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The Regulation of Risk in Islamic Law, the Common Law, and Federal Regulatory Law

Mohammad Fadel*

ABSTRACT

Executory contracts require assumptions regarding future states of the world about which contracting parties lack perfect information. This ignorance creates obstacles that can prevent parties from reaching efficient agreements, even where both parties are behaving rationally, when the future turns out radically different from the scenario anticipated by the parties themselves; moreover, opportunities for strategic behavior arise, which, if not mitigated, will deter parties from entering otherwise efficient agreements. Legal systems develop special rules regulating the limits of contractual rights and obligations in the face of these circumstances because there is an inevitable tension between ex ante efficiency and ex post efficiency. The different approaches taken by various legal systems can thus be understood as attempts to balance the conflicting goals of ex ante and ex post efficiency. Using this paradigm, some of the limitations that Islamic law places on the autonomy of contracting parties will be explained. As a useful comparison, the manner in which the common law traditionally dealt with some of these issues, especially derivative contracts, as well as the modern approach taken by federal regulators in the last quarter of the 20th century and going forward, will also be touched upon.

I. INTRODUCTION: THE NATURE OF LEGAL REGIMES AND LEGAL DECISION-MAKING

Analysis of legal rules requires attention to more than the content of particular rules of decision; one must also give due attention to the decision-making structure within which rules are applied, in order to obtain a fuller understanding of the purposes of legal rules. Accordingly, a brief description will be given of what are taken to be the most salient features of the three regimes that are the subject of this paper—Islamic law, American common law, and federal regulatory law.

A. Islamic Law

Islamic law is revealed law in origin, but is in fact a product of the interpretive labors of jurists who work using a case-by-case method of decision-making. One commentator has described Islamic law as a "jurists' law," to describe the fundamental role legal experts played in Islamic law's historical evolution. While jurists may be specialists in questions relating to the interpretation of legal texts, as well as procedural and evidentiary features of the legal system they administer, they are categorically *not* experts with respect to empirical questions of fact, although legal rules will often contain implicit within them empirical presumptions regarding the state of the external social world.

B. Common Law

When one speaks of the common law legal tradition, one generally has in mind the body of legal rules that originates in the decisions of the English law courts. While the common law originated in England, it is used in all parts of the English-speaking world. Generally, contract law, property law, tort law, and, to a lesser extent, criminal law, in the various subfederal jurisdictions, i.e., states and territories, that make up the United States, are products of the common law tradition, except where it has been changed by positive legislation.

Common law decision-making is similar to Islamic law in that the rules are made by legal specialists on a case-by-case basis. It differs in that the legal specialists making these decisions are sitting judges, whereas in the case of Islamic law, the legal specialist is usually a legal scholar who is usually not sitting on the bench. Thus, while in a common law system *stare decisis*, or precedent, is the chief means of creating legal stability, in Islamic law it is the judge's duty to practice *taqlīd* of an established jurist that accomplishes this result. Islamic law differs from common law in that the latter is explicitly pragmatic in ways that Islamic law, as a religiously inspired legal system, cannot claim to be.[i] Furthermore, common law rules are always subject to repeal, revocation, and reform by positive

* Clerk, U.S. Court of Appeals for the Fourth Circuit, Baltimore, Md.

legislation of the sovereign within existing constitutional constraints, whereas Islamic law has tended to claim a type of independence from the positive lawmaking powers of the sovereign.[ii]

Common law rules are commonly associated with the concept of "private law," emphasizing its concern with the interests of the private persons involved in the regulated conduct, e.g., trade. In this respect it is also similar to Islamic law, whose main concern is not the regulation of an individual's relationship with the state, but rather with the relationship of one individual to another. Thus, both systems rely overwhelmingly on *private ordering* rather than on centralized, top-down regulation.

C. Federal Regulatory Law

The impetus behind the creation of modern federal regulatory law was the perception that judges, exercising their common law responsibilities of adjudicating disputes on a case-by-case basis, were not capable of formulating coherent responses to the ever-increasing complexity of modern social and economic life.[iii] Accordingly, responsibility for the development of federal regulatory law has been assigned to expert agencies (bureaucracies) created by positive legislation of the U.S. Congress. Examples of such expert agencies in the financial field include the Securities and Exchange Commission and the Commodity and Futures Trading Commission, created, respectively, by the Security and Exchange Act of 1934 and the Commodity Exchange Act of 1936, as amended in 1974.

