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Islamizing Insolvency Laws in Pakistan

(Thesis for LLM in Corporate Law)

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"In the name of Allah, the beneficial and most merciful"

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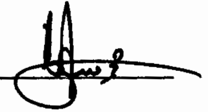
Supervisor ____________ 

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Islamizing Insolvency Laws in Pakistan

Submitted by me in partial fulfillment of LLM degree in Corporate Law, is my original work, and has not been submitted or published earlier and shall not in future be submitted by me for obtaining any degree from this university or any other university or institution.

Signature:

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Dedication

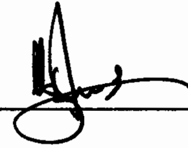
To my Father and mother.

Acknowledgement

- I kneel down and pay all my gratitude to Almighty Allah who made and blessed me with the interest, abilities and patience to think, see and compile my knowledge. Without His bestowment it was impossible for me to even imagine about it.
- This dissertation could not have been written without the guidance of Dr. Mohammad Zia-ul-Haq who not only served as my supervisor but also encouraged and challenged me throughout my academic career. He patiently guided me through research process, never accepting less than my best efforts. I am particularly indebted to him.
- I wanted to say very special thanks to my family.

Certificate

It is hereby certified that Mr. Mohammad Ayaz S/O Hamd-e-Akbar, Registration No. 156-FSL/LLMCL/F07 has successfully completed his thesis under my supervision. He affirms that he has neither submitted the thesis nor will submit it in future in any other university for thesis evaluation or viva voce examination. I recommend his thesis to be dully accepted for viva voce examination.

Supervisor 

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Abstract

Pakistan is an Islamic country. Constitution is the supreme law in Pakistan. Article 2 of the constitution states that Islam shall be the state religion. Article 2A states that Objective Resolution shall be operative part of the Constitution. Similarly Article 227 states that all the existing laws shall be brought into conformity with the injunctions of Islam as laid down in the Holy Quran and Sunnah, and no law shall be enacted which is repugnant to such injunctions. For this purpose the Council of Islamic Ideology (CII) has been constituted which is a recommendatory body. CII has been assigned the task of reviewing all the existing laws in Pakistan and to give recommendations to the parliament to Islamize these laws. Federal Shari 'at court has also been established to nullify the laws that are repugnant to injunctions of Islam. Therefore, Insolvency Laws in Pakistan need to be reviewed in the light of Islamic Laws of Insolvency in order to enact a full-fledged Islamic Act of Insolvency that would reflect true picture of Article 227 of the Constitution of Pakistan 1973.

Basically, Islamic law recognizes personality of a human being alone, and it does not attribute such personality to a non-human because the element of *'aql* is lacking in them, however modern Muslim scholars have attempted to do so. Thus, like English law, Islamic law also accommodated fictitious personality of non-humans these days.

This research is aimed to identify un-Islamic provisions of Insolvency Laws in Pakistan, and to describe Islamic provisions regarding insolvency, and finally to give my opinion in order to Islamize such provisions.

Through this research it is obvious that until and unless the insolvent debtor does not pay his debt amounts to his creditors, or his creditors waive their right to such amounts, the debtor is responsible for these amounts, and he is not absolutely released. Court cannot take his property into its possession until and unless the debtor himself does not want to sell. In such case court may appoint official receiver or liquidator as the case may be.

Importance of the Topic

Pakistan is an Islamic country. Constitution is the supreme law in Pakistan. Article 2 of the constitution states that Islam shall be the state religion. Article 2A states that Objective Resolution shall be operative part of the Constitution. Similarly Article 227 states that all the existing laws shall be brought into conformity with the injunctions of Islam as laid down in the Holy Quran and Sunnah, and no law shall be enacted which is repugnant to such injunctions. For this p-purpose the Council of Islamic Ideology (CII) has been constituted which is a recommendatory body. CII has been assigned the task of reviewing all the existing laws in Pakistan and to give recommendations to the parliament to Islamize these laws. Federal Shari 'at court has also been established to nullify the laws that are repugnant to injunctions of Islam. Therefore, there is a need to review Insolvency Laws in Pakistan from the perspective of Islamic Laws.

This becomes more important when we look at the fact that laws relating insolvency in Pakistan are in a scattered form. In Companies' Ordinance, 1984 some provisions are found in CHAPER IX that deals with winding up of companies. In Partnership Act, 1932 insolvency laws are discussed in CHAPTER IV that deals with the dissolution of partnership. It is not only remedy to wind up a company or to dissolve a partnership during insolvency. There is no full-fledged Act in Pakistan that comprehensively covers all aspects of insolvency. The existing Provincial Insolvency Act, 1920 does not cover the re-organization and rehabilitation of businesses. It does not fully determine the rights and extent of

liabilities of insolvents during insolvency. Islamic laws on the other hand, fully describe the rights and extent of liabilities of insolvent during insolvency.

An Overview of Existing Insolvency Laws in Pakistan

British have been ruling over us for many years. We have derived most of our laws from common law. Insolvency laws are among those. Insolvency laws were introduced in Pakistan in the form of Provincial Insolvency Act, 1920. Then in 1959, the said Act was amended by an Ordinance of the then President, and the Act is now called the Provincial Insolvency (West Pakistan Amendment) Ordinance, 1920, where a new sub-section (3) was inserted after sub-section (2) of section (60) of the said Act. Basically the Act deals with individual insolvency. Under this Act, insolvency is a proceeding by which, the state takes possession of the property of an insolvent. An officer is appointed for this purpose. The person adjudicated as insolvent is set free, and he is no longer liable for any debt. His property is distributed with equal proportionate among his creditors. Any person capable of contracting may be adjudicated an insolvent by the court provided that he is a debtor, and ha committed an act of insolvency. Both the debtor and creditor can move an application to the court for the adjudication of the debtor as insolvent. No insolvency petition can be presented against any corporation or an association, or a registered company. Person adjudicated as insolvent cannot be appointed as a magistrate, or is elected a member of any body.

The Companies' Ordinance, 1984 deals with corporate insolvency where some provisions regarding insolvency are in chapter IX of the Ordinance, which deal

with winding up of companies. Under this Ordinance, one of the reasons for the compulsory dissolution of a company is that the company shall be unable to pay its debts. Company shall be considered unable to pay its debts, if a creditor to whom a sum exceeding one percent of the paid up capital of the company or fifty thousand rupees, whichever is less, is due, has served a notice, demanding payment, of where an execution or other process issued on a decree or order of any court or any other competent authority in favor of a creditor of the company is returned unsatisfied in whole or in part, or where it is proved to the satisfaction of the court that the company is unable to pay its debts. In case of voluntary winding up, a "declaration of solvency" is made by the Board of Directors, in which they state the company has no debts or that it will be able to pay all its debts in full within such period not less than twelve months from the commencement of the winding up.

Similarly, in Partnership Act, 1932, insolvency provisions are in chapter VI that deals with the dissolution of partnership. Under this Act, one of the reasons for the compulsory dissolution of partnership among its partners is the becoming any one of its partners as insolvent. And when all its partners or all but one become insolvents, it is one of the reasons for the compulsory dissolution of the whole firm.

Thesis Statement

Insolvency laws in Pakistan need to be reviewed in the light of Islamic law of insolvency in order to enact a full fledged Islamic act of insolvency that would reflect the true picture of article 227 of the constitution of Pakistan, 1973.

Research Methodology

Most of the work will be comparative analysis of insolvency laws including Islamic laws of insolvency, but it will also include some sort of descriptive work, by applying analytical method, some general principles will be deduced and, then, exceptions to those principles will be mentioned to avoid analytical inconsistency. Review of laws will be in the light of Hanafi school of thought. Help may also be taken from other schools of thought.

INTRODUTION

Chapter No. 1 Introduction to Insolvency in *Shariah* and Law

Chapter No. 1 Introduction to Insolvency in Shariah and Law

1.1 Concept of Insolvency in Law

Insolvency is derived from an English word "solve" that means "to settle"[1], "to dissolve"[2] and "to clear up".[3] Literally, solvent is any thing that dissolves another thing.[4] Technically, it means "able to pay all debts."[5] So person who is able to pay his debts to his creditors is solvent.

Oxford dictionary defines the term solvent as: "able to pay all one's debts or liabilities".[6]

1.2 Insolvent

For launching projects, company requires finance. For this, company raises funds from two ways. It issues shares and bonds with some proportion. Then company invests such money in projects. If company gets profit, it pays dividends to its share-holders and interests to its bond-holders (creditors). And if project fails and company undergoes loses, and it is unable to pay its debts back to its creditors, then it is called insolvent.

"A person who is unable to pay his debts as they become due".[7]

---

[1] E M Kirkpatrick, *Chambers 20th century Dictionary*, e.d. E M Kirkpatrick (Suffolk: Richard Clay (the Chaucer Press) Ltd, 1983), P. 1232.
[2] *Ibid.*
[3] *Ibid.*
[4] *Ibid.*
[5] *Ibid.*
[6] J.A. Simpson; E.S.C. Weiner, *The Oxford English Dictionary*, 8th edition, vol.15 (New York: Oxford University Press, 1989), P. 984.
[7] P.G. Osborn, *A Concise Law Dictionary*, 4th edition, (London: Sweet & Maxwell, Limited, 1954), P. 177.

The definition shows that any person who owes debts to his creditor(s), and is unable to pay these debts is called insolvent. Here the word "unable" refers to his financial inability. Although, he may be eager to repay his debts, but is not having enough amount to fully satisfy his creditors.

Creditor and debtor may agree that debtor will repay the debt amount within, or at a particular time, or after it. If that particular time arrives and the debtor is unable to pay his debts, he is termed as insolvent. It means that person becomes insolvent only, when the time agreed upon by him, with his creditor, arrives, and he is unable to repay his debt. So the words "they (debts) become due" refer to that particular or determinable time, which is fixed, upon or within which debtor has to repay his debts to his creditors.

It is well-known to all that person includes both individual and company. Islamic law also recognizes corporate personality. Under Islamic Law fictitious personality is attributed to a company. For detailed discussion see next chapter.

Another definition of insolvent is:

"(Of a debtor) having liabilities that exceed the value of assets; having stopped paying debts in the ordinary course of business or unable to pay them as they become due".[8]

This definition has two parts. These two parts are two definitions of insolvent. The first part is that, any person whose liabilities exceed his assets, and he stops payments to his creditor in the ongoing ordinary course of business. The second part is that, any person whose liabilities exceed his assets, and becomes unable to

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[8] Bryan A. Garner, *Blacks Law Dictionary*, 8th edition, (USA: np 2004), P. 811.

pay debts after becoming due. But these two has the same result i.e. person's inability to satisfy his debts.

This definition states that any person whose liabilities are more than his assets is insolvent, but with the conditions that either he has stopped payments to his creditor in the ongoing course of business, or can not pay his debt, when time for its repayment arrives.

The definition can best be illustrated as follows:

B owes four million rupees to A. A demands his money back from B. B has 1.5 millions in cash, one motorcycle worth forty thousands, and a shop worth eight lacs. Beside this B has no property. Here B's liability is the amount of four million rupees and his total assets are of not more than 2.5 millions. So his liability is more than his assets. After demand by A from B, B can not fully satisfy his creditor (A), so B is insolvent.

The best example of insolvent in these days is that of 'Inayat Haji belonging to District Dir, whose liabilities are Rs. 75 millions, and his assets are not more than Rs. 10 millions.

Some other definitions of insolvent are below.

"An individual who has ceased to pay his or her debts or is unable to pay such debts as demanded by creditors".[9]

"An individual or concern that is unable to meet debts as they mature, or whose liabilities exceed assets".[10]

[9] Jerry M. Rosenberg, *The Investor's Dictionary* (New York: John Wiley & Sons, 1986), P. 229.
[10] Charles J. Woelfel, *Encyclopedia of Banking & Finance*, 10th edition, (New Dehli: S. Chand & Company Ltd, 1924), P. 594.

"A person is said to be insolvent who ceased to pay his debts in the ordinary course of business, or cannot pay his debts as become due, whether he has committed an act of insolvency or not".[11]

These three definitions of insolvent are similar to those discussed earlier.

1.3 Insolvency

From the above definitions of insolvent it becomes clear that insolvency is the status of insolvent. In other words it is the financial position or financial condition of an insolvent.

Insolvency is defined as:

"The inability to pay debts in full".[12]

In this definition the word "full" refers to the meaning that although the person would be able to satisfy claims of some of his creditors or of all to some extent, but even then he would be insolvent, until and unless he is able to satisfy the claims of all of his creditors in full. If creditor demands his money back from debtor and he can not repay debt amount in full, this shows he is in state of insolvency. In other words his position of inability is called insolvency.

In Black's Law dictionary insolvency is defined as:

"The condition of being unable to pay debts as they fall due or in the ordinary course of business".[13] Or

"The inability to pay debts as they mature".[14]

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[11] P. Ramanatha Aiyar, *Advanced Law Lexicon*, 3rd edition, vol.4 (New Dehli: Wadhwa and Company Nagpur, 2005), P. 2365.

[12] P.G. Osborn, *A Concise Law Dictionary*, 4th edition, (London: Sweet & Maxwell, Limited, 1954), P. 177.

[13] Bryan A. Garner, *Black's Law Dictionary*, 8th edition, (USA: 2004), P. 811.

Former definition shows that person who is unable to pay his debts after becoming due, his status is called insolvency. This occurs when he borrows money from creditor and then can not repay it at the time of demand by his creditor. Similarly, if he(debtor) is in course of business with creditor, for instance, he takes things on credit from creditor and then can not pay debt to his creditor because of his financial inability, his this status is called insolvency.

In the later definition of insolvency the words "as they mature" refer to the due time for repayment of debt by debtor.

So, person who can not repay his debts, after becoming due, because he actually does not have any property, or is having but not that much to repay all his debts, is called insolvent, and this state of inability is called insolvency.

Some other definitions of insolvency are below.

"The state of one who has not property sufficient for the full payment of his debts".[15]

"The condition of a debtor unable to pay debts".[16]

"A state of bad financial condition wherein debts and obligations cannot be repaid when due or a business that ceases to operate".[17]

"The inability to pay one's debts as they mature".[18]

These definitions too refer to the same meanings of insolvency as to those discussed before.

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[14] *Ibid.*

[15] Earl Jowitt, *Jowitt's Dictionary of English Law*, vol. 1(London: Sweet & Maxwell Limited, 1977), P. 983.

[16] Charles J. Woelfel, *Encyclopedia of Banking & Finance*, 10th edition, (New Dehli: S. Chand & Company Ltd, 1924), P. 594.

[17] Carl O. Trautmann, *A Complete Dictionary of Small Business Terms* (New Dehli: Vanity Books International, 1994), P. 128.

[18] Jerry M. Rosenberg, *The Invester's Dictionary* (New York: John Wiley & Sons, 1986), P. 229.

1.3.1 Kinds of Insolvency with respect to Person

This concept reflects from the definition of the terms of insolvent and insolvency. These terms refer to person, and person includes both individual and company. There are two kinds of insolvency in this respect.

These are:

1.3.1.1 Individual Insolvency

It is the inability of an individual to pay his debts when they become due.

All laws give individual the right to enter into contracts and to do lawful businesses. He can sell his property, and purchase other properties. He can borrow money for starting business. If an individual borrows money form creditors, and thereafter his business undergoes loses, and he is unable to pay the amounts to his creditors after they become due, the individual is called as insolvent under law. His this inability is called as individual insolvency.

'Inayat Haji is an individual known to me belonging to District Dir, whose liabilities are of seventy five million rupees and his assets are not more than ten million rupees, so he is insolvent, or in other words, individual insolvent.

1.3.1.2 Corporate Insolvency

Corporate Insolvency is the inability of company to pay its debts when they become due.

Company is a juristic person under the law these days. Like individuals, it has its own rights and liabilities separated from its owner. It makes contracts in its own name. It borrows money from lenders in its own name. As its business is separate from its owner therefore, in case if it takes more credits and then it undergoes loses, it is liable for its liabilities. If its creditors demand their money back and the company is unable to pay it, it is termed as insolvent, although the share-holders and bond-holders of such company may be rich.

The share-holders or contributories of such company are not liable for the liabilities of the company, and they are only liable for their unpaid share-capital and the amount guaranteed by the contributories respectively.

So here in this case the inability of the company is called as insolvency, which in other words, is corporate insolvency.

Historically this concept emerged during the first half of the 19th century with the establishment of distinct legal personality of a company from its members, where company is liable for its debs and its members are liable only to the extent of their paid amounts of their share-holdings or to their unpaid share-capital. Authoritative confirmation to the concept was given in *Salomon v. Salomon & Co*. (1897) A.C. 22.

Other kinds of insolvency are Balance Sheet Insolvency and Equity Insolvency.

If we analyze the definition of insolvency by A. Garner, there are two parts of this definition. First part is "(Of a debtor) having liabilities that exceed the value of assets" and second part is "unable to pay them as they become due". These are

actually two concepts of insolvency. A. Garner has defined these concepts under two different headings.

These are:

1.3.1.3 Balance-Sheet Insolvency

"Insolvency created when the debtor's liabilities exceed its assets".[19]

In this case it appears from the financial statements of a company that the company is insolvent, and it is not necessary that the time for payment of its debts has arrived. This is a pre-supposition of the company as insolvent. On the left side of balance-sheet[20] the assets of a company are given while on its right side liabilities of the company are given, from where one can easily understand that whether the company is going to be insolvent or not.

1.3.1.4 Equity Insolvency

"Insolvency created when debtor can not meet its obligations as they fall due".[21]

This is the real case of insolvency because in this case of insolvency the debtor is not in a position to pay his debts after his creditors demand. This type of insolvency includes the above mentioned one as first the liabilities of the person exceeds his assets, and then at the due time he is unable to pay his debts to his creditors.

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[19] *Ibid.*

[20] Balance-sheet is a financial statement of a company. It shows the assets and liabilities of a company at the end of financial year. Balance-sheet shows financial position of a company that whether it doing profitable business or is undergoing loses.

[21] *Ibid.*

1.4 Bankrupt

Black's Law Dictionary defines bankrupt. According to the author of the dictionary bankrupt is a person "indebted beyond the means of payment; insolvent".[22] Or

"A person who can not meet current financial obligations; an insolvent person".[23]

So person who is indebted and is having no means of repayment, or can not satisfy his creditors is called bankrupt. This definition has the same meaning with insolvent. So factually insolvent and bankrupt has the same status. Both are unable to repay their debts. But there is difference between the two terms, which can be identified after reading next few paras coming after the definition of bankruptcy.

