; all these are permissible according to the consensus (al-Nawawī, 1992; Ibn Qayyim, 1993a). This parameter is advocated by one of the Islamic legal maxim every *gharar* that is hardly avoidable in the contract, is permissible by the *shara'* ('Izzu al-Din, 1994).

The stated Islamic legal maxims related to the difficulties and hardships that will cause a change in the law. In fact, this matter has its evidences from the Quran and hadith. For protecting the interest of the society, the original law that causing hardship to the society can be lightened. This method encompasses all urgencies that require the change of law from its original regulation so that the obligation can be carried out in the capacity of a normal human being. Thus, for the element that is hard to avoid, it is included in the *gharar* that does not give effect as *shara'* has given leniency to the hardship experienced by human in the avoiding *gharar* element. Whereas if the *gharar* element is easily avoidable, and the contracting parties do not do so, hence it is not subjected to the leniency and dispensation granted by the *shara'*.

### 5) The Element of *Gharar* is Too Abundant (al-Darir, 2004)

The scholars were unanimous in saying that too much element of *gharar* will cause a contract to be voided (al-Ansari, 1992; Al-Azhari, 1990). Examples are such as the sale and purchase of birds in the sky and fish in the water. A small amount of *gharar* is forgiven and does not nullify the contract (Ibn Juzay, 1975; Al-Dusuqi, 1996). Examples for the forgiven *gharar yasir* are namely as the purchase of a house that is unknown of its basic condition, the same payment made by every person going into the public washroom although time and amount of water consumed are different for each person, as well as the amount of housing monthly rental payment because in a month there is 30 or 29 days but the rate of payment is the same and the selling of a lined overcoat though the lining is not seen (Al-Nawawī, 1992; Al-Qarafī, 2001; Al-Khirsyi, 1989).

The overly abundant element of *gharar* will void the contract. It is categorized as the prohibited *gharar fahish*. However, there is no specific guide or clear benchmark provided by the classical jurists to differentiate between *gharar fahish*, *mutawasit* and *yasir*. Therefore, Al-Darir (2004) and Al-Sanhuri (1954) put the measurement of *gharar*, be it much or less is based on the local condition and situation that is different according to respective periods. There were laws created by the *mujtahid* that based on their period. This makes the laws different according to the period because of the change in the people *uruf* or because of urgency or corruption of society's morality. If the previous law is retained, thus it will raise *masyaqah* and harm towards humanity and violate the methods of laws established on the fundamentals of lightening, facilitating and rejecting harm and damage to preserve the life system based on the best regulations (Al-Zarqā', 1989). However, the measurement on whether the element of *gharar* in the contract is much or less based on *uruf* still requires detailing and it is quite subjective. Thus, the measurement on the amount of *gharar* is based on its dominance in the contract and whether the contract can bring dispute that obstructs the submission and acceptance of the goods.

5.1) The element of *gharar* dominates the contract or can be seen apparently in the contract.

Al-Nawawi (n.d) defined what is meant by overpowering *gharar* is when the *gharar* can be seen or known apparently in the contract. Example for contracts that have the element of *gharar* which can be seen literally in the contract is the *gharar* that is in the consensus to be illegal such as to sell birds that are freely flying in the sky, to sell fish that is freely swimming in a wide pool, to sell milk that is still in its udder, *bay' mulamasah*, *bay' munabadhah*, *habal al-habalah*, *bay' muhaqalah*, *bay' mulaqih*, *bay' mudamin*, *bay' al-hasat* and transaction of unripe fruits. This notion was also supported by a few scholars who opined that this *gharar* element is too strong that it overpowers the contract (Ibn Rushd, 1988). Al-Baji (1999) also agreed to this view and suggested that the contract is voided when *gharar* dominates the contract. Al-Darir agreed with Al-Baji and supplemented the opinion by giving the example of unripe fruit transaction during the time of Rasulullah s.a.w. This transaction triggered quarrel because most of the fruits were rotten and imperfect when ripped. Rasulullah s.a.w. was then forbade this kind of transaction due to the excessive *gharar*.

5.2) The contract leads to rivalry.

The *gharar* contract is prohibited because of betting element that raises rivalry among the losing party (Al-Darir, 2004). The contracting parties are also exposed to risks and dangers (Ahmad Hidayat, 2000). No specific method refers to this statement. However, there is a method held by the Hanafis who stated that ambiguity that brings to hostility causes the nullification of the contract (Sarakhsi, 2000). The element of *jahalah* does not give effect if it does not lead to rivalry in regard to the delivery of goods and payment of the price. The Hanafis viewed that if the ambiguity will cause rivalry among the contracting parties, the transaction is illegal, but if the ambiguity does not bring to it, it is forgiven (Ibn `Abidīn, 1994).