An interesting feature of federal regulatory law is its tendency to displace many common law doctrines based on an assumption that private ordering sometimes fails to achieve public welfare. At times, this requires a contraction of common law rights, e.g., placing limitations on the right to contract as in labor law, while at other times public welfare is deemed to require affording private individuals greater freedom to enter cooperative agreements than the common law saw fit, e.g., trading in derivatives.

Regulatory law contrasts most strongly with common law and Islamic law in two respects. The first is its reliance on technical experts rather than generalist judges or legal experts to establish the appropriate legal rules. The second is that the obligations of regulatory law run primarily to the government and only secondarily to other persons. In contrast to private agreements, then, where only the parties to an agreement could seek its enforcement, the government always has standing to enforce its regulatory regime, even in situations where the regulated parties would rather do without the benefit of the regulatory protection.

II. THE LEGAL STATUS OF SPECULATION

Significantly, all three regimes are in agreement that restrictions must be placed on financial "speculation," although each system's restrictions are different. The fact that each regime's technical solution to the problem of financial speculation differs should not obscure their fundamental agreement that significant restrictions on transactions whose value derive largely from the occurrence or non-occurrence of specified contingencies are necessary for the enhancement of social welfare. What requires explanation is why each system draws its lines differently, although in principle all seek the same result—prohibition of trading that reduces social welfare while allowing trading that increases it.[iv]

A. Islamic Law's Approach to the Regulation of Speculation

Islamic law's approach to financial speculation is derived from the paradigmatic contract of exchange in Islamic law—the law of sales. Accordingly, we must begin first with a doctrinal review of the elements of a valid sale, second, with the legal consequences of an invalid sale, and finally, with the remedies that apply to an invalid sale.

<u>1. The Islamic Contract of Sale</u>

A sale is defined as "^{c}*aqd mu^{c}āwa∞a*," which means, literally, a commitment of mutual exchange. The essential requirements of this contract are consent and actual exchange of property. These requirements have their basis in verses of the Qur'an that prohibit "devouring the property of others unjustly (*akl amwāl al-nās bi-al-bā≤il*)."[v] A valid sale, according to the jurists, requires that each party deliver a price, known as a *thaman*, and accept in exchange property, known as a *muthamman*. Consider the following example: Buyer pays Seller $10,000 for a car. The $10,000 is the *thaman* that Buyer gives Seller in order to receive the car, which is the Buyer's *muthamman*. From Seller's perspective, the car is the *thaman* that Seller gives to Buyer in order to receive the $10,000, which is Seller's *muthamman*. Because of the prohibition against sales involving material uncertainty (*al-nahī ^{c}an bay^{c} al-gharār*), both the *thaman* and the *muthamman* must be known with reasonable certainty at the time of the transaction. If there is uncertainty in either of these, the sale will be invalid, either on the theory that consent is vitiated by the indeterminacy of the value of the exchanged property, or that the uncertainty leads to one party's devouring the property of another falsely.

Consider the following contract between a goldsmith and a sweeper for the purchase of the dust generated in the goldsmith's workshop. The sweeper is interested in purchasing the dust because it contains gold fragments that he intends to recover through the expenditure of labor. Because the quantity of the recoverable gold in the dust is unknown, however, jurists hold this trade to be invalid. The standard remedy in this situation is for the sweeper to return the dust to the goldsmith, and for the goldsmith to return the purchase price to the sweeper. If, however, the sweeper has already recovered the gold from the dust, the sweeper is entitled to a wage not exceeding the value of the recovered gold. The minority position is that he receives a market wage for his labor, even if it exceeds the value of the recovered gold.

The salient features of this remedy can be reduced to the following observations. First, an invalid sale does not transfer title to the property that is exchanged. Second, as a consequence of the first, the parties hold the exchanged property on behalf of its actual owner, viz., Islamic law imposes a constructive trust on the parties to an invalid sale, and requires them to restore the property in their possession to its rightful owner.[vi]

To conclude, a valid contract of exchange in Islamic law requires mutuality of exchange, whereby each party delivers property and receives property. If an exchange is valid, title is transferred, but an invalid sale will not transfer title. Instead, the parties will hold the properties exchanged until they can be returned to their legal owner.