Bryan A. Garner says that the meanings of "bankruptcy" include the following:

1. Statutory Procedure
2. Field of Law
3. Financial Inability

He says that bankruptcy is "A statutory procedure by which a (usu: insolvent) debtor obtains financial relief and undergoes a judicially supervised re-organization or liquidation of debtor's assets for the benefit of creditors; a case under the bankruptcy code".[24]

Here according to him liquidation or re-organization proceedings are called bankruptcy.

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[22] Bryan A. Garner, *Black's Law Dictionary*, 8th edition, (USA: n.p 2004), P. 156.
[23] *Ibid.*
[24] *Ibid.*

Again according to him it is "the field of law dealing with the rights of debtors who are financially unable to pay their debts and the rights of their creditors. - Also termed as bankruptcy law".[25]

He also says that "informally, the fact of being financially unable to pay one's debts and obligations as they become due; insolvency".[26]

So, according to Bryan's this definition, insolvency and bankruptcy are synonyms to each other.

Now in the next coming paras one can identify the difference between the two terms.

1.5 Bankruptcy and Insolvency

As I have already discussed that insolvent is a person who is unable to pay his debts as they become due, and insolvency is his state of inability to pay such debts. It is the factual position of person (both individual and company). But if such person is legally preceded, and formal actions are taken against him in court, he is then termed as bankrupt.

Ian F. Fletcher in his Book "The Law of Insolvency" has indicated this concept as:

"it was as a result of the un-coordinated and indeed illogical, condition of the laws relating to debt and bankruptcy that the distinction arose historically between insolvency as a factual condition, and bankruptcy as a legal condition or

[25] *Ibid.*
[26] *Ibid.*

status....when used as legal term, however, and particularly when used as substantives, it is only appropriate to refer to a person as " a bankrupt" if that status has actually been imposed in consequence of a formal, legal process to which the debtor has been a party. Conversely, the expression "an insolvent" has no formal or technical significance in English Law".[27]

An on-line answer by Schultz & Brawn[28], to a question (what is the difference between insolvency and bankruptcy?) is quoted as:

"...insolvency is a financial/accounting term that means one has liabilities or debts in excess of his assets.... 'Bankruptcy is a legal term and actually a legal process. To be bankrupt one needs to have filed with the US Bankruptcy Court the required documents, under the appropriate program or law, and be declared bankrupt".[29]

But this is true only in case of an individual and not a company. So, both individual and company are termed "insolvents" because of their factual status. And only the individual is termed as bankrupt after legal proceedings are taken against him. Company can not be termed as bankrupt after winding up or liquidation proceedings are taken against it.

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[27] Ian F. Fletcher, *the Law of Insolvency*, 2nd edition, (London: Sweet & Maxwell, 1996), P. 4.

[28] It is a German company which handles all Germany-related aspects of European, English and American business recovery and insolvency law, with each team member focusing on particular jurisdictions, legal cultures and languages. See http://www.linkedin.com/companies/schultze-%26-braun-gmbh

[29] http://wiki.answers.com/Q/what_is_the_difference_between_insolveny_and_bankruptcylast accesed: 28.10.2009.

"A company can never be declared bankrupt although it is unable to pay its debts".[30]

This has been referred to by aussielawyers[31], in their online answer to a question (difference between bankruptcy and insolvency). According to them "bankruptcy is the legal status applicable to individual debtors, being natural persons, who, either voluntarily or involuntarily, become bankrupts. In Australia, bankruptcy law is that branch of insolvency law which deals with personal insolvency, and thus bankruptcy refers to the legal status imposed by the bankruptcy Act, 1966(Cth) upon individuals but not on corporations".[32]

It is concluded that insolvency refers to the factual financial inability of a person as well as a corporation. The legal and formal position of an individual human being and not that of company is bankruptcy. On the other hand company is given no such sort of terminology. It is simply dissolved.

2. Concept of Insolvency in *Shari'ah*

Under Islamic Law there has been a comprehensive discussion on insolvency. Both Islamic law as well as English law is identical from the jurisprudential perspective of insolvency and its relevant terms, and the only difference between the two is that of terminologies. Let's see the follows.

[30] A.G. Chaudhary, *Mercantile Law in Pakistan* (Lahore: Khyber Law Publishers, 2003), P. 169.

[31] It is an independent organization to help all Australian people and Australian businesses receive immediate legal assistance on all areas of the law. See http://www.aussielawyers.com.au/

[32] www.aussielawyers.au/links/-bankruptcy-insolvency-legal-advice/ last accesed: 26.07.2010.

2.1 *Muflis* (Insolvent)

Under Islamic Law word "*Muflis*" is used for insolvent.

Literally, *Muflis* is a person "who does not have property or such thing that satisfies his necessities".[33]

This shows that any person who does not have property or any other thing for the satisfaction of his necessities is termed as *Muflis.* Necessities can be inferred to have meaning of debts, then *Muflis* is a person who can not satisfy his debts. So, Muflis means Insolvent under English law.

Technically, in Shari'ah, *Muflis* can be referred to that person "when his debt absorbs or exceeds his properties".[34]

This definition has the same meaning with the definition of insolvent under English Law.

2.2 *Iflaas* (Insolvency)

Under Islamic Law, word "*Iflaas*" is used for insolvency and it has two definitions.

(1) "Where debts absorb (exceed) property of debtor so that his property can not satisfy his debts".[35]

Here in this case, although debtor owns some property but unfortunately, his debts exceed his total property and he can not fully satisfy his creditors.

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[33] S 'adi Abu Jeb, *Al-Qamoos Al-Fiqhi* (Karachi: Idarat Al-Quran Wa-Al 'Uoloom Al-Islamiya, n.d.), P. 290.

[34] Mohammad Khalid Al-Atasi, Sharh *Al-Majallah*, vol.3 (Quetta: Maktabat-ul-Islamia, 1982), P. 554.

[35] Abu Al-Faiz Ahmad b. Mohammad Al-Siddique, Al-Ghumari, Al-Husaini, *Al-Hidaya Fi TakhreeJ Ahadees Al-Bidaya (Bidayat Al-Mujtahid by Ibn-e-Rushd)*, vol.8 (Bairut: 'Alim Al-Kutub, 1987), P. 59.

(2) "Where in fact he (debtor) does not have any property".[36]

This definition differs from the above one in the sense that in the later case the debtor does not have any property to satisfy his creditors. Whatever, but these two have the same result; financial inability of person to repay debts to his creditors. So, *Iflaas* under Islamic law is similar to insolvency under English Law.

2.3 *Taflees* (Bankruptcy)

Word *Taflees* is used under Islamic Law for Bankruptcy. *Taflees* is defined as: "Adjudication of a debtor as an insolvent by Judge, by restraining him from his property".[37]

So, all legal and formal proceedings taken in court by a judge, against insolvent, are called bankruptcy.

This definition has two parts. (1) Is that, judge adjudicates him insolvent, and (2) is that, judge restrains him from his property. First part is simple. Second part is complicated. It is actually legal consequences of adjudication of an insolvent by court. These shall be discussed in next chapters, where we shall analyze English Insolvency law in the light of Islamic law of insolvency, and then we will apply Islamic principles regarding insolvency.

So, till now there is no conflict between Shari 'ah and English Law. Terms and there meanings are same. Insolvent and *Muflis* refers to same person. Insolvency

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[36] *Ibid.*

[37] Abu Yahya Zakariya Al-Ansari Al-Shaf 'i, *Asna Al-Matalib Sharh Raudh Al-Talib,* vol.4 (Bairut: Dar-ul-Kutub Al-'Ilmiyah, 2001),P. 453.

and *Iflaas* refers to his same status. Similarly, bankruptcy means what *taflees* means under Islamic law.

3. Extension of Islamic Law of Insolvency to Modern Corporations

Before 1400 years, there was no concept of corporations as in the present form. Its history extends to the last five hundred years. So, the question arises that can we extend Islamic rules regarding insolvency to the modern corporations? And can a personality be attributed to corporation?

Modern Islamic scholars have recognized corporate personality. They have attributed a fictitious personality to it, although, their approaches may be different. But this is not our point of discussion. Our point is that Modern Islamic scholars have recognized corporate personality upon certain basis. The approach that seems to me best is that by a well-known scholar, Imran A. Nyazee in his book "Corporations in Islam". He suggests that deficient fictitious personality may be attributed to corporations. It means that company can acquire rights and obligations and perform such rights and obligations with the exclusion of the obligations hereafter. He says company has no concern with the obligations of life hereafter.[38] So, Islamic law of insolvency can be extended to modern corporations with certain changes which shall be discussed in next chapter, and that is why first we need to discuss legal capacity in the next chapter.

[38] Imran Ahsan Khan Nyazee, *Corporations in Islam* (Rawalpindi: Federal Law House, 2007), 139-40.

It is concluded that there is no difference between Islamic law and English law with respect to person who is unable to pay his debts, and his financial status. The difference is only that of words. Islamic law calls, insolvent as *Muflis,* insolvency as *Iflaas,* and Bankruptcy as *Taflees*

Chapter No.2 Legal Capacity in *Shariah* and Law

Chapter No. 2 Legal Capacity in Shariah and Law

1. Legal Capacity

In the first chapter I have discussed the concept of insolvency in law as well as in *shari'ah*. In this chapter I shall discuss legal capacity attributed to a person by law, and also by *shari'ah*. The importance of this chapter is that it is a bridge between the first and the third chapter as in the next chapter I shall discuss that what are the rights and liabilities of an insolvent person. In other words, there I shall discuss that what is the legal capacity of an insolvent person, therefore, it is necessary to first discuss legal capacity.

1.1 Meanings of Legal Capacity

Legal means "conforming to the law"[39] or "required or permitted by law"[40], and capacity means "fitness or capability"[41] or "the power to perform certain contracts or exercise certain rights".[42] By combining these definitions it is concluded that legal capacity means the power or capability of a person which is conforming to law, or in other words, it is the power of a person to perform certain contracts or exercising certain rights, which is required or permitted by law.

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[39] Henry Campbell Black, *Black's Law Dictionary*, 4th edition, (Washington D.C: n.p. 1951), P. 1030.
[40] *Ibid.*
[41] K.J. Aiyer, *Manual of Law Terms and Phrases*, rev. M.L. Chandak, 7th edition, (Allahabad: Law Book Co., 1973), P. 160.
[42] *Ibid.*

1.2 Legal Capacity (*Ahliyyah*) in *Shari 'ah*

In Islamic Law word "*Ahliyyah*" is used for legal capacity. Literally, *ahliyyah* means "absolute fitness or ability".[43] Technically, *ahliyyah* is "the ability or fitness to acquire rights and exercise them and to accept duties and perform them".[44]

So, the capacity of a person to acquire rights and obligations, and to exercise such rights, and to execute such duties, is called his *ahliyyah*.

This definition shows that there are two types *of ahliyyah*: *ahliyyat al-wajoob* (capacity for acquisition) and *ahliyyat al-Ada* (capacity for execution).

1.2.1 Capacity for Acquisition (*Ahliyyat al Wajoob*)

Capacity for acquisition is defined as "the ability of a human being to acquire rights and obligations".[45]

This term refers to legal capacity acquisition of both rights and duties. This is just acquisition and not acceptance to perform. By this one only acquires rights and obligations. For the exercise of such rights and performance of obligations, one needs to satisfy certain other conditions[46]. When one satisfies such conditions, only then he is entitled to exercise his rights, and liable to perform obligations. It becomes clear when we discuss capacity for execution.

[43] Abu Bakr Muhammad Ibn Abi Sahl Ahmad, Al-Sarakhsi, *Al-Mabsoot*, Ed. Abu Al-Wafa' Al-Afghani, vol.2 (Cairo: 1372), P. 232.
[44] Abd Al-'Aziz al-Bukhari, *Kashf al-Asar 'an Usool Fakhar al-Islam al-Bazdawi*, vol.4 (Beirut: Daar al-Kutub al-'1'Ilmiyyah, 1997), P. 335.
[45] *Ibid.* P. 335-38.
[46] These conditions are *'aql* and *rushd.*

There are two parts of the above definition: (1) capacity for acquisition of rights, and (2) capacity for acquisition of obligations. Examples of capacity for acquisition are, will and inheritance, so a person having capacity for acquisition can acquire rights in property inherited upon him, and in property bequeathed to him. Person having capacity for acquisition of rights only, and not for obligations, has deficient capacity for acquisition. This shall be discussed a bit later.

Examples of capacity for acquisition of obligations are liability for destruction of other's property and wages of labourer for his labour.

1.2.2 Capacity for Execution (*Ahliyyat al-Ada*)

Capacity for execution is defined as "the capability of a human being to issue statements and perform acts to which the Law-giver has assigned certain legal effects".[47]

Statements issued and acts preformed by a person having capacity for execution, have legal effect. Such legal effect may either be in terms of Punishment, reward, relief from responsibility.[48]

It means that if the law giver demands from a person the performance of certain act, or its omission and he does so, he shall be rewarded in the life hereafter. On the other hand if he does not perform the act the performance of which is demanded by Allah from him, or he performs that act which omission was

[47] Husain Hamid Hassan, *Usool al-Fiq* (Peshawar: n.p. 2003), P. 143.
[48] *Ibid.* P. 143-4.

demanded from him, then, he shall be punished in this world and in the life hereafter.

On the basis of legal capacity for execution, the law-giver gives the option to a person to enter in to different kinds of contracts or not. If he makes any contract, the rights and obligations incurred by him because of such contract have legal effect.[49]

Now some questions arise that when does one get right for acquisition of rights and obligations? Similarly, when can he exercise his rights, and is liable to perform duties? Or, in other words, what are the basis for the capacity for acquisition and execution, of rights and obligations? "Basis for the existence of capacity for acquisition is, the attribute of being a human or natural person (*insaniyyah*)".[50] It means only a human being can acquire rights and obligations. Basis of the capacity for execution is *'Aql* (intellect) and *Rushd* (discretion). Person having intellect *('Aql)* and discretion (*rushd*) can exercise his rights and is liable to perform duties.

1.2.3 *Zimma* and *Ahliyyat al-Wajoob*

Some Jurists are of the opinion that there is no difference between *Zimma* and *Ahliyyat al-Wajoob*. They define *Zimma* as "the ability to acquire rights and obligations". This definition is identical to the definition of *Ahliyyat al-Wajoob*. Closer examination of the two terms reveals the fact that there is a difference

[49] *Ibid.*
[50] Abu Bakr Mohammad Ibn Abi Sahl Ahmad Al-Sarakhsi, *Usool al-Sarakhsi*, Ed. Abu Al-Wafa' Al-Afghani, vol. 2 (Cairo: 1372), P. 333.

between *Zimma* and *Ahliyyat al-Wajoob. Ahliyyat al-Wajoob* is person's own capacity, which he acquires on the basis of *insaniyyay* (humanity). On the other hand, *Zimma* is an attribute conferred by the Law-giver upon human. *Zimma* emerges from an *"Ahd"* between the Law-giver and Human being. According to Al-Sarakhsi, *Zimma* is the "trust" that was offered to the mountains, but they refused; man accepted it.[51]

In *fiqh*, *Zimma* is defined as:

"A legal attribute by virtue of which a human being becomes eligible for acquiring rights and obligations".[52]

This means that it is an attribute by virtue of which one becomes eligible for *Ahliyyat al-Wajoob*. So *Zimma* is a pre-condition for *Ahliyyat al-Wajoob.*

1.2. 3.1 *Zimma* and Personality

Closer examination of the term *Zimma in figh* and personality in law reveals the fact that these terms are identical.

Zimma is an attribute by virtue of which one becomes eligible for *Ahliyyat al-Wajoob. Zimma* originally emerges from *"ahd"* between the Law-giver and human being. Only human being can acquire rights and obligations. Personality in law also refers to the same meanings. This is also an attribute given by the law to the *corpus*, in order to be capable of acquiring rights and duties.[53]

[51] Ibid. P. 332.
[52] Sadr al-Shari'ah, *al-tawdeeh*, vol.2, 750-51.
[53] John Salmond, *Jurisprudence*, rev. Mr. P.J. Fitzgerald (Lahore: PLD, n.d.), P. 127.

This means that it may be a human or non-human *corpus*. So, if law does not recognize a human being as a person, in other words, if law does not attribute personality to a natural human being, we can not call him person. On the other hand, if law recognizes a non-human *corpus* as person, then it can acquire rights and obligations, as Salmond states:

"Persons in law fall under two categories-Natural and artificial".[54] Further, he says: "a natural, as opposed to artificial, person is such a human being as is regarded by the law as capable of rights and duties and as having status".[55]

But one point should be clear that the *corpus* referred to by Salmond, is always real, either in shape of human or any other physical thing. Only personality attributed to it is either natural or fictitious.

About legal person he says: "A legal person is a being other than human, to which personality is attributed by the law. The law always creates legal persons by personifying some real things. The legal person thus has a real existence; his personality alone is fictitious. This real existence, as opposed to personality, is called the *corpus* of the legal person".[56]

"One acquires *Ahliyyat a-Wajoob*, even yet not born (feotus)".[57] It means that an unborn child can have capacity for acquisition. But this capacity is incomplete or deficient. In this case an unborn child has only capacity for acquisition of rights and not obligations. The reason is that in some respects he is considered as part of his mother. He is set free with his mother and is sold as part of his mother. From

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[54] *Ibid.*
[55] *Ibid.*
[56] *Ibid.*P. 129.
[57] Abu Bakr Mohammad Ibn Abi Sahl Ahmad Al-Sarakhsi, *Usool al-Sarakhsi*, Ed. Abu Al-Wafa' Al-Afghani, vol. 2 (Cairo: 1372), P. 333-4.

the other aspect he is considered as human being. From this aspect he can acquire only those rights which need not acceptance, for instance, right of inheritance and right to property bequeathed to him. He has no capacity to acquire those rights which need acceptance for its acquisition, such as gift. His capacity for acquisition becomes complete, when he borns. After birth his capacity for acquisition becomes complete and he acquires both rights and obligations. This capacity then rests during his life till death.

One acquires capacity for execution with the attainment of *'Aql* and *Rushd. 'Aql* is the developed mental faculty. Person having developed mental capacity is called *'Aaqil.*

As there are no parameters for checking the development of one's mental faculty, the Law-giver has associated it with puberty. So, person who attains puberty is also *'Aaqil.* Puberty is associated with the exhibition of certain signs in person's body. Most common of these signs is the ejaculation in male and menstruation in female. In absence of these signs, jurists presume puberty with attaining the age of 15 years by both male and female. However, Abu-Hanifa says that it is 18 years for male and 17 years for female.[58]

Rasheed (person having discretion), is a person who can handle his financial matters by applying reasoning. However, Imam Shafi adds maturity of actions as well in matters of *Deen* (religion).