Based on the view of Al-Kasani, the element of *jahalah* that leads to rivalry obstructs the submission and acceptance, while the element of *jahalah* not invoking hostility and not hindering submission and acceptance, does not void the contract. *Jahalah* not causing hostility involves submission and acceptance and realizes the objective of the contract. For example, selling the house which its structural foundation is unknown, but it does not retard the submission and acceptance, therefore the contract is legal (Shibir, 2001). This opinion was also agreed by Al-Zuhaylī (1997) who opined that meagrar ambiguity is the ambiguity that does not lead to hostility and commonly promotes consideration.

The view stated by Al-Kasani refers to the element of *jahalah*, however it is suggested that it is suitable to be used as a parameter of *gharar* due to the fact that some classical jurists defined *gharar* as *jahalah*. In fact, based on the concept, *gharar* is wider than *jahalah*, although there is difference between *jahalah* and *gharar*. Thus, it is concluded that the element of *gharar* that brings rivalry will hinder the submission and acceptance of the price and goods will cause the element of *gharar* in the contract to give effect. Examples of contracts containing the *gharar* element that is able to bring hostility which hinders the acceptance and submission of price and goods are the sale of birds which are still freely flying in the sky, the sale of fish which are swimming at large in a wide

pool, the sale of milk that is still in its udder, *bay' mulamasah*, *bay' munabadhah*, *habal al-habalah*, *bay' muhaqalah*, *bay' mulaqih*, *bay' mudamin*, *bay' al-hasat* and the sale and purchase of immature fruit. For the example of transaction of birds which are freely flying in the sky, this contract can lead to rivalry when the seller cannot submit the sold birds because of failure to catch the flying birds. The rivalry occurs when the buyer does not receive the purchased birds, although payment has been made.

### 5. Findings and Discussion on the Existence of *Gharar* in the Forward Contract

Based on the five *gharar* parameters above, we examined either that elements prevail in the forward contract. After thorough investigation, we encounter that *gharar* element in forward contracts does not effect on the validity of the contract. Following is our analysis base on the parameters above:

#### 1) The Element of *Gharar* in the Contract of Exchange (*uqud mua'awadat*).

A forward contract is a contract between two parties to buy or sell an asset at a certain future time for a certain price (Jarrow & Turnbull, 1996; Chance, 2008). *Gharar* issues arise when the underlying commodity does not exist (*bay' ma'dum*) during the contract and deferment of both counter values (*ta'jil badalayn*). Under the Islamic law of transaction the exchange of goods and price should be made during the contract and deferred either one of them is allowed only in *bay' al-salam*, where the delivery of goods deferred and the price given on the spot and *bay' bithaman ajil* when the goods delivered on the spot and the price deferred. As far as we understand in the forward contract which using the purchase contract the deferment of goods and price happen simultaneously, which is not complying with the Islamic Law of the transaction. Therefore, forward contracts fulfil this parameter as the *gharar* element exists in the forward contract which is an exchange contract. *Gharar* in the exchange contract will lead to dispute and one of the contracting parties unjustly taking the property of another.

#### 2) The Element of *Gharar* Exist in the Origin of *Ma'qud Alayh*, not in the Subsequence (*Tabi'*).

The element of *gharar* in forward contract is in its origin (*asl*), not in the subsequence (*tabi'*). *Asl* in the forward contract refers to the element of *gharar* in its *ma'qud alayh*, that is in the price and goods. The *gharar* element is such as *bay' ma'dum*, that is when the palm oil does not exist during the contract is signed and postponement of goods and payment (*ta'jil badalayn*) happens as the goods and price will only be delivered and paid in the future. In a forward contract, there is a possibility for any of the parties to default when there is no third party to supervise the contract and guarantee the seller will deliver the commodity and the buyer will pay the price. Contrast to a futures contract, the clearing house will guarantee the fulfilment of the contract. Thus, the uncertainty over the seller's ability to deliver the commodity and the buyer to pay in the future is *gharar*. The issue of *qabd* occurs when contracting parties sell the sealed contract with the third party. Then, forward contract meets this second parameter. When there is element of *ma'dum* and *ta'jil badalayn*, there is a possibility for any of the parties to default the obligations or breach the contract when there is no third party to supervise the contract.