2. Risk of Loss (*∞amān*)

Risk of loss, i.e., casualty, in Islamic law is generally a function of either legal ownership or possession of the res. As a general matter, Islamic law frowns upon any agreement whose result is to separate ownership from possession. Nevertheless, it occurs, especially as a result of an invalid sale, in which case risk of loss will pass by possession, although title does not. Because risk of loss is either a function of legal ownership or possession, as a general matter, parties are not allowed to stipulate by contract which party will bear the risk of loss if their agreement contradicts the established rules allocating which party bears this risk. The only exception known to this author occurs in the sale of goods not present at the time of the contract (*bay*^{c} *al-ghā'ib*). In this case the parties can determine, by agreement, which party will bear the risk of loss until delivery is completed.

Because risk of loss is deemed to be a characteristic either of legal ownership or possession, "risk of loss" as such is not deemed property that can be exchanged for other property. When this fact is combined with the structure of the Islamic law of sales that requires mutuality of exchange, it is easy to understand why Islamic law declares trades of risk to be invalid. Take an insurance contract. At T_1, A, the insured, pays a premium to B, the insurer, in exchange for B's promise to protect A against certain losses should a predetermined contingency occur. A pays a *thaman* in the form of premiums but does not receive a *muthamman*, at least not immediately, in return. Likewise, B receives a *muthamman* but does not immediately deliver a *thaman* to A. After the parties enter into the insurance contract, one of two scenarios is possible. In the first scenario, the specified contingency occurs and B compensates A for his loss. From the perspective of the jurists, the money delivered from B to A is A's *muthamman* that he receives in exchange for the premiums that he had already paid. Similarly, the money B pays A in this scenario is the *thaman* that B paid in order to receive A's *muthamman* (premiums). Accordingly, they conclude that this exchange is invalid: first, because it involves *ribā* (the deferred exchange of money); and second, because of uncertainty in the *thaman* and the *muthamman*. Recall that the promise to indemnify against a loss cannot serve as the *muthamman* that would complete the exchange because it is not property that can be delivered to the insured.

In the second scenario, the term of the insurance contract is completed without the occurrence of the specified contingency. In this case, according to the jurists, there simply has been no exchange: although the insured has delivered property to the insurer in the form of premiums, the insured has never delivered any property (*muthamman*) to the insured in return. Likewise, the insurer has received property (*muthamman*) without paying a price (*thaman*) in exchange. Accordingly, the trade fails because it entails "consuming the property of another unjustly (*akl amwāl al-nās bi-al-bā≤il*)." In the view of the jurists, it is unjust for the insurer to keep the property of the insured without ever giving him property in return.

3. Financial Surety (*al-damān bi-ju*^{c}*l*)

The rules of sale apply not only to preclude casualty insurance; they also invalidate surety agreements in which the surety is compensated for agreeing to serve as the guarantor. This transaction is known to the jurists as a "surety with compensation." In this case, A, the merchant-debtor, pays B, the guarantor, X, in exchange for B's promise to pay C, the creditor, should A default. As a result of B's promise, C agrees to sell A, the merchant-debtor, goods on credit. In this transaction, one of two possibilities can occur. In the first scenario, A pays C the amount owed. In this case, B, the guarantor, has received a *thaman*, X, but never delivered any property to A in return. The mere promise to pay C in the event of A's inability or unwillingness to pay his debt, as was the case in the discussion of risk of loss above, is not deemed to be "property" that can serve as the *muthamman* necessary to render the exchange valid. Consequently, the agreement is condemned because it results in B's consuming A's property unjustly.

In the second scenario, A does not pay C, forcing B to pay C. Because A is now indebted to B in the amount he paid to C, and B is entitled to collect that debt from A, B will receive two payments from A: first, the fee to serve as guarantor; and then second, the amount of the debt that B paid on behalf of A. According to the jurists, in this situation, the money B paid to C is a loan (*salaf*) from B to A. The amount A paid to B in exchange for his willingness to guaranty A's debt is thus a profit (*naf*^{c}) that accrues to B as a result of the loan extended on his behalf to pay C. Thus, the arrangement stands condemned as an instance of *salaf jarra manfa*^{c}*a* (a loan that generates a profit).

<u>4. Options to Buy (*bay*^{c} *al-*^{c}*urbūn*)</u>

In this contract, the Buyer agrees to give the Seller an amount of money in exchange for the Seller's promise not to sell the specified property to another person for a specified period of time. The parties further agree that if the Buyer does not complete the purchase, the Seller keeps the Buyer's down payment. This agreement is also invalid for it contemplates allowing the Seller to take property from the Buyer without giving the Buyer any property in return. In other words, the jurists also deem it an instance of "*akl amwāl al-nās bi-al-bā≤il*."