Majority Jurists are of the opinion that person, having developed mental faculty who can discriminate between right and wrong, has complete capacity for

[58] Burhan-ud-Din Ali Bin Abi Bakr Al-Marghenani, Al-Hidayah Sharh Fi Bidayat al-Mubtadi, Urdu trans. Mufti Mohammad Zubair, *Ashraf Al-Hidayah Sharh Urdu Al-Hidayah*, vol. 12 (Lahore: Ali Ijaz Printers, n.d), P. 265.

execution. If he does not have *'aql* and *rushd,* he can not be assigned such capacity.[59]

Imam Abu Hanifa acknowledges another category of capacity; deficient capacity for a person, on the basis of certain degree of discretion by such person, although his mental faculty has not yet fully developed. In this case he acquires capacity for execution of transactions (*Mu'amalat*) only.[60] He does not yet acquire capacity for execution of obligations.

Again there is no parameter for checking out his attaining discretion, therefore Abu Hanifa has fixed the age of 7 years for attaining such discretion. So, according to Abu Hanifa, person above 7 years of age is assigned deficient capacity for execution.[61]

The capacity then completes with *'aql* and *rushd*, and rests with the person till his death.

So, the crux is that capacity for acquisition starts from fetus, and capacity for execution starts form above 7 years of age.

1.3 Complete, Deficient and Imperfect Capacity

Human beings possess different capacities at different stages of their life starting from their being as feotus to mature human beings with fully developed mental faculty. Capacity of a feotus in the womb of his/her mother is different from that

[59] Imran Ahsan Khan Nyazee, *Islamic Jurisprudence* (Islamabad: International Institute of Islamic thought & Islamic Research Institute, 2000), P. 111.
[60] 'Ala' al-Din Abu Bakr b. Mas 'ud, Al-Kasani, *Bada'I-i 'al-Sana'i' Fi Tartib al-Shar'i'*, Urdu trans. Professor Khan Mohammad Chawla, vol. 7 (Lahore: Imprint Press, 1987), P. 4245.
[61] Abdul Karim Zedan, *Al-Wajeez Fi Usool al-Fiqh* (Lahore: Daar-o-Nashr-ul-Kutub al-Islamiyah, n.d.), P. 97.

of a child up to the age of seven years, and capacity possessed by a minor child is different from that possessed by an *'aqil* (intellectual) and *rasheed* (person having discretion). Similarly, slave and dead person have different capacities.

"Muslim Jurists have divided capacity into three types. These are *ahliyyah al-kamila, ahliyyah al-naqisa,* and *ahliyyah al-Qasira*".[62]

Kamila (Complete Capacity) for acquisition is acquired by a human being after his birth. It is the capacity of a human being in which he is entitled to acquisition of both rights as well as obligations.[63] *Ahliyyat al-Naqisa* (deficient capacity) for acquisition is found in human being when he is yet unborn. *Naqisa* capacity entitles a human being only for acquisition of rights and not for obligations.[64]

Complete capacity for execution is found in human being after attaining intellect and discretion. Complete capacity for execution is the capacity of a human being, which entitles him for execution of both rights as well as obligations.[65]

If one possesses intellect and discretion but an external attribute does not permit the recognition of the legal validity of his certain acts, he is assigned imperfect capacity. For example capacity of a woman in certain cases, and that of a slave.

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[62] Abd Al-'Aziz al-Bukhari, *Kashf al-Asar 'an Usool Fakhar al-Islam al-Bazdawi*, vol.4 (Beirut: Daar al-Kutub al-'l'Ilmiyyah, 1997), P. 13.
[63] Abdul Karim Zedan, *Al-Wajeez Fi Usool al-Fiqh* (Lahore: Daar-o-Nashr-ul-Kutub al-Islamiyah, n.d.), P. 95.
[64] *Ibid.* P. 94.
[65] *Ibid.* P. 98-9.

1.3.1 Comparison between Complete Capacity for Acquisition and Complete Capacity for Execution

Jurists have consensus that human being attains complete capacity for acquisition after his birth. But he is not liable for criminal liability. In other words, he is not liable for *Khitab Jinai* (communication from the Law-giver pertaining to criminal acts).[66]

For criminal offences, he is only liable to deterrence (*ta'dib*).

Also he is not liable for the *Khitab* of *ibadat* (communication form the Law-giver pertaining to the acts of worship).[67] Although, jurists differ among them for, whether the *Khitab* of *ibadat* to him, is a recommendation from the Law-giver, or a choice from the person? But there is no dispute among them that *thawab* (reward) will be given to him for the performance of such acts.

Human beings become liable for *Khitab jinai* (communication from the Law-giver pertaining to criminal acts) and *khitab* of *ibadat* (communication form the Law-giver pertaining to the acts of worship) only after attaining *'aql* and *rushd*.[68]

As for as financial transactions are concerned, according to *Hanafi* jurists, these are divided into three types.[69]

These are:

(1) Purely Beneficial Transactions:

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[66] *Ibid.* P. 95.
[67] *Ibid.* P. 96.
[68] *Ibid.* P. 98.
[69] 'Ala' al-Din Abu Bakr b. Mas 'ud, Al-Kasani, *Bada'l-i 'al-Sana'i' Fi Tartib al-Shar'i'*, Urdu trans. Professor Khan Mohammad Chawla, vol. 7 (Lahore: Imprint Press, 1987), P. 424.

Subject to permission from guardian (*wali*), person having complete capacity for acquisition can make such transactions which are totally beneficial to him. These are acceptance of gift, charity (*sadaqa*).[70]

(2) Purely harmful Transactions:

Transactions purely harmful to him are not allowed to be entered into by him. These are: granting of divorce, manumission (*'itq*), Charity (*sadaqa*), loan, creating of a trust (*waqf*), and bequest (*wasiyat*).[71]

(3) transactions Vacillating between Profit and Loss:

Transactions, entered into by a person having complete capacity only for acquisition, vacillating between profit and loss are considered valid, if ratified by his guardian (*wali*).[72]

After attaining complete capacity for execution, one becomes liable for all kinds of *khitab* from the Law-giver. In other words, he becomes liable for *khitab jina'i* (communication from the Law-giver pertaining to criminal acts), *khitab* of *ibadat* (communication from the Law-giver pertaining to the acts of worship), and *khitab* of *mu'amalat* (communication from the Law-giver pertaining to transactions).[73]

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[70] *Ibid.* P. 425
[71] *Ibid.*
[72] *Ibid.*
[73] Abdul Karim Zedan, *Al-Wajeez Fi Usool al-Fiqh* (Lahore: Daar-o-Nashr-ul-Kutub al-Islamiyah, n.d.), P. 93.

1.3.2 Some Cases of Deficient (*naqisa*) and Imperfect (*qasira*) Capacity

1.3.2.1 Capacity of an Unborn Child (*janin*)

We look at the existence of an unborn child from two aspects. From one aspect, he is a part of his mother. So he is sold, and or is set free with her. From other aspect his is separate from his mother, and one day he has to come out in physical existence as an independent person from his mother after birth. Therefore, an unborn child possesses capacity but only for acquisition of rights, and not for obligations. Here his capacity is deficient or incomplete. "Deficient or incomplete capacity is established for an unborn child or fetus (*janin*)".[74]

Unborn child has deficient capacity for acquisition because he is entitled to, for acquisition of some rights. These rights are: in *waqf* property, inheritance, and bequest.[75]

He is not liable for payment of amount under *'Aqilah*. Likewise, maintenance of close relatives can not be enforced against him.

1.3.2.2 Capacity of a Dead Person

If a person dies, he is no longer bound for execution of his obligations. More specifically, it is stated that "he is not liable for the performance of those

[74] *Ibid.* P. 94.
[75] *Ibid.*

obligations in which his act is required".[76] For example in paying *zakat*, his act, and not his property, is required. If he does not pay *zakat* when he was alive, then after his death it shall not be paid from the property left by him. "If the obligation is of such type in which his property is required, then his property is liable for that after his death".[77] But this is only in case when he leaves property behind him.

Capacity assigned to a dead person is deficient for acquisition as well as execution of rights and obligations. After his death it is the right of the deceased to be properly coffined and buried. This is his deficient capacity for acquisition of rights.

His capacity for execution is deficient in case of his liability for matters involving property, however, he is no longer personally bound to perform his obligations. So his property is liable for his debts, bequest, and alternative of *qisas* upon him after his death.

1.3.2.3 Capacity of Minor (*Sabi*)

Jurists have consensus that human beings attain complete capacity for acquisition after his birth. So, a minor is not liable for criminal liability. In other words, he is not liable for *Khitab Jinai* (communication from the Law-giver pertaining to criminal acts).[78]

For criminal offences, he is only liable to deterrence (*ta'dib*).

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[76] Abd Al-'Aziz al-Bukhari, *Kashf al-Asar 'an Usool Fakhar al-Islam al-Bazdawi*, vol.4 (Beirut: Daar al-Kutub al-'l'Ilmiyyah, 1997), P. 1433, 1437.
[77] *Ibid.*
[78] Abdul Karim Zedan, *Al-Wajeez Fi Usool al-Fiqh* (Lahore: Daar-o-Nashr-ul-Kutub al-Islamiyah, n.d.), P. 95-6.

Also he is not liable for the *Khitab* of *ibadat* (communication form the Law-giver pertaining to the acts of worship).[79] Although, jurists differ among them for, whether the *Khitab* of *ibadat* to him, is a recommendation from the Law-giver, or a choice from the person? But there is no dispute among them that *Thawab* (reward) will be given to him for the performance of such acts.

Human beings become liable for *Khitab jinai and khitab* of *ibadat* only after attaining *'aql* and *rushd.*[80]

As for as financial transactions are concerned, according to *Hanafi* jurists, these are divided into three types".[81]

These are:

(1) Purely Beneficial Transactions:

Subject to permission from guardian (*wali*), a minor can make such transactions which are totally beneficial to him. These are acceptance of gift, charity (*sadaqa*).[82]

(2) Purely harmful Transactions:

Transactions purely harmful to a minor, are not allowed to be entered into by him. These are: granting of divorce, manumission (*'itq*), Charity (*sadaqa*), loan, making of a trust (*waqf*), and bequest (*wasiyat*).[83]

(3) transactions Vacillating between Profit and Loss:

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[79] *Ibid.* P. 96.
[80] *Ibid.* P. 98.
[81] 'Ala' al-Din Abu Bakr b. Mas 'ud, Al-Kasani, *Bada'I-i 'al-Sana'i' Fi Tartib al-Shar'i'*, Urdu trans. Professor Khan Mohammad Chawla, vol. 7 (Lahore: Imprint Press, 1987), P. 424.
[82] *Ibid.* P. 425.
[83] *Ibid.*

Transactions, entered into by a minor, vacillating between profit and loss are considered valid only, if ratified by his guardian (*wali*).[84]

So, a minor has complete capacity for acquisition of rights and obligations, and has deficient capacity for execution of obligations. Here deficient capacity for execution means that he is not liable to perform, but if performs, he shall be rewarded for that in *Akhirah.*

1.3.2.4 Capacity of Fictitious Person

Some modern Muslim scholars recognize fictitious personality in Islam. 'Abduh 'Isa, Abdur Rahim, Abdul Qadir 'Awdah, Mustafa al-Zarqa, Taqi Usmani are among these. 'Isa Abduh says that although Shari'ah does not support existing of fictitious personality, however, the text of Arabs and muslims convey the idea that it can be established, so it is therefore, established.[85] This statement has no base in *Shari'ah* because mere anxiety to accept a fact does not validate the fact.

The Islamic Fiqh Academy of the Organization of Islamic Countries (OIC) also says about the validity of fictitious personality, even it validates the limited liability of such personality. It says that "There is no objection in *shari'ah* to setting up a company whose liability is limited to its capital for that is known to the company clientele and such awareness on their part precludes deception".[86]

[84] *Ibid.*

[85] 'Adduh 'Isa, *al-'Uqood al-Shari 'ah al-Hakima* (Dar al-I'tisaam, P. 1977), 25.

[86] Financial Accounting Standard Board, *Objectives and Concepts of Financial Accounting, Presentation and General Disclosure Standard and Information about the Organization* (Jeddah, 1994), 50 quoting para 12, Resolution No.65/17 of the Islamic Fiqh Academy adopted in its seventh session in May, 1922.

Although there is no objection in *shari'ah* to create a fictitious person, but there is nothing about its permission, and it is not easy to accept corporation as fictitious person in its present form, and the matter needs to be analyzed in the light of general principles of Islam.

Abdur Rahim, a modern Islamic writer says that it is doubtful to say that earlier muslim scholars recongnized fictitious personality…., but the later scholars seem inclined to recognized it.[87]

Imran Ahsan Khan Nyazee says that "his finding about the view of the later jurists is apparently based upon their discussions of the institution of *waqf*.

The first person who says that Islam recognizes fictitious personality from the very first day is Abdul Qadir 'Awdah. He says that "the Islamic *shari'ah*, from the first day of its existence, has acknowledged juristic persons. The jurists considered the *bayt al-mal* an institution, the *waqf* an institution, that is, a juristic person. Likewise, the schools and hospitals and other things were considered institutions. These institutions, or juristic persons, had the capacity to own property and possessed the right of disposal in them".[88]

These scholars seem to be very anxious about recognizing fictitious personality in Islam. I do not deny its recognition, but I do not agree with their approach. The approach, for recognition of fictitious personality that seems to me the best is that by Imran Ahsan Khan Nyazee.[89] He has analyzed the issue in depth, and has proposed a modern Islamic model for corporations. According to him deficient personality may be granted to corporations on the basis of certain conditions.

[87] Abdur Rahim, *Principles of Islamic Jurisprudence* (Madras: np 1908), P. 318.
[88] 'Abdul Qadir 'Awdah, *al-Tashri' al-Jina'I al-Islami*, vol. 1 (Berut: Mu'assasat al-Risalah, 1992), P. 393.
[89] See generally his book on *Theories of Islamic Jurisprudence, and Corporations in Islam.*

He says that "the ruler may assign a restricted or limited *dhimmah* to a non-human on the following conditions.

1. That no religious duties will be expected of a fictitious person. In other words, the fictitious person will not be subject to the *khitab* of *'ibadat*, and will not be liable for any religious duty or obligation that may flow from it. Thus, it will have no liability for *zakat*, for *sadaqah* or for any other religious task. These duties pertain to the *'ahd* of the *'ahd* with the Creator.
2. That some form of *'aql* must be associated with the fictitious person. This *'aql* may be that of one individual or group of individuals like the board of directors. The *ahliyat al-ada'* will always be associated with this source of *'aql*, and so will the liability for such acts.
3. That a concept of dual title of ownership must be associated with a fictitious person. Any property held by the fictitious person in its own name must be assumed to be held on behalf of the members of this fictitious person as a result of *khalt* or mingling of capitals. The fictitious person, if permitted by its members, may have the full right of disposal and transaction in this property."[90]

So, according to Nyazee these are the conditions which are to be fulfilled in order to create a fictitious person. After mentioning these conditions he says that "the corporation will be juristic person established in accordance with the conditions listed above".[91]

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[90] Imran Ahsan Khan Nyazee, *Corporations in Islam* (Rawalpindi: Federal Law House, 2007), P. 139-40.
[91] *Ibid.* P. 228.

2. Legal Capacity in Law

Legal capacity in law is associated to personality. Things having personality also have legal capacity for rights and obligations. Let us discuss legal capacities of different persons under law.

Legal Capacity of Human Being

Under law human being is a natural person. He has legal capacity for acquisition of rights and execution of obligations. If human being has attain the age of majority under law, then he is entitled to do all kinds of transactions and is liable to perform his obligations, and in case of violation of law he shall be punished. But human being is person only if law attributes him with the character of personality, and so he then has the legal capacity for rights and obligations. And law attributes him such character only if he is alive and not slave.[92]

As for as the capacity of a slave is concerned, although he is human being, but law does not recognize his personality, and so he does not have any legal capacity. Slave does not have rights and obligations. All what he does, is on the behalf of his master, and it is his master who is liable for the actions of his slave and not the slave himself.[93]

Capacity of a dead person shall be discussed in topic after the next.

[92] V.D. Mahajan, *Jurisprudence and Legal Theory* (Lahore: Mansoor Book House, 2004), P. 266.
[93] *Ibid.*

2.1. Legal Capacity of Lower Animals

As lower animals, such as cow, goat, sheep are not persons in the eyes of law, so they have no legal capacity. They are not required to do some acts or not to do the others. They are only things.

"The only natural persons are human beings and beasts are not persons, either natural or legal".[94]

Its rights are not recognized by law.

"if a beast is hurt, it is a wrong to the owner of the beast or society of mankind but not to the beast".[95]

Animals are unable to own property even by way of trust. They can not be the beneficiaries of the property entrusted for their nourishment etc. this is test by a rule that if a testator has made a will that such portion of his property shall be used for the nourishment of animals, then if the trustee thinks fit, he may spend all or part of the trust property for the nourishment of such animals, and the rest of the property shall be vested in the representatives of the testator without any dispute".[96]

According to V.D. Mahajan, there are two cases in which animals may be thought to have legal rights. These are:

"(1) cruelty to animals is a criminal offense

(2) a trust for the benefit of particular classes of animals, as opposed to one for individual animals, is valid and enforceable as a public and charitable trust, e.g., a

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[94] *Ibid.*
[95] *Ibid.* P. 267.
[96] *Ibid.*

provision for the establishment and maintenance of a home for stray dogs or broken down horses".[97] If there is conflict of interests between the rights of human beings and animals, the rights of human beings are preferred".[98]

2.2. Legal Capacity of Dead Persons

Human beings are persons as long as they are alive, and not slaves. After death they are no longer persons. So they do not have any rights or obligations, and so have no legal capacity. Under English law his desires while he was alive, are taken in to account with respect to three things. These are:

(1) Body (2) reputation, and (3) estate.[99]

As for as his dead body is concerned, it is not the property of any one. So, it can not be disposed of in any way i.e. by will ob the deceased when he was alive. Similarly, no wrongful dealing with it shall amount to theft, but it should not be treated indecently and therefore, violation of a grave is a criminal offence".[100] But in these days the trend has been changing, and it is legal to donate the organ of one's body after death.

As for as his reputation is concerned, it is protected by law, but is not because of his right but because of the rights of his living relatives, which are violated.[101]

[97] *Ibid.*
[98] *Ibid.*
[99] *Ibid.* P.268.
[100] *Ibid.*
[101] Imran Ahsan Khan Nyazee, *Jurisprudence* (Rawalpindi: Federal Law House, 2007), P. 240.