#### 3) The Contract not Attaining the Level of Need (*Hajah*)

This method enables leniency from the original rule in the state of urgency (*darurah*) and human need (*hajah*). In the context of a forward contract, there is *hajah* or need towards this contract. However, the permissibility on the basis of *hajah* also has specific parameters to be met. The specific parameters are as follows:

##### 3.1) *Hajah* parallel to *maqāṣid al-shari'ah*.

*Hajah* toward forward contract must be suitable with the *maslahah* created by the *shara'* because the Islamic law is for people's convenience and rejecting harm. This contract supposedly not causing difficulty and not eliminating *maslahah*. The *shara'* permits the contract of sale and purchase for the sake of protecting human *maslahah* to secure the property. There is a need for protecting the value of diversity of price and unexpected risks of the crude palm oil producing companies, manufacturers, packagers and manufacturers of palm oil based products. Efforts in managing and reducing risks are permissible by the Shariah and in line with the objectives of Shariah (*maqāṣid al-shari'ah*) which specific place one of its objectives to protect the wealth from any harmful exposure. In fact, in the verse of al-Baqarah: 282-283 it is encouraged for the Muslim society to document the debt or to present a witness as one of the ways to reduce the risk of having a dispute in the future.

##### 3.2) Leniency based on *hajah* according to the permissible degree only.

This parameter refers to the permissible leniency only for the purpose of hedging and this contract is carried out just in the *primary market*. The primary and main purpose of a forward contract is to protect the value from the risk of change in crude palm oil commodity in the market. Commonly, in the industry of palm oil, this contract is

done for the purpose of hedging. For instance, for crude palm oil producers, they manage the risk of price movements by the activity of hedging. The price market of crude palm oil will experience the rise and fall in the future. Hence, forward contract can act as an insurance that assists a company in dealing with price change in the future.

However, apart from the purpose of hedging, forward contract can also be used for speculating on price movements that can generate an unearned income. The commodity is transacted and sold to another third party, and they also sell it further and so on. When the specified date of delivery appears, each party settles the difference between the buying and selling price, usually before the maturity date. The idea is to gain profit without having to actually delivering the commodity. The forward contract is then considered as not fulfilling the parameter of *hajah* if it is only carried out for profit gain per se.

The permissibility is only for primary market, which is the first contract happens between the primary seller and the buyer, not for secondary markets. The stage of secondary market will involve the sale of contract with the third party and so forth (Zaharuddin, 2011). For forward contract of crude palm oil, there are contracting parties who sell their contracts to the third party to gain profit put of the price difference from the first party purchase. Nonetheless, in Malaysia, the sale to the third party is not frequently done and usually the contract is held until the date of contract maturity (Teoh, 2011).

### 3.3) There is no other alternative than the contract.

The leniency due to *hajah* is given when there is no other alternative for hedging than to practice forward contract. We opine that the permissibility of a forward contract is one of the exceptions which have limitation, which is when there is no other better or comparable alternative compared to this contract. When there is another alternative, thus this contract does not meet one of the parameters of *gharar*. Based on our observation and interview, the forward contract offers the best alternative for managing risks and hedging for parties involved in the industry of palm oil commodity (Hassan, 2012).

In the industry of crude palm oil, forecasts of price in the future can help the producers to plan the production and process of crude palm oil due to the price uncertainty in the cash market. Compared to selling the crude palm oil in the cash market, the palm oil producers and manufacturers will face difficulty if there is no demand on the palm oil during that time. Producers of palm oil will be exposed to the fall of palm oil price in the future and the possibility of no demand. The manufacturers will be exposed to the rise of palm oil price and the possibility of source scarcity. Forward contract aids both parties in hedging and planning business activities respectively (Nik Mohamed Ruslin, 1998). Therefore, we suggest that forward contract is the best alternative for palm oil industry and it has been practiced by many contracting parties in this industry.

Based on the drawn parameters as mentioned, there is no restriction for the contracting parties to obey the obligated parameters. If the contracting parties oblige the prescribed parameters, thus they fulfil *hajah mu'tabarah*.

### 4) The Element of *Gharar* is Easily Avoidable.

The elements of *gharar* in the forward contract namely as *bay' ma'dum*, deferment of both counter values (*ta'jil badalayn*) and selling deal before getting possession (*qabd*). In a forward contract, the element of *gharar* such as the nonexistence of goods during the signing of the contract (*bay' ma'dum*) and deferment of both counter values (*ta'jil badalayn*) are unavoidable by the contracting parties. This is because it has become the nature of the contract to condition the nonexistence of the goods and deferment of goods and price. If the goods are provided during the contract and the goods and price are not postponed, it is not categorized as forward contracts; in contrast it becomes a sale and purchase contract. Forward contract builds on these elements. As a matter of fact, the forward contract itself does not permit the contracting parties to pay or submit the goods during the signing of the contract. However, the issue of *gharar* in forward contract, such as selling deal before getting possession is avoidable by the contracting parties by not selling the owned contract with the third party and others. The contracting parties have to only hold the sealed contract until the date of contract maturity and surrender the goods and pay for the price of transacted crude palm oil. This is because the original purpose of the contract is to buy the crude palm oil in the future.