As for his estate is concerned, his will with respect to his estate shall be enforceable, and shall be executed. The rest of the property left by him shall be vested in his legal heirs.

2.3. Legal Capacity of an Unborn Person

Under English law, an unborn child is a person, but his legal capacity is contingent on his birth as a a living human being. He can acquire rights and can own property. Even his father can make a will for his unborn children and other descendents, but it should not be long extended as for 100 years for example. He can inherit the property of his father even if his father dies intestate but it is subject to his birth as a living human being even for an hour, if not then no one can claim through him. Abortion and child destructions are crimes but these acts do not amount to murder.[102]

2.4. Capacity of Legal person

Legal persons[103] are persons, other than human being, to whom law attributes personality, and therefore, they have legal capacity for rights and obligations. Legal persons can acquire all types of rights and are liable for their obligations except they can not vote to elect members of parliament.

[102] *Ibid.* P.238-39.

[103] There are three kinds of legal person. These are: corporations, institutions, and fund or estate. Corporation is a group or series of persons to which law has personified as person. Institution is not a group or series of person, rather its corpus is the institution itself, for example, hospital, college, etc. funds and estates are also personified as person by law such as *mudarabah* fund and estate of a deceased person. See V.D. Mahajan, *Jurisprudence and Legal Theory* (Lahore: Mansoor Book House, 2004), P. 271-72.

2.4.1. Legal Capacity of Corporation (Legal Person)

Corporations have legal capacity to perform all lawful objectives provided in its memorandum of association. Legal capacity of a corporation may be summarized in the following.

1. A corporation has no mind, so it acts through its board of directors (BOD). Board of directors is considered as the mind of a corporation.
2. When the corporation is used as a shell for unlawful activities the court has the power to access the actual wrong doers and to held them directly liable. This is called lifting of corporate veil or piercing the corporate veil.
3. Corporations are not responsible to perform religious activities i.e. going to church, or offering prayer.
4. Corporation is not liable for the tasks performed beyond its objectives. For such ultra vires activities its directors are liable. But it is liable for its acts while performing its lawful objectives.
5. Corporation is liable for willful breach of statutory duties such as fraud and deception.
6. A corporation may be treated as enemy company if its members belong to an alien[104] state.[105]

[104] Alien state is a state which is in state of war with one's own state. For example A belongs to Pakistan and B belongs to India. When India and Pakistan are in state of war, then India for Pakistan is an alien state. So the company of B in Pakistan shall be as company of alien state, and thus it shall be treated as enemy company.

[105] Imran Ahsan Khan Nyazee, *Jurisprudence* (Rawalpindi: Federal Law House, 2007), P. 247-8.

3. Comparison between Legal Capacity in *Shari'ah* and Law

Islamic law is very much organized and based on certain rules which either validate or invalidate a matter. Therefore it divides capacity into different types; *Ahliyat al-Ada, Ahliyat Al-Wajoob, Ahliayat Al-Ada Al-Qasira, naqisa, kamila.* Then on the basis of such division it explains that which person has what type of capacity. If one simply comes to know that who has what type of capacity, then on the basis of mentioning such principle, he can easily understand that what is the extent of rights and obligations of such person.

On the other hand, English law regarding legal capacity is not that much organized. It does not mention any principle on the basis of which it gives rights and obligations to different persons. It does not divide capacity into different types. It simply mentions different rights and obligations that such and such are the rights and duties of such persons. And it is impossible to pre-mention all rights and obligations, while under Islamic law if there arises any question about any right or obligation of a person, it has to pass a simple test of knowing that what type of capacity does that person possess, and on the basis of just mentioning the type of capacity of the person, one can conclude that whether this is his capacity or not.

Chapter No. 3 The Analysis of Pakistani Insolvency Laws in *Shariah* Perspective

Chapter No. 3 The Analysis of Pakistani Insolvency Laws in *Shari'ah* Perspective

The chapter is actually the summary of relevant provisions Pakistani Laws relating to insolvency, and their analysis in the light of Islamic law of insolvency. Following are the three statutes, which contain insolvency provisions.

1) The Provincial Insolvency Act, 1920
2) The Insolvency (Karachi Division) Act, 1909
3) The Companies' Ordinance, 1984

While discussing the relevant provisions some issues shall be identified, which shall be resolved in the light of Islamic law.

The Provincial Insolvency Act, 1920, and the Insolvency (Karachi Division) Act, 1909 are about individual insolvency while the Companies' Ordinance, 1984 is about corporate insolvency. The former two Acts deal only with individual insolvency, and do not apply to corporations or any other statutory body because for insolvent companies there is special proceeding of winding up. Section. 8 of the Provincial Insolvency Act, states that: "no insolvency petition shall be presented against any corporation or against any association or company registered under any enactment for the time being in force".[106]

Section. 107 of the Insolvency (Karachi Division) Act, also states that: "no insolvency petition shall be presented against any corporation or against any association or company registered under enactment for the time being in force".[107]

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[106] *The Provincial Insolvency Act, 1920*, Sec. 8.
[107] *The Insolvency (Karachi Division) Act, 1909*, Sec. 107.

In Companies' Ordinance, 1984, provisions regarding Insolvency are discussed in chapter-11 under the heading of "winding up"[108]

1. The Companies' Ordinance, 1984

Under section 297 of the Companies' Ordinance, 1984, there are three modes of winding up of companies. These are:

"(i) by the court; or

(ii) Voluntary; or

(iii) Subject to the supervision of the court"[109]

Cases in which company may be wound up voluntarily are discussed in section 305 of the Companies' Ordinance. These are the following:

"Company may be wound up by court:

(a) if the company has, by special resolution[110], resolved that the company be wound up by the court;

(b) if default is made in delivering the statutory report to the registrar or in holding the statutory meeting or any two consecutive annual general meetings;

(c) if the company does not commence its business within a year from its incorporation, or suspends its business for a whole year;

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[108] Winding up of companies is the process in which all affairs of companies are wound up. "The liquidation or winding up of a company is a proceeding in which all its affairs are wound up, its rights and liabilities are ascertained, and the claims of its creditors paid off out of the assets of the company including the contributions by its members to the extent to which they may be necessary. If any surplus assets are left they are divided among the members of the company in proportion to their rights under articles". See Barrister A.G. Chowdhry, *Mercantile Law in Pakistan* (Lahore: Khyber Law Publisher, 2003), P. 169.

[109] *The Companies' Ordinance, 1984*, Sec. 297.

[110] Special resolution means 3/4 majority of the members of the company.

(d) if the number of members is reduced in the case of private company, below two or, in the case of any other company, below seven;

(e) if the company is unable to pay its debts;

(f) if the company is—

(i) conceived or brought forth for, or is or has been carrying on, unlawful or fraudulent activities;

(ii) carrying on business not authorized by the memorandum;

(iii) Conducting its business in a manner oppressive to any of its members or persons concerned with the formation or promotion of the company or the minority shareholders.

(iv) run and managed by persons who fail to maintain proper and true accounts, or commit fraud, misfeasance or malfeasance in relation to the company; or

(v) managed by persons who refuse to act according to the requirements of the memorandum or articles or the provisions of this ordinance or fail to carry out the directions or decisions of the court or the registrar or the [commissions] given in the exercise of powers under this Ordinance;

(g) if, being a listed company, it ceases to be such company;

(h) if the court is of opinion that it is just and equitable that the company should be wound up; or

(i) if the company ceases to have a member".[111]

In this section our concern is with clause (e). For the purpose of the meaning of this clause, section 306 of the Ordinance, is stated below.

[111] *The Companies' Ordinance, 1984*, Sec. 305.

"A company shall be deemed to be unable to pay its debts—

(a) if a creditor, by assignment or otherwise, to whom the company is indebted in a sum exceeding one per cent., of its paid-up capital or fifty thousand rupees, which ever is less, than due, has served on the company, by causing the same to be delivered by registered post or otherwise, at its registered office, a demand under his hand requiring the company to pay the sum so due and the company has for thirty days thereafter neglected to pay the sum, or to secure or compound to it to the reasonable satisfaction of the creditor; or

(b) if execution or other process issued on a degree or order of any court or any other competent[commission] in favour of a creditor of the company is returned unsatisfied in whole or in part; or

(c) if it is proved to the satisfaction of the court that the company is unable to pay its debts, and, in determining whether a company is unable pay its debts, the court shall take into account the contingent and prospective liabilities of the company".[112]

So a company shall be presumed to be unable to pay its debts if the company's debts exceed its paid up capital by 1 per cent of such paid up capital or by 50,000 rupees, and its creditors have served notice for demand of such debts and the company has, for one month neglected to pay or otherwise answered to its creditors. Similarly, it is unable to pay its debts if judgment-creditor asks for payments from the company, and the company does not satisfy its creditors

[112] *Ibid.* Sec. 306.

returning such demand unsatisfied to such creditors, or otherwise it is proved before the court to its satisfaction that the company is unable to pay its debts.

Under section 358 of the Ordinance, company may be wound up voluntarily. Following are the circumstances in which company may be wound up voluntarily.

"(a) when the period(if any) fixed for the duration of the company by articles expires, or the event(if any) occurs, on the occurrence of which the articles provide that the company is to be dissolved and the company in general meeting has passed a resolution requiring the company to be wound up voluntarily;

(b) if the company resolves by special resolution that the company be wound up voluntarily"[113]

So, under two circumstances a company may be wound up.1st, if article of association provides for a fixed time for which company is to be in operation, or it provides for the occurrence of a particular event, and that duration comes to an end or the event occurs, then company passes a resolution in general meeting for winding up of the company, and 2nd, if company passes special resolution for voluntary winding up.

Voluntary winding up may under the supervision of court. Section 396 of the Companies' Ordinance, provides for such winding up.

"when a company has passed a resolution for voluntary winding up, the court may of its own motion or on the application of any person entitled to apply to the court for winding up a company, make an order that the voluntary winding up shall continue, but subject to such supervision of the court, and with such liberty for

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[113] *Ibid.* Sec. 358.

creditors, contributories or others to apply to the court, and generally on such terms and conditions, as the court thinks just".[114]

Court supervises voluntary winding up either on its own motion or on the application of any creditor.

Our main concern here is with insolvency. Insolvency is the inability of a company to pay its debts, which is one of the conditions for compulsory winding up of the companies, so, our main focus in this chapter, shall be on compulsory winding up and its relevant provisions.

Normally a company raises funds from two ways. It borrows money from creditors for which creditor are paid fixed amount of interests, and issues shares.[115] So the total capital of a company consists of debts and equity. Debts may either be borrowed from long term lending institutions for which loan deeds are prepared mentioning the terms and conditions of loan amount, its repayment, and payment of interest thereon, or from individual persons, for which

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[114] *Ibid.* Sec. 396.

[115] Share is actually portion of ownership of its holder in the assets of a company. it is the right of its holder to a specified amount of the share-capital of a company carrying with it certain rights and liabilities while the company is a going concern and of the capital of the company when it is wound up. See A.G. Chaudhary, *Mercantile Law in Pakistan* (Lahore: Khyber Law Publishers, 2003), P. 9.

There are two main types of shares. (1) ordinary shares, and (2) preference shares
Preference shares may be redeemable or irredeemable, accumulative or non-accumulative, participating or non-participating, convertible or non-c convertible.
Preference shares in Pakistan means accumulative, non-participating, irredeemable, and non-convertible. So it means that for preference shares dividends shall be calculated for every year, and no extra amount shall be paid to its holders beyond the fixed dividends, and company is not bound to buy back such shares, and the holders of such shares have no right to convert such shares into ordinary shares. See Safdar Ali Butt, *Business finance* (Lahore: Azeem Academy, 2006), P. 31-32

Bonus shares: company may issue bonus shares to its existing share-holders if it does not distribute its all profits or extra profits. These bonus shares shall be full paid up, and may be issued to eh existing share-holders instead of dividends or in addition to dividends payable to such share-holders. See A.G. Chaudhary, *Mercantile Law in Pakistan*, P. 56.

debentures[116] or bonds are issued. The holders of these debentures or bonds also get fixed interests upon their principal amounts. Shares are issued to the share-holders which entitle them the ownership of the assets for the company, and they receive dividends in case if the company earns profit.

Now the issues of the entitlement of the share-holders to profit and interests received by bond-holders and debenture-holders are discussed from the Islamic point of view in the following paragraphs.

First the issue of entitlement to profit is discussed here. Well-known tradition in Islamic law that "*Alkharaaj-u-Bil-Dhaman*", entitlement to profit is on the basis of liability for bearing loses. It means that one who is entitled to profit arising from some thing, shall also be liable to bear loses. This is not necessary that every profit comes after losses, and not to lose something first to get profit, but this shall

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[116] Debenture is a piece of paper which shows the amount paid up by its holder as a loan to the company which issues it. It is a document which either creates debt or acknowledges it. Debenture includes bonds, Term Finance Certificate etc. See A.G. Chaudhary, *Mercantile Law in Pakistan*, P. 10.
Debentures may be secured or un-secured. Secured debentures are those debentures which carry with it, a charge on the companies assets, whether it is fixed charge or floating charge. The holders of these secured debentures have the right to sell the charged property and to get their amount in preference to any other creditors, or share-holders. Secured debenture-holders can avail such right only if the borrowing company does not pay back their loans, or at the time of liquidation of the company.
Unsecured debentures those debentures which carry no charge on the property of the company, and the holders of such kind of debentures are treated as ordinary creditors at the time of liquidation of the company.
Charge is actually a right which a company gives to its lender for the purpose of the security for loans lended by the lender. Charge is of two types; fixed charge and floating charge. When a company gives fixed charge on its assets to its lender, the company is unable to use the charged property in any way without the prior permission from the charge-holder (lender.) fixed charge is given on a particular and definite property of company. In case of liquidation the charge-holder has arrived over the particular property in preference to all the other creditors. Floating charge, on the other hand, is not on a definite property rather it is given on a class of property in which the company has the right to do business upon such property until and unless the floating charge becomes fixed. Floating charge becomes fixed when the company goes into liquidation. See generally A.G. Chaudhary, *Mercantile Law in Pakistan*, P. 97-98.
Debentures may be redeemable or irredeemable, convertible or non-convertible. Most debentures in Pakistan are redeemable and inconvertible. It means that debentures in Pakistan con not be converted into ordinary shares, and the issuing company buys back its debentures after a particular time.

be the rule that in order to get profit arising from some property by someone, he may bear losses that may go beyond the value of the property.

For example A gives money to B to do business with it, and the profit arising from such business shall be divided between them with equal proportion i.e. 50% each and B agrees. If B does business and earns profit, this profit shall be divided between A and B with equal proportion. Here A gets profit although no losses occur to him or his property, so that is why we say that the rule "*Alkharaj-u-Bil-Dhaman*" is explained like this: In case if B does business and the business undergoes losses beyond the property provided by A, here A is liable for the extra liability in terms of losses incurred beyond the property invested by him. This also clarifies one thing more that not only wealth but also liability along with wealth entitles someone to profit. So A gets share in profit because he has provided the wealth and has accepted the liability for loses. And B gets profit because he accepts the liability of doing business (labour).

According to *Hanafi* jurists there are three types of liability which entitle one to profit. These are:

(a) Liability for wealth (*Daman Al-Mal*)

(b) Liability for performance of work accepted (*Daman Al-'Amal*)

(c) Liability for the amount to be paid because of purchase on credit (*Daman Al-Thaman*)

Al-Kasani says:

Entitlement to profit is either due to *Mal* (wealth), or *'Amal* (labour), or because of D*aman* (liability for bearing loses).[117]

The liability for wealth and performance of work accepted can be best understood from the example of *Mudarabah* contract. In *mudarabah* A transfers wealth to B to do business with it, and the profit arising from such business is divided between them with equal proportion. Normally there may be two consequences of the business. First, if B does business and earns profit, this profit shall be divided between A and B. And second if the business operated by B undergoes loses beyond the total assets provided by A to him, then A is liable to bear such loses. So, the profit taken by A in first case is because of his wealth and the corresponding liability beyond the amount provided by him to B for business.

So, we can say that A gets profit because of his accepting *Daman al-mal*. And B gets profit because of his acceptance of *Daman al-'amal*. In case of loses A bears extra loses and B bears the liability of loses in terms of doing work in vain.

If we compare this example with the contract between share-holder and company, share-holder provides funds to the company and the company does business with such funds. Share-holder is *rub al-mal* and the company is *Mudarib*. If the company does business with the assets of the share-holders, and it earns profit, it should be divided between the company and its share-holders according to the rule of *Mudaraba* i.e. 50% to be taken by the company and the remaining 50% to be divided among the share-holders according to their proportionate shares.

[117] 'Alauddin Abi Bakr Ibn Masuood Alkasani, *Bada'i'al-Sana'i' Fi Tarteeb al-Shara'i'*, vol. 7 (Karachi: Educational Press, 1910), P. 3545.

But unfortunately, this is not the case. These are only the share-holders who take whole profit after the claims of the creditors are fulfilled, and the company gets nothing. This is un-Islamic. It should be like this: 50% of the profit must be taken by the company, and the remaining 50% should be divided among the share-holders according to their proportionate shares.

Likewise, under the present Pakistani law, if the company undergoes loses beyond its total capital, the share-holders are liable only to their paid-up share capital, or to the extent of the remaining un-paid share capital, and are not liable for_any loses beyond it, although they take the whole of the profit earned by the company. This is un-Islamic under the rule of Islamic law that is "*Alkharaj-u-bil-dhaman*", entitlement to profit is based on the liability for bearing loses, because the share-holder is the owner of the wealth, and he is *rub al-mal*, and gets profit, so he should also bear loses according to his proportionate share, beyond the capital provide by him to the company.

The third type of *Dhaman* which is *Dhaman al-thaman*, is the liability accepted by the partners who buy some thing on credit, and do business with the property, and share profit according to their shares, and are liable to pay the price of the property purchased according to their proportionate ownership, agreed upon by them.

This discussion was about the entitlement of share-holders to profit on the basis of liability. Now the second issue of interest received by the bond-holders and debenture-holders is discussed in the next coming paras.

Interest is an English word for which the word *riba* is used under Islamic law. *Riba* literally means excess.[118] Technically, there are two types of *riba*: *riba al-nasi'ah* and *riba al-fadl.*[119]

Riba means excess and *nasi'ah* means delay, postpone, defer. So *riba al-nasi'ah* means excess with or because of delay and delay means delay in delivery of some thing. Therefore, the technical meaning of *riba al-nasi'ah* is receiving some thing in excess over the principal because of delay in its delivery.[120]

For example A gives Rs. 2000 to B, and after six months B gives Rs. 2010 to A. this increase of Rs. 10 over the principal is because of delay, thus it is *riba al-nasi'ah.*

Fadl is an Arabic word, and it means additional, extra etc.

Technically *riba al-fadl* means receiving some thing extra, in the exchange of two fungible things in case of spot transaction, or it is exchange of two fungible things with one thing in delay.[121]

The above definition has two parts; (1) receiving some thing extra in the exchange of two fungible things in case of spot transaction, and (2) exchange of two fungible things with on thing in delay.

Example of 1st part of the definition of the *riba al-fadl* is that if A and B make transaction on wheat, and A gives 1kg wheat to B, and B in return gives 1.5kg to A in spot transaction, this is *riba al-fadl.*

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[118] Burhan-ud-Din Ali Bin Abi Bakr Al-Marghenani, Al-Hidayah Sharh Fi Bidayat al-Mubtadi, Urdu trans. Mufti Mohammad Zubair, *Ashraf Al-Hidayah Sharh Urdu Al-Hidayah*, vol. 8 (Lahore: Ali Ijaz Printers, n.d), P. 286

[119] 'Alauddin Abi Bakr Ibn Masuood Alkasani, *Bada'i'al-Sana'i' Fi Tarteeb al-Shara'i'*, vol. 5 (Karachi: Educational Press, 1910), P. 183.

[120] *Ibid.*

[121] *Ibid.*

Example of the 2nd part of the definition is that if A gives 1kg of wheat to B, and B after five days, gives 1kg to A, this is also called *riba al-fadl.*

Qard Hasan[122] is an exception to this rule.

Imran Ahsan Khan Nyazee has elaborated *riba* in the context of the contract of *sarf.*[123]

He says:

"All cash loans in Islamic law are governed by the contract of *sarf.* This contract governs all currency transactions and most loans are made in currency or in fungibles like gold and silver. Despite the importance of this contract for loans,, modern scholars writing on *riba* almost never relate loans with this contract".[124]

He has worked on *riba* and has related it to the contract of *sarf,* and has made it easier for readers to know that what excess shall be considered as lawful profits (*Halal*) and what should be considered as unlawful (*riba*).

For a transaction to be usurious, he has laid down rules, which he has extracted from the work of the early Muslim jurists. These rules are as follows:

"(1) a usurious transaction involves the exchange of two counter-values.

(2) *riba* is found when ownership in the item exchanged is passed on to the other party.

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[122] "*Qard hasan* is an exchange of two currency values with a delay in which the period of delay is not fixed and the potential benefit derived during the delayed period (time value) is consciously gifted to the beneficiary". See generally Imran Ahsan Khan Nyazee, *Corporations in Islam* (Rawalpindi: Federal Law House, 2007), P. 188.

[123] Contract of sarf is the exchange of two currency-values. See generally Mufti Mohammad Zubair, *Ashraf Al-Hidayah Sharh Urdu Hidayah*, vol. 9 (Lahore: Ali Ijaz Printers, n.d), P. 80.

[124] Imran A. Nyazee, *Corporation in Islam* (Rawalpindi: Federal Law House, 2007), P. 178.

(3) *riba* is found when the items exchanged are the same or are the species of the same genera.

(4) An excess must be found and passed on to the other party either in one of the exchanged items or in both".[125]

For a transaction to be usurious, all of the above conditions must be fulfilled. It means that identical or similar things shall be exchanged by the parties to the contract of the exchange, wherein ownership in the things exchanged shall also be transferred by the parties, and there shall be an additional value transferred to each other or to one of them. For example A gives two million rupees to B, and B does business with it. After one year, B returns two millions and twenty five thousand rupees to A. Here four conditions are tested to know whether it is a usurious transaction or not?

1st, whether there is exchange of two values? The answer is yes, there is exchange to two values. A transfers two million rupees to B and after one year B transfers two million and twenty five thousand rupees to A.

2nd, whether the values transferred are similar, identical, or not? The answer is yes, because both parties transfer amount in rupees.

3rd, whether, they transfer ownership to each other? The answer is yes, they transfer ownership to each other.

And 4th, that whether, there is any excess in the value transferred? The answer is yes, because B returns two millions and twenty five thousand rupees in exchange of only two million rupees, so there is an increase of twenty five thousand rupees.

[125] *Ibid.* P. 182.

So this transaction is usurious and it is prohibited in Islam.

Now I shall apply it to the interests received by the bond-holders, share-holders and preference share-holders.

We know that *riba* (usury) is *haram* (prohibited) in *islam*, and its *tehreem* (prohibition) is clear from the text of the *Holy Quran* and *Sunnah* of the Prophet (P.B.U.H.).

As for as its prohibition from *Qura'n* is concerned, so *Allah* says in *Qura'n*:

"O ye who believe! Fear *Allah*, and give up what remains of your demand for usury, if ye are indeed believers".[126]

Then further in this verse the Almighty *Allah* challenges us if we do not give up usury.

In another verse of *Qura'n* He says:

"And *Allah* has permitted sale and prohibited *riba*".[127]

In the above two verses of *Qura'n*, the *Allah* Almighty clearly prohibits *riba*. Similarly, Prophet Mohammad (PBUH) has said:

"The Messenger of *Allah* has cursed one who charges *riba*, he who gives it, one who records it, and the two witnesses; and he said they are equal".[128]

Bond-holders, debenture-holders get a fixed amount of interest over the principal amounts. Bond-holders and debenture-holders give loan to a company for fixed term, where the company is liable to pay their principal amounts after the expiry of the term and also it pays a fixed amount of annual interests to them.

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[126] *Qur'an* 2: 278.

[127] *Qur'an* 2: 275.

[128] Imam Abu 'Isa Mohammad Ibn-e-'Isa Al-Tarmizi, *Jaame'o Al-Tarmizi, Abwab-ul-Buyo', Bab Ma Ja'a Fi Akl-e- Al-Riba*, 1206.

The transaction between the bond-holders, debenture-holders and the company is actually the exchange of two identical things i.e. currency, with delay, where the ownership is first transferred by the bond-holders and debenture-holders to the company, and then the company transfers the ownership in the currency to the such bond-holders and debenture-holders after the expiry of the fixed term, and this exchange brings an extra amount to be given by the company to the bond-holders and debenture-holders.

So it is *riba*, and *riba* is *haram*.

Unlike the ordinary share-holders, preference share-holders are not the real owner of the assets of the company, so they are like the bond-holders because they receive fixed amount of interests, whether the company earns profit or undergoes loses. So the transaction between preference share-holders and the company is like that of between the company and its bond-holders, so the fixed amount received by these share-holders is interest, and it is *Haram*.

Companies limited by guarantee "are companies in which the liability of its members is limited by the memorandum of association to such amount as the members may respectively thereby undertake to contribute to the assets of the company in the event of the its being wind up".[129]

Section 298 of the Companies' Ordinance states the liabilities of contributories. Its clause (v) states that in the case of a company limited by guarantee, no contribution shall, subject to the provisions of sub-section(2), be required from

[129] A.M. Choudhry, *Company Law* (Lahore: PLD Publisher, 1991), P. 5.

any past or present member exceeding the amount undertaken to be contributed by him to the assets of the company in the event of its being wound up.[130]

So this means, if a contributory has promised to contribute a certain amount, or certain percentage to the company during winding up, he shall only be liable to contribute to that extent. This is his sole liability, subject to his liability of unpaid share-capital if he has shares in the company for which he has not yet fully or partially paid.

The contract between the company and the contributory is Islamic because this contract is permitted under Islamic law which is *Sharikat al-wajooh 'inan* and *Kafalah. Sharikat 'inan* in the sense that there is no equality in *mal 'amal* etc. It is *wajooh* in the sense because the contract between company and contributory is on the basis of *wajh* (reputation) of the contributory, and *kafalah* in the sense that the contributory guarantees payment of certain amount.

Section 298 (iv) states that in the case of a company limited by shares, no contribution shall be required from any past or present member exceeding the amount, if any, unpaid on the shares in respect of which he is liable as such member.[131]

According to the Islamic point of view the liability of the share-holders shall not be limited to the extent of their paid up or un-paid share-capital. They should bear extra loses beyond their share-capital provided by them, in case if the company undergoes loses beyond its capital according to a well-known tradition

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[130] *The Companies' Ordinance, 1984, Sec. 298.*
[131] *Ibid.*

"entitlement to profit is based on liability to bear loses" as I have discussed before.

If a contributory dies, or become insolvent, or is a body corporate and is wound up then section 302-304 of the Companies' Ordinance are relevant. Section 302(1) states that, "if a contributory dies either before or after he has been placed on the list of contributories, his legal representatives shall be liable, in a due course of administration, to contribute to the assets of the company in discharge of his liability, and shall be contributories accordingly".[132]

Section 302(2) further states that, "if the legal representatives make default in paying any money ordered to be paid by them, proceedings may be taken for administering the property of the deceased contributory, and of compelling payment there out of the money due".[133]

So, if contributory to assets of a company dies, his legal representatives are liable. If he becomes insolvent, then "assignees in insolvency shall represent him for all the purposes of winding up, and shall be contributories accordingly, and may be called on to admit to proof against the estate of the insolvent, or otherwise to allow to be paid out of his assets in due course of law, any money due from the insolvent in respect of his liability to contribute to the assets of the company".[134]

As the property of insolvent vests in his assignee, and he is discharged from all of his liabilities, therefore, in case if he is contributory and becomes insolvent, his assignee is liable for it.

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[132] *The Companies' Ordinance, 1984*, Sec. 302(1).
[133] *Ibid.* Sec. 302(2).
[134] *Ibid.* Sec. 303 (a).

Similarly, if a body corporate undertakes to contribute to the assets of a company, as a contributory, at the time of winding up of such company, and it by itself is wound up, then official liquidator of the body corporate is liable.

Section 304(a) of the Companies' Ordinance, 1984 states that if a body corporate, which is a contributory of a company, is wound up, then "the liquidator of the body corporate shall represent it for all purposes of the winding up of the company and shall be a contributory accordingly, and may be called on to admit to proof against the assets of the body corporate, or otherwise to allow to be paid out of its assets in due course of law, any money due from the body corporate in respect of its liability to contribute to the assets of the company".[135]

While discussing the above three issues, first I shall discuss rules regarding the liability of the deceased insolvent and then shall apply such rules to these issues.

From the rules discussed below, it becomes clear that no one shall be liable for the liabilities of the deceased debtor. It is only his property left by him behind him is liable to distributed among his creditors. And if such property is not sufficient to satisfy all his creditors, then his heirs are not liable for the balance amount, however, they may pay it. And the creditor may either wait till *Akhirah* (lifehereafter), or may waive his right to such amounts and may earn *Sawab* (reward). Here in case of company too, only its assets are liable to satisfy its creditors, and not the liquidator. The issues covered by the following rules.

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[135] *Ibid.* Sec. 304 (a).

Firs of all the funeral expenses shall be paid from the property of the deceased debtor.[136] After his funeral expenses, any property left behind him shall be paid for satisfying his debt liabilities.[137]

There are some debts which shall be paid in preference to all other debts, even over his funeral expenses.

First the mortgaged property to his creditors, and second the property bought by him from seller, for which neither such debtor paid its price, nor took its possession, and it is still in the possession of the seller. So the property of the deceased debtor is liable for these two debts in preference to all other debts.[138]

If debtor has mortgaged any property in exchange of taking loan, and then he dies before payment of his debts back, and he does not leave any property, the mortgagee is entitled to sell such mortgaged property, and to take his right from it and to pay back the rest of the amount to the deceased heirs.[139]

It means if he leaves any property behind him then first the debt taken from the mortgagee in exchange of the property shall be paid and the property mortgaged shall be redeemed from him.

We know that there are two main types of rights; right of *Allah*, and right of human being, so two types of liabilities; liability towards *Allah* and liability towards human being, and consequently two types of debt liabilities; debt liability towards *Allah* and debt liability towards human being.

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[136]Syed Mian Sahib Asghar Hussain, *Mufeed al-Wariseen* (Lahore: Wifaq Printing Press, 1980), P. 32.
[137] *Ibid.* P. 36.
[138] *Ibid.* P. 37.
[139] *Ibid.* P. 28.

First debt liability towards human being shall be relieved and then liability towards *Allah* shall be relieved. Liability towards *Allah* shall be relieved only if the deceased debtor has created a *will.* Debts towards *Allah* shall be paid after the debts_towards human being are paid, and it shall be paid only from the 1/3 of the property remained after payment of funeral ceremony of the deceased, and payment of debts towards human beings. If 1/3 is insufficient then his legal heirs shall not be liable, however, they have discretion as to allow more than 1/3 of the property remained to satisfy debts of the deceased.

Debts towards *Allah* are *Zakat, Kafarah, Fidyah* etc.[140]

As for as debt liability towards human being is concerned, it shall be proved either before the *maraz al-maut* (mortal disease) or after the mortal disease. So from this aspect there are two types of debts; debts proved before the *maraz* and debts proved after *maraz.* Before *maraz* debts are either proved by witnesses or by the acknowledgement of the debtor. Debts at the time of *maraz* are proved by the acknowledgement of the debtor.[141]

With respect to these two types of debts, the author of the book has put following rules that:

1. If the rest of the property left after payment of funeral expenses, is sufficient for the payment of both types of debts, these shall be paid without any hesitation.
2. If there is only one type of debt, and the property left is sufficient, then it shall be paid without hesitation.

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[140] *Ibid.* P. 39.
[141] *Ibid.* P. 37.

3. If property is insufficient, and there is only one type of debt and only one creditor, then after his funeral expenses whatever remains, it shall be paid to him, and the rest if he wants may waive, or postpone till *Akhirah,* it shall not be the liability of the heirs of the deceased to pay it.
4. And if there is one type of debt and more creditors then all shall be entitled according to their proportionate shares….
5. If he is liable for both types of debts, and the property left by him is not sufficient for both to be paid, then firstly, debts payable from type number one shall be paid and then the rest of the property shall be paid to satisfy the second type of debt,_and if creditors in the second type are more, then they shall be entitled to the rest of the property according to their proportionate shares.
6. If the property left is too much less that it is insufficient for the payment of debts under first type, then it shall be paid only to the creditors under 1st type, and if he is only one creditor, all the property shall be paid to him, and if more than one creditors , then the property shall be distributed among them according to their proportionate shares.
7. If the property left is insufficient for the debts under 1st type, or is sufficient only for this type of debts, then in these two cases creditors of the second type shall be deprived(of their rights to loan amount). They have the option to leave the matter for *Akhirah* or to waive their right to such loan amounts. Heirs of the deceased shall not be compelled to pay these debts from their own property, however, if they are rich, then it is

appropriate to pay such debts to relieve their deceased relative of his responsibility.[142]

From these rules it is clear that no one shall be liable for the debts of the deceased person. It is only his property which is liable to satisfy his creditors. If his property left behind him is not sufficient for his debts, then his heirs are not liable for his debts. However, they may pay such debts in order to relieve their relative from the responsibility.

Further section 299 of the Ordinance tells us about the liability of director having unlimited liability. This section states that, "in the winding up of a limited company any director, whether past or present, whose liability is, in pursuance of this Ordinance, unlimited, shall, in addition to his liability, if any, to contribute as an ordinary member, be liable to make a further contribution as if he were, at the commencement of the winding up, a member of an unlimited company:

Provided that—

(i) a past director shall not be liable to make such further contribution if he has ceased to hold office for a year or upward before the commencement of the winding up;

(ii) a past director shall not be liable to make such further contribution in respect of any debt or liability of the company contracted after he ceased to hold office;

(iii) Subject to the articles, a director shall not be liable to make such further contribution unless the court deems it necessary to require that

[142] *Ibid.* P. 38-39.

contribution in order to satisfy the debts and liabilities of the company, and the costs, charges and expenses of the winding up".[143]

Director of a limited company, having unlimited liability, is liable to further contribute in excess of his contribution undertaken by him, if court thinks it fit and necessary.

Court appoints liquidator for liquidation. Liquidator conducts the proceedings of winding up. He winds up all affairs f a company. In this regard section 326(1) is stated as:

"The official liquidator shall conduct the proceedings in winding up the company and perform such duties in reference thereto as the court may impose".[144]

Official liquidator takes possession of the property to the company during winding up of the company.

Section 330 (1) of the Companies' Ordinance is stated as:

"The official liquidator shall take into his custody all the properties of the company undergoing winding up, and its relevant documents. Any person who has the property of the company or its relevant documents, in his custody shall forthwith hand over such property or documents, or report such information to the official liquidator".[145]

Official liquidator and provisional manager are appointed for the same work. They are appointed for the same purpose of winding up of affairs of a company. If he is appointed at the time of presentation of winding up petition, he is called provisional manager, and if appointed at the time of order of winding up of a

[143] *The Companies' Ordinance, 1984*, Sec. 299.
[144] *Ibid.* Sec. 326 (1).
[145] *Ibid.* Sec. 330 (1).

company, then he is called official liquidator. Generally, official liquidator is appointed.

Other powers of the official liquidator are mentioned in section 333 of the Companies' Ordinance. These are:

Official liquidator has the right to do all such acts and things as may be necessary for the winding up the affairs of the company and distributing its assets, and to execute all deeds, receipts and other documents on behalf of the company. He may do any business on the company's behalf, and may institute any suit and may defend it. He may sell the property of the company to pay to the creditors of the company. He may appoint any person as his agent to do such things as he requires from him to do.[146]

Now the power of liquidator in case of corporate insolvency, and those of the Official Assignee, Official Receiver, Interim Receiver, Official Manager, in case of individual insolvency shall be analyzed according to the Islamic point of view.

Under Islamic law it is the responsibility of the insolvent debtor to sell his property and to distribute the price among his creditors. If he does not want to sell it then according to *Sahibain* judge shall sell his property and shall distribute the price of such property among his creditors according to their proportionate sharers.[147]

So the property shall remain with the insolvent, and he shall sell it by himself. In case if he does not want to sell then court has the power to do so.

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[146] *Ibid.* Sec. 333.

[147] Burhan-ud-Din Ali Bin Abi Bakr, Al-Marghenani, *Al-Hidayah Sharh Bidayat Al-Mubtadi*, Urdu trans. Mufti Mohammad Zubair, *Ashraf Al-Hidayah Sharh Urdu Hidayah*, vol. 12 (Lahore: Ali Ijaz Printers, n.d), P. 273.