### 5) The Element of *Gharar* is Excessively Abundant.

#### 5.1) The element of *gharar* dominates the contract or can be seen apparently in the contract.

Deferment of both counter values (*ta'jil badalayn*) and selling deal before getting possession are apparent on the contract literally. The issue of *bay' ma'dum* occurs when the subject of the contract, which is the crude palm oil, is not existing during the contracting. The issue of delivery of goods and price payment (*ta'jil badalayn*) occur

when the price and goods will be paid or delivered in the future. While the issue of selling deal before getting possession (*qabd*) only happens when the contracting parties sell the sealed contract with the third party. These elements dominate the contract until it is characterized with the *gharar* (Nurdin, 2011). Thus, the element of *gharar* in the forward contract dominates the contract and can be seen literally.

5.2) The contract leads to rivalry.

Determination to the degree of *gharar* element in the contract is based on whether the element can bring to hostility that hinders the submission and acceptance of goods. The rivalry does not happen due to ambiguity of terms because the terms and conditions of the contract are clear in a forward contract. However, when there is an element of *ma'dum* and *ta'jil badalayn*, there is a possibility for any of the parties to default the obligations or breach the contract when there is no third party to supervise the contract (Aznan, 2011). Rivalry may exist when the contracting parties do not comply with the sealed agreement. A forward contract is different with future contracts that have cleared house that will ensure the contractual terms are complied with.

Default by contracting parties can happen, especially for the buyers when there is a sudden price drop in the crude palm oil market. If the price drops, buyers have to buy at an expensive price from the sellers, which are based on the agreed price in a forward contract. This matter will adversely affect the buyers. If the price soars in sudden, sellers will experience a loss if they sell the palm oil at a cheap price, which is based on the agreed price in a forward contract. However, the palm oil producer comprises of large companies normally will not breach the agreement, for the sake of maintaining reputation in the market. Nonetheless, it is on the opposite if the sellers are from the unknown small companies. This situation can be seen in 2008 when there was a huge slump in price due to economic crisis occurred in that year. There were more than 60 cases of default which mostly caused by buyers who refused to pay with the agreed price in the forward contract (Teoh, 2011).

As such, the default occurred will lead to hostility that prevents the submission and acceptance of goods and price between both contracting parties. Although the contracting parties can refer to the conciliatory body, such as The Palm Oil Refiners Association of Malaysia (PORAM) or take their case to the court, from the point of Shariah, this kind of rivalry should be avoided as it is the cause of *gharar* transaction prohibition. Since the consensus wisdom of *gharar* prohibition is to prevent rivalry, inability to surrender the goods and falsehood in devouring the wealth of human. Accordingly, we conjecture that when the contract leading to disputes involving submission and acceptance of goods, it closely resembles the definition of *gharar* stated by the classical jurists who defined *gharar* as the unknown consequences, that is, whether the contract will occur or not and the definition given by the current scholars which is a risky contract.

In conclusion, the analysis shows that element of *gharar* in a forward contract is not affected because not all parameters are met. We conclude our analysis and discussion in table 1 below:

Table 1. Analysis of forward contracts on the parameter of *Gharar*

Parameter of <i>Gharar</i>	Existing element of <i>gharar</i> in the forward contract
1. An element of <i>gharar</i> exists in contract of exchange.	Yes
2. An Element of <i>gharar</i> in the <i>asl</i> (original), not in the subsequence ( <i>tabi'</i> ).	Yes
3. The contract does not reach the level of need ( <i>hajah</i> ).	No
4. The element of <i>gharar</i> is easily avoidable.	No
5. The element of <i>gharar</i> is too abundant.	Yes

## 6. Conclusion

A contract containing the element of *gharar* has different laws. The Islamic scholars unanimously stipulate that contracts with the element of *gharar fahish* are voidable while contracts that have the element of *gharar yasir* are not voidable. However, there are contracts debated by some scholars and some of them categorize these contracts as *gharar fahish* and some of them classify them as *gharar yasir*. To facilitate the classification of *gharar*, the current scholars categorize the contracts debated by the classical jurists as *gharar mutawasit*. Therefore, the formation of parameters to determine whether a contract contains the element of *gharar* that voids the contract or not is very essential.

Findings from the analysis conducted on the elements of *gharar* in forward contracts show that the element of *gharar* does not affect the forward contract. However, it is subjected to the obligation of the stated parameters. These parameters are only a guide to determine whether the element of *gharar* in the contract nullifies the contract or not. Although there are contracts that have the element of *gharar* that are not voidable, the contract is not necessarily permissible, if the contract contains other Shariah issues such as *riba* (usury), *maysir* (gambling) and others.

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