Now as in these days it is not feasible for a judge to sell the properties because of bulk of case work, therefore, the court may appoint any person under the contract of *Wakalah*[148] to sell the property of the insolvent.

The person may be any one, and in the present days it may be liquidator, official assignee, official receiver, official manager, etc.

According to the above rules, this is not mandatory that liquidator shall be appointed, he is appointed only in case if the company does not want to sell its property as I discussed above. Court appoints him as court's agent under the contract of *wakalah* in Islam.

So the mandatory provision for the appointment of such person shall be amended and a condition shall be put there that if the person does want to sell his property by himself, then court may appoint these persons to do so.

Wakeel under Islamic law has the power to do all business for which his principal gives permission him to do.[149]

All debts are provable under this Ordinance, but only those debts are payable back which are proved.

Section 346 and 403 of the Companies' Ordinance deal with this, and are stated below:

"in every winding up (subject; in the case of insolvent companies, to the application in accordance with the provisions of this Ordinance or the law of insolvency) all debts payable on a contingency, and all claims against the company, present or future, certain or contingent, ascertained or sounding only in

[148] *Wakalah* is a contract in which one person appoints another person to perform on his behalf what he is appointed for. See *ibid.* vol. 10, P. 153.
[149] *Ibid.*

damages, shall be admissible to proof against the company, a just estimate being made, so far as possible, of the value of such debts or claims as may be subject to any contingency, or may sound only in damages, or for some other reason do not bear a certain value".[150]

Those creditors who have not yet proved their debts, are excluded from the benefit of the company as to dividends, interests etc.

Section 346 of the Ordinance is stated in this regard. It states that:

"the court may fix a time or times within which creditors are to prove their debts or claims, or to be excluded from the benefit of any distribution made before those debts are proved".[151]

From the Islamic point of view no objection raises about the point that only those creditors are entitled to payments who have proved their debts, but in addition to this under Islamic law court shall not delay the division of the present property among the present creditors till the time to know whether the debtor has more creditors or not. The present property of the insolvent shall be divided among his creditors according to their proportionate shares. Court shall neither delay the division of the property among present creditors till the time to know whether any other creditors have right against him, nor put burdon upon the present creditors to prove that there are no other creditors other than the present.[152]

But one thing must be clear that such creditors shall not be entitled to any interests as this is prohibited in Islam with the most express words.

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[150] *Ibid.* Sec. 403.
[151] *Ibid.* Sec. 346.
[152] Abd-Ur-Rahman, *Kitab-Ul-Fiqh*, vol.2, trans. Manzoor Ahsan Abbasi (Lahore: Maktaba-e-Jadeed Press, 1978), P. 750.

Court gives reasonable time to the creditors for the proof of their debts, if within that reasonable time they do not prove such debts, then they are not entitled to any payments.

When winding up of a company completes, it still remains as juristic personality until and unless it is dissolved.

As discussed above that court shall not delay the distribution of the assets of the company till the time to know that whether the debtor has any other creditors or not?

"A company being wound up shall continue to be company for all purposes till its final dissolution in accordance with the provisions of this ordinance and, unless otherwise specified, all provisions and requirements of this ordinance relating to companies shall continue to apply *mutatis mutandis* in the case of companies being wound up".[153]

Section 350 subsection (1) of the Companies' Ordinance states that:

"when the affairs of a company have been completely wound up, or when the court is of the opinion that the official liquidator can not proceed with the winding up of the company for want of funds and assets or any other reason whatsoever and it is just and reasonable in the circumstances of the case that an order of dissolution of the company be passed, the court shall make an order that the company be dissolved from the date of the order, and the company shall be dissolved accordingly".[154]

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[153] *The Companies' Ordinance, 1984*, Sec. 402.
[154] *Ibid.* Sec. 350 (1).

Company is dissolved under two circumstances, (1) where the winding up of a company completes successfully, (2) where there is insufficient funds and assets for the operation of winding up proceedings of a company, and court thinks it just and equitable to dissolve the company.

If a company is being wound up voluntarily, its directors at the board meeting may pass a declaration that the company has no debts or it is able to pay its debts. "where it is proposed to wind up a company voluntarily, its directors, or in case the company has more than three directors, the majority of the directors, may, at a meeting of the board of directors, make a declaration verified by an affidavit to the effect that they have made a full inquiry into the affairs of the company, and that having done so, they have formed the opinion that the company has no debts, or that it will be able to pay all its debts in full within such period not exceeding twelve months from the commencement of the winding up, as may be specified in the declaration".[155]

"if thereafter, liquidator is of the opinion that the company would not be able to pay all its debts in the time fixed, or that fixed time has expired and the company has not satisfied its creditors in full, then such liquidator shall call a meeting of the creditors of the company, and shall give information about the assets and liabilities of the company to the creditors".[156]

During the winding up of a company, some debts are to be paid in priority to the others. "In a winding up, there shall be paid in priority to all other debts—

[155] *Ibid.* Sec. 362 (1).
[156] *Ibid.* Sec. 368 (1).

(a) all revenues, taxes, ceases ant rates due from the company to the Federal Government or a Provincial Government or to a local[commission] at the relevant date and having become due and payable within the twelve months next before that due;

(b) all wages or salary(including wages payable for time or piece of work and salary earned wholly or in part by way of commission) of any employer in respect of any services rendered to the company and due for a period not exceeding four months within the twelve months next before the relevant date and any compensation payable to any workman under any law for the time being in force subject to the limit specified in sub-section (2);

(c) all accrued holiday remuneration becoming payable to any employee or in the case of his death to any other person in his right, on the termination of his employment before, or by the effect of, the winding up order or resolution;

(d) unless the company is being wound up voluntarily merely for the purposes of reconstruction or of amalgamation with another company, all amounts due, in respect of contribution towards insurance payable during the twelve months next before the relevant date, by the company s employer of any person, under any other law for the time being in force;

(e) unless a company is being wound up voluntarily or of amalgamation with another company, or unless the company has, at the commencement of the winding, under such a contract with insurers as is mentioned in section 14 of the Workmen's Compensation Act, 1923(viii 1923) right capable of

being transferred to and vested in the workman, all amounts due in respect of any compensation or liability for compensation under the said Act in respect of the death or disablement of any employee of the company;

(f) all sums due to any employee from a provident fund, a pension fund, a gratuity fund or any other fund for the welfare of the employees maintained by the company".[157]

This section states that all government dues, salaries of the company's employees, their holiday remunerations, etc., all insurance payments by company as employer of any person, compensation under Workmen's Compensation Act, 1923 for the death or disablement of any workman, all sums due from the pension fund, provident fund, gratuity fund, for the welfare of the employees etc., shall be paid in priority to all other debts of the company.

Under Islamic law all types of creditors shall be entitled to their amounts according to their proportionate shares, and there shall be made no distinction of the debts owed by the debtor to his creditors, and thus no preference shall be given to any of his creditors. It becomes clear from the following paras.

All the property of the insolvent shall be distributed among his creditors according to their proportionate shares.[158] After he (debtor) has been restrained from his property, all his property shall be distributed among his creditors according to their proportionate_shares.[159]

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[157] *Ibid.* Sec. 405 (1).

[158] Abd-Ur-Rahman, *Kitab-Ul-Fiqh*, vol.2, trans. Manzoor Ahsan Abbasi (Lahore: Maktaba-e-Jadeed Press, 1978), P. 750.

[159] Burhan-ud-Din Ali Bin Abi Bakr, Al-Marghenani, *Al-Hidayah Sharh Bidayat Al-Mubtadi*, Urdu trans. Mufti Mohammad Zubair, *Ashraf Al-Hidayah Sharh Urdu Hidayah*, vol. 12 (Lahore: Ali Ijaz Printers, n.d), P. 274.

All the creditors of the insolvent shall be entitled to the property of the debtor in accordance with their proportionate shares.[160]

All of these three paragraphs expressly mention that the property of the debtor shall be divided among his creditors according to their proportionate shares, whether such creditor is Government or any one else.

The third paragraph which is in *kitabul fiqh*, expressly mentions the word all his creditors, which further clarifies the point that no preference shall be given to any of his creditors. So the Government, employees of debtor, etc shall be considered as his creditors like the other creditors. Even his wife is joined with the other creditors, and is entitled to her dower according to her proportionate share.

When all creditors are paid off, any surplus amount shall be paid to the members of the company after dividends.

If any property belonging to any person, remained unclaimed in the hands of liquidator for a term of six months, shall be paid to the State Bank of Pakistan, wherefrom the person claiming himself to be entitled to such property, may apply to the registrar for its payment.

Section 432 is stated in this regard as:

"(1) where any company is being wound up, if the liquidator has in his hands or under his control any money of the company representing unclaimed dividends payable to any creditor or undistributed assets refundable to any contributory which have remained unclaimed or undistributed for six months after the date on which they became payable or refundable, the liquidator shall forthwith pay the

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[160] Abd-Ur-Rahman, *Kitab-Ul-Fiqh*, vol.2, trans. Manzoor Ahsan Abbasi (Lahore: Maktaba-e-Jadeed Press, 1978), P. 745.

said money into the State Bank of Pakistan to the credit of the Federal Government in an account to be called Companies Liquidation account, and the liquidator shall, on the dissolution of the company, similarly pay into the said account any money representing unclaimed dividends or undistributed assets in his hands at the date of dissolution".[161]

Then further in sub-section (6) of 432, it is stated that:

"Any person claiming to be entitled to any money paid into the Companies Liquidation Account in pursuance of this section may apply for the registrar for payment there of, and the registrar, if satisfied that the person claiming is entitled, any offer obtaining approval of the [commission], make the payments that the person of the sum due:

Provided that no claim under this subsection shall be entertained after a period of fifteen years from the date of deposit of the amount in the State Bank of Pakistan".[162]

This point is Islamic because under Islamic law too ruler has the right to restrain plaintiff from filing suit after a certain period i.e. fifteen years, although his right to ownership remains valid. Only he is restrained to claim his right.

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[161] *The Companies' Ordinance, 1984*, Sec. 432 (1).
[162] *Ibid.* Sec. 432 (6).

2. The Provincial Insolvency Act, 1920 and the Insolvency (Karachi Division) Act, 1909

For insolvency proceedings to be initiated against an individual, it is essential that he has committed the act of insolvency.

According to section 6 of the Provincial Insolvency Act, 1920, and section 9 of the Insolvency (Karachi Division) Act, 1909 person commits an act of insolvency in the following circumstances.

"(a) if, in Pakistan or elsewhere he makes a transfer of all or substantially al his property to a third person for the benefit of his creditors generally;

(b) if, in Pakistan or elsewhere, he makes any transfer of his property or of any part thereto, with intent to defeat or delay his creditors;

(c) if, in Pakistan or elsewhere, he makes any transfer of his property or of any part thereof, which would, under this or any other enactment for the time being in force, be void as a fraudulent preference if he were adjudged an in solvent;

(d) if, with intent to defeat or delay his creditors:-

(i) he departs or remain out of Pakistan.

(ii) he departs from his dwelling-house or usual place of business or otherwise absents himself.

(iii) he secludes himself so as to deprive his creditors of the means of communicating with him.

(e) if any of his property has been sold or attached for a period of to less than twenty one days in execution of the decree of any Court for the payment of money;

(f) if he petitions to be adjudged an insolvent;

(g) if he gives notice to any of his creditors that he has suspended, or that he is about to suspend, payment of his debts;

(h) if he is imprisoned in execution of the decree of any Court for the payment of money".[163]

So, if a debtor whether honestly or dishonestly, does any thing with respect to his property or with himself in case he would be unable to pay his debts, is called his act of insolvency.

Mohammad Aamir Sohail, the writer of book "Manual of Insolvency Laws", says that "What a man does when could not or would not pay debts is called his act of insolvency. An act of insolvency forms the cause of action to institute the insolvency proceedings and it is on act of insolvency that the jurisdiction of the insolvency court rests".[164]

Now from Islamic point of view if we look into the matter, then it is concluded that there is no concept of commission of act of insolvency for initiating insolvency proceedings. Creditor may apply to the court to restrain the debtor from his property, simply if such debtor's debts exceed his assets. It becomes clear from the following para.

If debtor has taken so many amounts of debts which exceed his assets, then his creditors may apply to the court to restrain him from his property, and the court shall thereupon do so, and thereafter such debtor shall not be entitled to dispose off his property in any way. Court may issue an order for his restraint form his

[163] *The Provincial Insolvency Act, 1920*, Sec. 6; the Insolvency (Karachi Division) Act, 1909, Sec. 9.
[164] Muhammad Aamir Sohail, *Manual of Insolvency Laws* (Lahore: Haji Tajammal Hussain, 2008), P. 17.

property even in his absence, but such order of restraint shall be effective only when such debtor has notice of such order, and if he has no notice of order, then all his transactions shall be valid unless and until he comes to know about such order.[165]

District Court has jurisdiction to proceed over insolvency petitions.

"The District Courts shall be the Courts having jurisdiction under this Act".[166]

Both creditor as well as debtor is entitled to present insolvency petition to Court.

Creditor is entitled to petition only if:

"(a) the debt owing by the debtor to the creditor, or, if two or more creditors join in the petition, the aggregate amount of debts owing to such creditors, amounts to five hundred rupees, and

(b) the debt is a liquidated sum payable either immediately or at some certain future time, and

(c) the act of insolvency on which the petition is grounded has occurred within three months before the presentation of the petition".[167]

Debtor is entitled to petition if:

"(a) his debts amount to five hundred rupees; or

(b) he is under arrest or imprisonment in execution of the decree of any Court for the payment of money; or

(c) an order of attachment in execution of such a decree has been made, and is subsisting, against his property".[168]

[165] Abd-Ur-Rahman, *Kitab-Ul-Fiqh*, vol.2, trans. Manzoor Ahsan Abbasi (Lahore: Maktaba-e-Jadeed Press, 1978), P. 744.
[166] *The Provincial Insolvency Act, 1920*, Sec. 3.
[167] *Ibid.* Sec. 9.

The minimum amount which entitles both creditor and debtor to insolvency petition is five hundred rupees debt. Debtor is entitled to such petition if he owes five hundred rupees to his creditors, and creditor is entitled if such or more amount is owed to him by his debtor.

Islamic law does not mention any minimum amount for the insolvency petition. Islamic law just mentions the word debt absolutely. So any creditor whether his credit is five hundred rupees or less, can give the insolvency petition to the court, and also can apply to the court to issue an order of restraint against his debtor. The only requirement that needs to be fulfilled before a creditor may apply to the court for the restraint of a debtor from his property and for his adjudication as insolvent, is that the debts of such debtor should exceed his total assets. If debtor has taken so many amounts of debts, which exceed his assets, then his creditor may apply to the court to restrain him from his property, and the court shall thereupon do so.[169]

After admitting the petition by court, it may appoint an interim receiver of the property of debtor, and may direct him to take immediate possession of debtor's property.[170]

Debtor is liable to furnish all details of his property and to give list of his creditors, other debtors if there any, and the debts due to them and from them.

From Islamic point of view again it is said that first the debtor himself shall deal with his property in order to pay debts amounts to his creditors and for this purpose he may_sell his property or does any thing to satisfy the claim of his

[168] *Ibid.* Sec. 10.
[169] *Ibid.*
[170] *Ibid.* Sec. 21.

creditors, and there is no need of appointment of interim official receiver, but if he does not want to sell his property for the purpose of payment of debt amounts, then court has the power to do so, and for this purpose court may appoint interim receiver as agent of court, as I have already discussed in detail.

Court may, after his adjudication as insolvent, summon the debtor, or any person who is in possession of such insolvent's property, or is indebted to him, or any such person who has information about insolvent's property or his dealing with the property, to appear before the court or to produce any such documents, which may help the court in discovery of insolvent's property.

If such person admits that he is indebted to the insolvent, court may require him to pay such debt to the official assignee. If he admits that he is in possession of insolvent's property, the court may also require him to deliver such property to the official assignee".[171]

This point is in accordance with the principles of Islam, so no need to explain.

"If an insolvent removes, more than the value of fifty rupees, any property in his possession, without the permission of the official assignee, or he is about to remove such property in his possession in order to delay or prevent its possession by official assignee, or he is about to conceal or destroy such property, or the court has reason to believe that he has absconded or is about to abscond in order to avoid his examination or to delay insolvency proceedings against him, then court may order for his arrest and to put him in jail until such time as the court may order".[172]

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[171] *The Insolvency (Karachi Division) Act, 1909*, Sec. 33.
[172] *Ibid.* Sec. 34.

There are two points in this paragraph which are un-Islamic, and need to be Islamized. First one is his imprisonment. Islamic law allows a debtor's imprisonment only to know his status that whether he is having property or not? Suspicious persons may be imprisoned to know that whether they have property or not?

Muslim Jurists have different opinions about the duration of his imprisonment. This duration ranges from one to six months but in fact there is no fixed duration for his imprisonment. He shall be imprisoned until court comes to know about his financial status because some people require slight punishment to tell the truth while the other require more to tell the truth.[173] Any way this imprisonment duration shall not be more than six months even if the court does not reach to any conclusion upon his financial status.

So if he is restrained from his property then if he disposes off his property, he can not be imprisoned for that, however, his transactions with respect to his property shall be invalid.

According to ***sahibain***, the person restrained from his property can not give his property in gift or charity.[174] However, he can enter into a marriage contract and can fix dower amount for his wife, and if it is equal to *Mahr Misl* then his wife is entitled to such *mahr* as a creditor like his other creditors.[175]

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[173] Burhan-ud-Din Ali Bin Abi Bakr, Al-Marghenani, *Al-Hidayah Sharh Bidayat Al-Mubtadi*, Urdu trans. Mufti Mohammad Zubair, *Ashraf Al-Hidayah Sharh Urdu Hidayah*, vol. 12 (Lahore: Ali Ijaz Printers, n.d), P. 271.

[174] Maulana Sheikh Nizam & Others, *Fatawa Alamgeeriah*, Urdu trans. Syed Ameer Ali, vol. 7(Lahore: Little Star Printers, n.d), P. 532.

[175] Abd-Ur-Rahman, *Kitab-Ul-Fiqh*, vol.2, trans. Manzoor Ahsan Abbasi(Lahore: Maktaba-e-Jadeed Press, 1978), P. 745.

Moreover, expenses for maintenance of himself, his wife, children, and near relatives shall also be paid from his property.[176]

Second point is about his abscondance. This point is also un-Islamic. As I have already discussed above that he is imprisoned only if court wants to know about his financial status that whether he is having property or not, and for nothing else, so if he absconds court may issue an order of restraint from his property against him, and may sell his property to distribute the price of the property among his creditors. Court may issue an order of his restraint against him even in his absence.[177]

"Property for which claim under this Act may be presented to court, and entertained by the court, is called debt provable under this Act. All debts and liabilities, present orfuture, certain or contingent, to which debtor is liable whether at the time of hisadjudication or before his discharge, shall be deemed to be provable under this Act, butthis does not include claims for unliquidated damages arising otherwise than by reason of a contract or breach of trust.

Under Islamic law debts incurred in any way shall be considered as the liability of debtor, and the creditor may demand for such debt amounts. There is no need to know that how he incurred such liability. Whether he incurred by way of mutual agreement or otherwise, he shall be liable and the person to whom such liability is owed shall be entitled todemand from him.

While discussing the procedure for the proof of debts *Al-Kasani,* the

[176] Burhan-ud-Din Ali Bin Abi Bakr, Al-Marghenani, *Al-Hidayah Sharh Bidayat Al-Mubtadi*, Urdu trans. Mufti Mohammad Zubair, *AshrafAl-Hidayah Sharh Urdu Hidayah*, vol. 12 (Lahore: Ali Ijaz Printers, n.d), P. 277.

[177] Abd-Ur-Rahman, *Kitab-Ul-Fiqh*, vol.2, trans. Manzoor Ahsan Abbasi (Lahore: Maktaba-e-Jadeed Press, 1978), P. 744.

Hanafi jurist says that: if none of them (debtor and creditor) can prove their claims then according to Abu Muhammad (R.A.) if debt is due because of mutual agreement between them i.e. sale, marriage, guarantee (*Kafalah*), compromise for culpable homicide, compromise for destruction etc. of one's property, or *Khul'a*, or for the reason being collateral to the contract for example maintenance expenses because of marriage contract,then claim of the creditor shall be accepted. Similarly, usurp (*Ghasb*) and *zakat* shall bedealt. And if debt is due by reason other than the above then the claim of the debtor shall
be accepted.[178]

So in this paragraph *Al-Kasani* quotes *Abu-Muhammd*, who states that all liabilities incurred whether by way of contract, ancillary to contract, or by way otherwise than contract, shall be deemed to be debts of debtor and insolvency proceedings may be initiated for these debts.

Similarly, any debt incurred by debtor after petition of insolvency has been filed Against him, and the creditor has notice of such petition, shall not be provable under this Act.

This point is un-Islamic because under Islamic law mere application, to court for his restraint from his property, or adjudication him as insolvent, does not have any effect upon his right of *tasrruf*, as I have already discussed that debtor can not do any kind of *tasrruf* in his property only after order of restraint has been issued against him by court. So he can dispose off his property before such order.

[178] 'Ala' al-Din Abu Bakr b. Mas 'ud, Al-Kasani, *Bada'I-i 'al-Sana'i ' Fi Tartib al-Shar'i '*, Urdu trans. Professor Khan Mohammad Chawla, vol. 7 (Lahore: Imprint Press, 1987), P. 431-2

Similarly, debts incurred, by him before order of restraint against him has been issued, may be demanded from him.

If after such order of restraint against him has been issued, he incurs any debt or the kind of liability, the creditor can not demand his debts from him during his restraint. After the order of restraint against debtor, if any one gives loan to him, or sells his property under such debtor's hand, he can demand it from him until such order of restraint is withdrawn from him.[179]

So debts incurred before such order shall be demanded from him even if application for his adjudication or for his restraint has been filed.

These are the debts, which one can demand from insolvent under the Insolvency Acts. This shows the extent of liability of an insolvent; he is liable only to these debts. Now the property, which shall be deemed to be the property of insolvent for the purpose of realization and distribution among creditors, is discussed in section 52 of the Insolvency (Karachi Division) Act, 1909.

"This includes all such property, which belongs to him, or to be vested in him at the commencement of his insolvency, or such property, which he acquires before his discharge.

Similarly, it includes the property with respect to which he has the capacity to exercise, or start proceedings for exercising all powers as might have been exercised by him for his benefit at the commencement of his insolvency or before his discharge.

[179] Abd-Ur-Rahman, *Kitab-Ul-Fiqh*, vol.2, trans. Manzoor Ahsan Abbasi (Lahore: Maktaba-e-Jadeed Press, 1978), P. 752.

It also includes all goods being in the possession, order or disposition of insolvent in his business with permission of its true owner in such circumstances that he is the reputed owner of such property".[180]

But it shall not include any property in the possession of insolvent, held on trust. It shall also not include tools of his trade, necessary wearing apparel, beds, utensils, furniture, for himself and for his family etc. provided that it does not exceed three hundred rupees as a whole".[181]

This point is un-Islamic and needs to be reformed from the Islamic point of view. Under Islamic law court has the power to sell all belongings of insolvent debtor, to which he is not presently in need. If his house is big then court may sell his house to pay his creditors and to buy a smaller house for him with the remaining amount. If he has that much pair of clothes that he can manage to live with the lesser pair of clothes, then judge shall sell his extra clothes to pay to his creditors.[182]

So there is no need of limitation of worth of his clothes, shoes, beds etc. Present Insolvency law says that the worth of his belongings shall not be more than Rs. 300. And in these days only a normal single pair of clothes worth 300 rupees.

The property of the insolvent which is subject to realization and distribution among his creditors goes into the possession of official assignee.

"Official assignee shall take possession of all deeds, books, and documents relating to the property of insolvent, and all parts of his property, if these are in

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[180] The Insolvency (Karachi Division) Ac, 1909, Sec. 52.

[181] *Ibid.*

[182] Maulana Sheikh Nizam & Others, *Fatawa Alamgeeriah*, Urdu trans. Syed Ameer Ali, vol. 7(Lahore: Little Star Printers, n.d), P. 535.

position of manual delivery. If the property of insolvent consists of stock, shares, shares in ship, or any other property transferable in the books of any company, office or person the official assignee may exercise the right to transfer such property to that extent to which the insolvent would be entitled if he would have not been adjudicated insolvent.

I have already discussed from the Islamic point of view that the property shall remain with the insolvent, and he shall sell it by himself. In case if he does not want to sell then court has the power to do so. Now as in these days it is not feasible for a judge to sell the properties because of bulk of case work, therefore, the court may appoint any person under the contract of *Wakalah* to sell the property of the insolvent. So the court may appoint official assignee for this purpose. *Wakeel* under Islamic law has the power to do all business for which his principal gives permission to him.

If court has reasons to believe that he has concealed his property in a house not belonging to him, then it may issue a search warrant to any officer who may execute it accordingly".[183]

If Court orders for adjudication of debtor, as insolvent, all his property shall vest in the Court, and thereafter he shall apply for his discharge from all liabilities. He may also apply to the Court for his protection from further arrest or detention. Sections 28, 27 and 31 are respectively stated in this regard. "On the making of an order of adjudication, the whole of the property of the insolvent shall vest in the Court or in a receiver".[184]

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[183] *The Insolvency (Karachi Division), Act, 1909*, Sec. 59.
[184] *The Provincial Insolvency Act, 1920*, Sec. 28 (2).

"If the Court does not dismiss the petition, it shall make an order of adjudication, and shall specify in such order the period within which the debtor shall apply for his discharge".[185]

"Any insolvent in respect of whom an order of adjudication has been made may apply to the Court for protection, and the Court may on such application make an order for the protection of the insolvent from arrest or detention".[186]

If we look into the issue from Islamic point of view it is concluded that a debtor is confined only to know his financial position that whether he is having any property or not and for nothing else.[187]

So, if court is not clear that whether a debtor is insolvent or not, and his creditors move an application to the court to confine him, then court shall confine him until it comes to know about his financial status. If he is insolvent, he shall forthwith be released, and if he is solvent, he shall be confined until he pays his debts.[188]

When court comes to know that he is insolvent, he can not be further confined after his release, and shall be given time till his ease. The insolvent debtor shall be given time till his easement.[189]

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[185] *Ibid.* Sec. 27 (10)
[186] *Ibid.* Sec. 31 (1).
[187] Under Islamic law he may be confined for his wrongs as for example the Holy Prophet (P.B.U.H.) confined a person in the offense of *Qazf*, but here I mean to say that as for as insolvency proceedings are concerned, debtor is confined only to know his financial status. Once, court comes to know about his financial status that he is insolvent, he can not be further confined until and unless his creditors prove that he is solvent, in which he is confined until he pays all his debts.
[188] Professor Khan Mohammad Chawla, *Urdu tarjama Badayi 'Al-Sanayai 'fi tarteebe al-Sharai '*, vol. 7 (Lahore: Imprint Press, 1987), P. 430-31.
[189] Burhan-ud-Din Ali b. Abi Baker Al-Marghenani, *Alhidayah, Sharh Bidayat al-Mubtadi*, Urdu trans. Mufti Mohammad Zubair, *Ashraf Al-Hidayah Sharh Urdu Hidayah*, vol. 12 (Lahore: Ali Ijaz Printers, n.d), P. 277.

Relaxation till his easement means that he shall not be bothered by his creditors until he gets money from some lawful way and becomes solvent or is in a position to satisfy his creditors' rights.

When court declares a debtor as insolvent, then according to *sahibain*, the court shall interfere between him and his creditors, and shall prevent them from demanding their amounts from such debtor until they prove that he is having money.[190]

From the above paragraphs it is clear that a debtor is confined only for the reason to know his financial position, or for no other reason.

Order for discharge of an insolvent may either be absolute or subject to certain contingencies as the court may impose.

Section 41 of the Provincial Insolvency Act, 1920 may be stated in this regard as:

"Order of discharge may either be absolute or subject to any condition with respect to any earnings or income which may afterwards become due to the insolvent or with respect to his after acquired property. An absolute order of discharge shall release him from all liabilities except Government dues, or liability incurred by fraudulent breach of trust to which he was party, or any debt for which he has fraudulently obtained waiver from other party"[191] or "his liability under an order of Court, for maintenance of his wife and_children".[192]

Here three points need to be Islamized (1) order of discharge from all liabilities (2) discharge subject to contingencies with respect to future income etc. (3) liability for Government dues etc after order of discharge.

[190] *Ibid.* P. 279.

[191] *The Provincial Insolvency Act, 1920*, Sec. 44.

[192] The Islamic Republic of Pakistan, *the Code of Criminal Procedure, 1898*, Sec. 488.

The first two issue i.e. his permanent discharge from his debt liabilities, and his discharge subject to contingencies with respect to future earnings and acquisition of property by him in future are un-Islamic. Because under Islamic law the liability of a debtor remains as his responsibility until and unless he relieves from it, and he relieves from such liability only if he pays such debts to his creditors or his creditors waive their right to such debts.

Similarly, the order of restraint against him is effective only to his present property and not to his property acquired by him in future. As after distribution of his present property among his creditors, the order of restraint against him is withdrawn from him whereafter he can enjoy his property in future until and unless his creditors again file a petition before court to restrain him from his property. It can be easily understood from the following texts from *fiqh* books.

Order of restraint against him shall be effective only against his present property and shall not be effective for his future earnings if any. The debtor shall be entitled to use such property freely unless and until again his creditor give an application to the court and the court issues order of restraint against him.[193]

The present property of the insolvent shall be divided among his creditors with their proportionate shares. Court shall neither delay the division of property among present creditors till the time to know whether any other creditors have right against him, nor put burdon upon present creditors to prove that there are no creditors other than them.[194]

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[193] Maulana Sheikh Nizam & Others, *Fatawa Alamgeeriah*, Urdu trans. Syed Ameer Ali, vol. 7(Lahore: Little Star Printers, n.d), P. 534.

[194] Abd-Ur-Rahman, *Kitab-Ul-Fiqh*, vol.2, trans. Manzoor Ahsan Abbasi (Lahore: Maktaba-e-Jadeed Press, 1978), P. 750.

After division of debtor's property among his creditors, court shall make him take oath that he has not concealed any of is property, and after taking oath by such debtor, court shall release him from restraint, although the remaining debts shall remain his responsibility.[195]

And if, after his such release from restraint, he receives any property by way inheritance, or he does business, or some one gifts him some property, then he is free to use it freely until and unless court restrains him again from his such property.[196]

Although he is responsible for his debts but he shall not be bothered till the time of his ease. I mean when he becomes solvent, or attains such position to be able to satisfy his creditors, only then court may ask him to satisfy his creditors, and not before his such position. The insolvent debtor shall be given time till his easement.[197]

Now as for as issue no 3 is concerned i.e. his responsibility to government debts etc. in case of his absolute discharge from liabilities, it is said that from the above discussion under Islamic law it is clear that the debtor can not be discharged absolutely from his liabilities until and unless he pays all his debts or his creditors waive their right to such debt amounts.

So his responsibility remains as obligation against him not only for government debts, or liability incurred by fraudulent breach of trust to which he was party, or any debt for which he has fraudulently obtained waiver from other party or his

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[195] *Ibid.*

[196] *Ibid.*

[197] Burhan-ud-Din Ali Bin Abi Bakr, Al-Marghenani, *Al-Hidayah Sharh Bidayat Al-Mubtadi*, Urdu trans. Mufti Mohammad Zubair, *Ashraf Al-Hidayah Sharh Urdu Hidayah*, vol. 12 (Lahore: Ali Ijaz Printers, n.d), P. 277.

liability under an order of Court, for maintenance of his wife and children, but it also remains for his all the other debts.

Court may nullify the order of adjudication. All transactions, made in respect of the property of the insolvent during such adjudication, shall be valid.

Section 35 and 37 of the Provincial Insolvency Act, 1920 are stated in this regard as:

"After adjudication of a debtor as insolvent, if the Court is of the opinion that he should have not been adjudicated insolvent, or that he has paid all debts due to him in full, it shall annul such adjudication".[198]

"Where an adjudication is annulled, all sales and dispositions of property and payments duly made, and all acts theretofore done, by the Court or receiver, shall be valid; but, subject as aforesaid, the property of the debtor who was adjudged insolvent shall vest in such person as the Court may appoint, or, in default of any such appointment, shall revert to the debtor to the extent of his right or interest therein on such conditions (if any) as the Court may, by order in writing, declare".[199]

Generally any transfer of property by debtor, if it is not in consideration of marriage or made in favour of purchaser or encumbrance in good faith and for valuable consideration, and such debtor is adjudged insolvent, shall be avoidable as against receiver and may be annulled by the Court.[200]

Subject to the above rule, any payment made by any of his creditors, or any payment or delivery to the insolvent, or any transfer by insolvent for valuable

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[198] *The Provincial Insolvency Act, 1920*, Sec. 35.
[199] *Ibid.* Sec. 37.
[200] *Ibid.* Sec. 53.

consideration, or any contract or dealing entered into by or with insolvent, shall be valid provided that such contracts take place before the date of adjudication, and the other party has no notice of presentation of any petition against such insolvent.[201]

Under Islamic law this is not the case of notice to the other party. All transactions made by the debtor before the order of restraint has been issued against him although an application for his adjudication as insolvent and restraint from his property has been forwarded, shall be valid until and unless the court issues such order against him. I have already discussed this. When court issues order of restraint against debtor, he shall no longer be entitled to use his property in any way. Court may issue such order in his absence, but the order shall not be effective until the debtor has notice of the order. So all transactions made by him with respect to his property before such notice to him are also valid.[202]

Official assignee has all powers to do with the property of insolvent after his discharge. He may sell all or any part of the property, and may give receipt for receiving the property of insolvent. He may, with the leave of the Court:

(a) carry on the business of the insolvent so far as may be necessary for the beneficial winding up of the same.

(b) Institute, defend or continue any suit or other legal proceedings relating to the property of the insolvent.

[201] *Ibid.* Sec. 55.

[202] Abd-Ur-Rahman, *Kitab-Ul-Fiqh*, vol.2, trans. Manzoor Ahsan Abbasi (Lahore: Maktaba-e-Jadeed Press, 1978), P. 744.

(c) accept, a consideration for the sale of insolvent's property, a sum of money payable at future time of fully paid shares, debentures stock in any limited company.

(d) mortgage or pledge any part of the property for the purpose of raising money for payment of insolvent's debts.

(e) refer any dispute to arbitration, and compromise all debts, claims and liabilities, on such terms as may be agreed upon.

(f) divide any property in its present form, among creditors, if it is not easily salable or otherwise.[203]

If a creditor, at the time adjudication, proves that his credit is provable at future time, he is entitled receive dividends equal to all the other creditors subject to deduction of interest at rate of six per cent per annum.

Section 45 of the Provincial Insolvency Act is stated in this regard as:

"A creditor may prove for a debt not payable when the debtor is adjudged an insolvent as if it were payable presently, and may receive dividends equally wit the other creditors, deducting therefrom only rebate of interest at the rate of six per centum per annum computed from the declaration of a dividend to the time when the debt would have become payable, according to the terms on which it was contracted".[204]

Here two points need to be Islamized. The fist one is entitlement of a creditor to dividends at the time of division of property of insolvent debtor, if such creditor

[203] *The Insolvency (Karachi Division) Act, 1909*, Sec. 68.
[204] *The Provincial Insolvency Act, 1920*, Sec. 45.

proves his debts which is payable at a future time. The second one is his entitlement to interest.

As for as the first issue is concerned, it is said that under Islamic law the property of the insolvent debtor is divided only among his those creditors whose debts are due at the time of distribution of his property, and the creditors whose debts are payable at a future time shall not be entitled to receive any amount in the present distribution although they may recover their amounts according to their proportionate shares from the creditors who have received amounts in the present distribution. This becomes clear from the following paras from *fiqh* books.

There are three conditions which need to be fulfilled in order to declare a debtor as insolvent, and to distribute his property among his creditors. These are:

1. That the creditors move an application to the court for his declaration as insolvent.

2. That the debts of the creditors have become due.

3. That the debt amounts exceed the assets of the debtor.

After the satisfaction of these three conditions, court shall declare him as insolvent and such order has the following consequences.

1. Debtor shall be restrained from all kind of transactions with respect to his property.

2. And his property shall be divided among his those creditors whose debt amounts have become due.[205]

[205] Abd-Ur-Rahman, *Kitab-Ul-Fiqh*, vol.2, trans. Manzoor Ahsan Abbasi (Lahore: Maktaba-e-Jadeed Press, 1978), P. 749.

At the time of distribution of property of insolvent debtor, only those creditors shall be entitled whose loans time has become due, and those whose debts are not yet due to be paid, when its time becomes due they shall receive according to their proportionate shares from the other creditors.[206]

As for as the issue of interest is concerned, a detailed discussion has been made upon this issue at the start of this chapter. However, it is said to the extent that interest is *Haram* under Islamic law, so such creditor shall not be entitled to any kind of interest.

If both debtor and creditor mutually owe money to each other, and they make a deal between them, then debt owed to one is set off against the debt owed to the other in respect of their debts owed by them mutually to each other".[207]

Our financial system is based on interest. Company pays interest to its bond holders. Normally interest is a fixed amount, which is paid to creditor over the principal amount. If contract between debtor and creditor does not provide for interest agreed upon by them, and debt is overdue at the time of adjudication of debtor as insolvent, creditor may prove for interest at a rate not exceeding six percent per annum.

If such debt is payable by virtue of written agreement, interest shall be calculated from the time due for the payment of debt till the date of adjudication.

If debt is payable on demand, then interest shall be calculated from the date of demand till the date of adjudication. If any interest or monetary compensation in lieu of interest is proved along with debt, such interest etc., shall be payable at a

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[206] Maulana Sheikh Nizam & Others, *Fatawa Alamgeeriah*, Urdu trans. Syed Ameer Ali, vol. 7(Lahore: Little Star Printers, n.d), P. 539-40.

[207] *The Provincial Insolvency Act, 1920*, Sec. 46.

rate not exceeding six percent per annum without prejudice to his right to receive a higher rate of interest if all debts are paid in full.[208]

Riba whether pre-determined or calculated at a later stage is absolutely *haram* in Islam, and there is no place for usury in Islam, so no interests shall be paid to the creditors as I have discussed number of times, earlier.

At the time of distribution of the property of debtor, following shall be paid in priority to all other debts:

(a) Government debts

(b) All salaries and wages for rendering services and labor by any servant or labor subject to the condition that these do not exceed twenty rupees as a whole.

Under Islamic law all types of creditors shall be entitled to their amounts according to their proportionate shares, and there shall be made no distinction of the debts owed by the debtor to his creditors, and thus no preference shall be given to any of his creditors.

All the property of the insolvent shall be distributed among his creditors according to their proportionate shares.[209]

After he (debtor) has been restrained from his property, all his property shall be distributed among his creditors according to their proportionate shares.[210]

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[208] *Ibid.* Sec. 48.

[209] Abd-Ur-Rahman, *Kitab-Ul-Fiqh,* vol.2, trans. Manzoor Ahsan Abbasi (Lahore: Maktaba-e-Jadeed Press, 1978), P. 750.

[210] Burhan-ud-Din Ali Bin Abi Bakr, Al-Marghenani, *Al-Hidayah Sharh Bidayat Al-Mubtadi*, Urdu trans. Mufti Mohammad Zubair, *Ashraf Al-Hidayah Sharh Urdu Hidayah*, vol. 12 (Lahore: Ali Ijaz Printers, n.d), P. 274.

All the creditors of the insolvent shall be entitled to the property of the debtor in accordance with their proportionate shares.[211]

All of these three paragraphs expressly mention that the property of the debtor shall be divided among his creditors according to their proportionate shares, whether such creditor is Government or any one else.

The third paragraph taken from *kitabul fiqh*, expressly mentions the word all his creditors, which further clarifies the point that no preference shall be given to any of his creditors.

So the Government, employees of debtor, etc shall be considered as his creditors like the other creditors. Even his wife is joined with the other creditors, and is entitled to her dower according to her proportionate share.

In case of partnership, the partnership property shall first be paid for partnership debts, and if any surplus remains from it then it shall be paid for separate debts of partners according to their proportionate shares and interests in the partnership property and *vice versa*.[212]

If debtor, who is unable to pay his debts, transfers any property or makes any payment etc. from his property to his creditor with a view to give preference over his other creditors and he is thereafter, adjudge insolvent, such transfer or payment etc. shall be considered fraudulent transfer as against receiver and shall be annulled by Court.[213]

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[211] Abd-Ur-Rahman, *Kitab-Ul-Fiqh*, vol.2, trans. Manzoor Ahsan Abbasi (Lahore: Maktaba-e-Jadeed Press, 1978), P. 745.

[212] *The Provincial Insolvency Act, 1920*, Sec. 61.

[213] *Ibid.* Sec. 54.

If an un-discharged debtor obtains a sum of fifty rupees or more as credit without giving any notice of his status of being un-discharged, to the creditor, shall be punishable with imprisonment for a term which may extend to six months.[214]

Under Islamic law an insolvent debtor is discharged from his liability only if his creditors waive their right to the debt amounts, or he has paid all his debts to his creditors. If his creditors do not waive their rights against such debtor, and the debtor is unable to pay such debts, then such debts remain his responsibility till *Akhirah*. This has been discussed earlier.

Now the issue is whether the debtor can take money from any person as loan or not? And whether any notice about his status is necessary to be disclosed?

The answer to the 1st issue is that yes, he can take more credit. After the order of restraint against debtor, if any one gives loan to him or sells his property under his hand, they are entitled to demand their debts from the debtor after the order of restraint against him is withdrawn from him.[215] Even he can take that much of loan to pay all his debts, and there is no need to give notice of his being as un-discharge.

Debtor is liable only to pay his debts, and this is not the only way that judge shall sell his property. The judge may confine him in order to compel him to sell his property. Moreover, debtor may take more credit or some one may gift him some property, or he may demand money from some one to pay his debts.[216]

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[214] *Ibid.* Sec. 72.

[215] Abd-Ur-Rahman, *Kitab-Ul-Fiqh*, vol.2, trans. Manzoor Ahsan Abbasi (Lahore: Maktaba-e-Jadeed Press, 1978), P. 752.

[216] Burhan-ud-Din Ali Bin Abi Bakr, Al-Marghenani, *Al-Hidayah Sharh Bidayat Al-Mubtadi*, Urdu trans. Mufti Mohammad Zubair, *Ashraf Al-Hidayah Sharh Urdu Hidayah*, vol. 12 (Lahore: Ali Ijaz Printers, n.d), P. 273.

If insolvency petition against debtor is admitted by any court, and such court requires his personal appearance or surrender of his property or production of books and accounts, or requires him to do any thing in relation to his property, and he willfully fails to perform that, or he fraudulently and with intent to defeat his creditor, has destroyed such property or books, or has kept false records and books, or has discharged or concealed any debt due to him or has given it to someone as charged or mortgaged property in order to fraudulently diminish such property, shall be punished with imprisonment which may extend to one year.[217]

Creditor may enter into a credit contract on the basis of bailment, wherein some property is either pledged or mortgaged as the case may be. Bailment of immovable property is mortgage and that of movable is pledge. In both of these cases creditor is a secured one. He is entitled to realize the property in his possession, and shall prove for the balance due to him from insolvent debtor.

If he relinquishes his right to the security for the general benefit of other creditors, then he shall prove for his whole debt owed to him by such debtor.[218] Then he shall be entitled to his right according to his proportionate shares like the other creditors.

From Islamic Point of view in addition to it, if the creditor sells the mortgaged property, he shall take his right from the price of the property and shall return the balance to the debtor.[219]

[217] *The Provincial Insolvency Act, 1920*, Sec. 69.
[218] *Ibid.* Sec. 47.
[219] Mulana Syed Mian Sahib Asghar Hussain, *Mufeed-ul-Wariseen* (Lahore: Wifaq printing Press, 1980), P. 28.

Court may appoint insolvent as to manage and administer his property during insolvency for the benefit of his creditor. Court may also make allowances to him, for his support of himself and his family, or in consideration of his services.[220]

After adjudication of a debtor as insolvent, he disqualifies from being appointed as magistrate, or being elected to any office of any local authority where the appointment to such office is by election, or holding or exercising such office to which no salary is attached, or being elected to sitting or voting as member of any local authority. His disqualification is removed if his adjudication is annulled by the court, or he obtains an order of discharge from such court with a certificate that his insolvency was caused by misfortune without misconduct on his part.[221]

As for as this issue is concerned, this is in accordance with the Islamic provisions because under Islamic law if one is restrained from using his own property, how can he be appointed as *wakeel* to work on behalf of the others.

The official assignee shall declare and distribute first dividend, within one year, after insolvent's adjudication, and within six months the subsequent dividends, to those creditors who have prove their debts. When he declares such dividends, he shall give a notice to the creditors, of such declaration, and shall mention the amounts of dividends, and describe the particulars of the property to be distributed.[222]

There is no objection regarding this point, and is not against the provisions of Islamic law.

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[220] *The Provincial Insolvency Act, 1920*, Sec. 66.
[221] *Ibid.* Sec. 73.
[222] *The Insolvency (Karachi Division) Act, 1909*, Sec. 69.

While distributing such dividends, the official assignee shall retain sufficient property in his hand to satisfy:

(a) The debts of any person who is, by reason of distant resident, unable to communicate and prove his debts within the given time;

(b) Debts the subject of claims of which has not yet been determine;

(c) Disputed proofs or claims;

(d) Expenses necessary for the administration of the property.[223]

I have already discussed that court shall not delay the distribution of the property of the insolvent debtor among his present creditors, and the property shall be distributed among his present creditors.

When official assignee has realized all or any part thereof, which was necessary, of the property of the insolvent, he shall declare final dividends to be distributed among those creditors who have proved their claims, subject to a prior notice to the creditors who have not yet proved their debts, stating that they should prove their debts within a specified time.

If they do not prove their debts within that particular time then official assignee shall declare final dividends to be distributed among those who have proved their claims accordingly.[224]

No suit for dividends shall lie against official assignee except in case he refuses to pay dividend to a creditor who has proved his debts.

After all creditors have been paid in full, the surplus property shall go to insolvent.[225]

[223] *Ibid.* Sec. 71.
[224] *Ibid.* Sec. 73.

If a debtor dies, then proceedings by or against him shall continue as if he were alive, until and unless the court directs otherwise.

Creditors may present petition to the court for administration of the estate of the deceased debtor. If the court is satisfied that the estate of deceased debtor is not sufficient for the payment of all debts owed by him then it may make an order for administration of his estate after a notice has been given to his legal representatives.[226]

Upon such order of administration the property of the deceased shall vest in official assignee, who shall then distribute it in accordance with the provision of the Insolvency Act, 1909.

During such distribution, the official shall regard to the claim of legal representatives of the deceased debtor with respect to the payment of funeral ceremony, and testamentary expenses incurred by him about the debtor's property.

Legal representatives of the deceased debtor are entitled to such payments as preferential debts as compared to any other debts owed by the deceased.[227] Whatever remains as surplus, after all debts along with interests have been paid, shall go to the legal representatives of the deceased.[228]

No objection rises under Islamic law about the above few paragraphs as these are not against the principles of Islam, so no need to discuss.

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[225] *Ibid.* Sec. 74.
[226] *Ibid.* Sec. 108.
[227] *Ibid.* Sec. 109.
[228] *Ibid.* Sec. 110.

Chapter No.4 Conclusion

Conclusion and Suggestions

1. Conclusion

Insolvent is a person who is unable to pay his debts when they become due, and insolvency is the inability of such person to pay his debts. The person may be individual or a company.

The difference between the liability of individual and company emerged in the nineteenth century, and the concept was confirmed in *Salomon v. Salomon & Co. (1897) A.C. 22.*

When legal proceedings are taken against an individual, he is adjudicated as bankrupt, however, this is not the case with a company. When legal proceedings are taken against a company, it is not adjudicated as bankrupt, and still it may be called as insolvent, whereafter it may either be dissolved or re-organized.

In Islamic law the word *"Muflis"* is used for an insolvent, and insolvency is called *Iflaas.*

The meaning of *Muflis* is the same as that of insolvent in law, and same is the case of insolvency and *iflaas.*

Islamic law of insolvency only talks about individual. It does not tell about corporations, however, modern Muslim scholars have attempted to attribute personality to corporation, but their approach does not base on any Islamic legal principle. The only approach that seems to the best is, by Imran Ahsan Khan Nyazee, a well-known scholar of the Modern Muslim world. He has proposed Islamic Model of corporation on the basis of certain rules. He says that ruler may

assign a restricted or limited personality to a non-human on the basis of the following rules:

1. That no religious duties will be expected of a fictitious person.
2. That some form of intellect (*'aql*) must be associated to the fictitious person. And
3. That a concept of dual title must be associated to a fictitious person.

According to him a corporation established on the basis of the above mentioned rules will be a juristic person.

So it is concluded that now we can extend the insolvency provisions under Islamic law to corporations established in accordance with the above listed rules.

So, now we can say that Muslim scholars recognize fictitious personality now a day.

Legal capacity of a person is the capability of a person to acquire rights and obligations, and to exercise such rights and to perform such obligations.

In Islamic law there are two types of capacity; capacity for acquisition of rights and obligations (*ahliyat al-wajoob*) and capacity for execution of such rights and obligations (*ahliyat al-ada'*). Deficient capacity for acquisition is attributed to an unborn child, and the capacity completes after his birth. So, a minor below seven years of age has complete capacity for acquisition, and he has no capacity for execution, however when he is above seven years, he attains deficient capacity for execution.

Complete capacity for execution is attributed to a human being, when he attains intellect (*'aql*) and discretion (*rushd*). Muslim jurists have associated his *'aql* and *rushd* with his puberty.

After attaining legal capacity for execution by him, the Law-giver gives effects to his statements issued, and acts performed, by him. It means that the Law-giver permits him to perform certain acts, and requires him to perform or to omit the others.

In Islamic law it is only the human being to whom personality is assigned, and thus, only he has the legal capacity, however, modern Muslim scholars also attribute a deficient legal personality to a corporation as I have already discussed before.

In law too legal capacity is associated to personality, however, it is not only the human being to whom personality is assigned, and a non-human is also attributed personality. So in law person is any being whether a human or non-human to whom law recognizes as person, and thus, law also recognizes a fictitious personality of non-human beings such as corporation.

When the debt liabilities of a person exceed his total assets, his creditors may forward an application to court for his restraint from using or disposing off his property. If the court is satisfied on the basis of evidence, it shall issue an order of restraint against such person, and shall declare him as insolvent, whereafter, he is not entitled to use or dispose off his property, but subject to the amount of maintenance for himself, his wife, children, and his *zavi al-arhaam* (near relatives).

Such order of restraint shall be effective only to his present property, and it has no concern with his future acquired property. So, if he receives any property in future after his release from such restraint, he shall be entitled to freely enjoy such property until his creditors again forward an application to the court for his restraint from his property, and the court re-issue an order for his restraint.

The property in the ownership of the insolvent in present shall be distributed among his present creditors who have proved their amounts, according to their proportionate shares, and such distribution shall not be delayed till the time to know that whether he has any other creditors or not?

All his creditors shall be deemed to have the same status, and no preference shall be given to any of his creditors.

For the purpose of repayment of debt amounts, the insolvent shall sell his property, and in case if he does not want to sell his property, then court shall do so, and for this purpose, it may appoint an official receiver, etc. under the contract of *wakalah*. However, this is not the only way to sell his property to relieve his responsibility, and some one may lend or gift him any property to satisfy his creditors.

After the distribution of the property of the insolvent among his creditors according to their proportionate shares, court shall withdraw the order of restraint from him, and he shall be released, however, the remaining debts still remain as his responsibility, and he is liable for such debts in future until and unless he totally pays these, or his creditors waive their right to such amounts.

The creditors of the insolvent shall not be entitled to any interest over the principal amount because interest is prohibited in Islam.

In case of insolvent company too, its creditors shall forward an application to court for the restraint of the company from using or disposing off its property, and for its liquidation. Thus, if it is proved to the satisfaction of the court that debt liabilities of the company have exceeded its total assets, then it shall issue an order of restraint against the company, and may appoint liquidator under the contract of *wakalah* for the purpose winding up of the company.

Liquidator shall distribute the property of the company among its present creditors who have proved their claims, according to their proportionate shares, and all its creditors shall be deemed to have same status, and no preference shall be given to any of its creditors.

Here in this case too, the creditors are not entitled to any interest because it is prohibited in Islam.

If at the time of winding up of the company, its property is not sufficient to fully satisfy all claims of its creditors, it shall be the liability of the share-holders of the company to contribute according to their proportionate shares, to the assets of the company for the purpose of repayment of its debts. If the company is limited by guarantee, its contributories may also contribute to the assets of the company according to their agreed terms with the company.

2. Suggestions

Now following are the suggestions which I would like to give for bringing the necessary changes in the relevant provisions of insolvency laws of Pakistan.

2.1 The Companies' Ordinance, 1984

Section 298 (iv) should be repealed because it talks about the limited liability of the share-holders.

Section 321 (1) is amended as: "After, if the insolvent debtor does not want to sell his property by himself,... then the court may appoint any person as its agent, for the purpose, who may be called as provisional manager or official liquidator".

Section 346 should be repealed because it states about the delay in distribution of the property of company.

Section 405 should be repealed because it gives preference to some creditors to whom debts are paid in priority to all the other creditors.

2.2 The Provincial Insolvency Act, 1920

Section 6 of the Act should be repealed because there is no concept of "act of insolvency" by an insolvent for the purpose of initiating legal proceedings against him.

Section 9 (a) and 10 (a) should be repealed because there is no minimum limit of debt amount under Islamic law.

Similarly, clause (c) of section 9 should be repealed because it is about the act of insolvency by an insolvent.

Section 20 is amended as:

"If the insolvent does not want to sell his property, then the court, for the purpose, may appoint any person as its agent, who may be called as interim receiver or official receiver…"

Section 28 (2) is amended as follows:

"Subject to the provisions of section 21,... except with the leave of the court and on such terms as the court may impose".

Section 31 and 32 should be repealed because these two talks about the arrest of the insolvent after his adjudication as so.

Section 48 is repealed because it talks about the interest upon the principal amount of debt.

In section 55 of the Act, proviso should be substituted by the following words:

"Provided that any such transaction takes place before the order of restraint has been passed against such insolvent".

Section 61 should be repealed because it gives preference to some creditors over the others.

Section 72 should be repealed because it restricts the insolvent to take more credit.

2.3 The Insolvency (Karachi Division) Act, 1909

Section 9 and 12 (c) of the Act should be repealed because these talk about the "act of insolvency".

Section 16 should be substituted with the following words.

"If the insolvent does not want to sell his property, or he can not do so then the court may appoint any person as its agent who may be called as interim receiver or official receiver, for the purpose of sale, etc. of the property of the insolvent".

Section 38 should be substituted for the following words.

"After the debt amount is proved against an insolvent, court shall issue an order of restraint against him from his property, whereafter he shall be released but the debt amount shall remain his responsibility until:

1. He pays all his debts back to his creditors. Or
2. His creditors waive their right to such amounts.

Section 49 of the Act should be repealed because it gives preference to certain payments to be made in priority to all the others.

Section 72 shall be repealed because it restricts the right of the insolvent to take more credit.

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