<u>5. Derivatives</u>

The author is not aware of a discussion by medieval Muslim jurists of agreements that resemble modern derivatives. Nevertheless, it is clear that application of the established rules would render derivative contracts unenforceable. In a plain-vanilla derivatives contract, the parties agree to exchange cash flows at a specified time or times based on the price of an underlying asset at the time of performance. For example, an oil refinery might agree with an oil company to take delivery of 100,000 barrels of oil on January 1, 2001, at a price of $25 per barrel. Instead of the refinery's taking delivery on the delivery date, however, the parties agree that they will settle their performance obligations simply by paying the difference between the contract price and the spot price on the day of delivery. Thus, if the price of oil on the spot market is $26, the oil company will simply pay the refiner $100,000. If the price of oil on the date of delivery is $24, however, the refiner will pay the oil company $100,000. In neither case, however, is there an actual exchange of property. Instead, one party will receive money but not give anything in return. Accordingly, it would be invalid because it would be an instance of "*akl amwāl al-nās bi-al-bā≤il*." Again, the promise of the counter-party to pay money in the event that the price moves in the opposite direction is not "property," and, accordingly, cannot save the contract from the perspective of Muslim jurists.

<u>6. Conclusion</u>

The requirement, derived from the law of sales, that property (^{c}*iwa∞*) be mutually exchanged permeates the Islamic law of exchange. Indeed, the sine qua non of a lawful exchange is that both parties receive property whose material characteristics, e.g., price, quality, and quantity, are ascertainable at the time of the contract. Islamic law's "property" requirement is much narrower than the common law's requirement of a "consideration," defined simply as "a performance or a return promise [that] is bargained for." The "performance" may consist either in "an act other than a promise, or a forbearance, or the creation, modification or destruction of a legal relation." *Restatement* (*Second*) *of Contracts*, § 71. Islamic law's requirement that property exchange hands, when applied rigorously, renders invalid numerous contracts deemed valid at common law.

At a formal level, Islamic law refuses to enforce contracts that include significant speculative elements because there is no mutual exchange of property. Instead, only one side receives property, while the other's receipt of property is contingent on the occurrence of an event in the future. Empirically, this strict position is based upon an irrefutable presumption that the absence of an actual exchange of property reduces the welfare of the contracting parties.

B. The Common Law's Approach to Speculative Contracts

Although the common law's concept of consideration is considerably wider in scope than Islamic law's concept of ^{c}*iwa∞*, there were, nevertheless, significant restrictions placed on parties' freedom of contract in the name of forbidding gambling. Just as Islamic law refused to enforce contracts on the ground that to do so would entail "the consumption of property unjustly (*akl amwāl al-nās bi-al-bā≤il*)," so too the common law traditionally refused to enforce wagering agreements[vii] because, were they to be enforced, "the consideration received would not be commensurate with the detriment imposed on one side."[viii] In this context, the common law's treatment of insurance contracts and derivatives is enlightening.

1. The Common Law and Insurance

Because insurance contains a speculative element, it can easily be condemned as a type of gambling. Indeed, the early common law refused to enforce insurance contracts for precisely this reason. Even with the common law's acceptance of insurance, however, important restrictions were placed on the contract so as to insure that the insurance contract could not be used as a vehicle for speculation. The first requirement was that of an "insurable interest." Thus, before a court would enforce an insurance contract, the policyholder had to demonstrate that he would suffer a significant economic detriment should the insured property be destroyed. Under this doctrine, only the owner of the insured property, or the financier holding a lien on the property, could purchase insurance on the property. Insurance contracts taken out on the property of a third party, however, lack an insurable interest in the insured property, and accordingly cannot be enforced. Where an insurable interest exists, the common law reasoned that the purpose of the contract is not to speculate on future contingencies with the hope of profiting thereby, but only to protect one's property in the event of an accident. Where there is no insurable interest, on the other hand, the only purpose for entering into the contract would be to profit from future contingencies, i.e., gambling.[ix]

In addition to the insurable interest requirement, the common law placed a second restriction on insurance to lessen the possibility that it would be used as a vehicle for speculation—the "indemnification principle." Under this doctrine, a policyholder cannot recover under an insurance contract any amount that exceeds his interest in the economic value of the insured asset.[x] The owner of an insured automobile may recover the market value of his car upon its destruction, but not twice that amount, even if he has purchased two policies. Thus, at common law, "insurance policies are to compensate for losses suffered—not to generate profits."[xi]

2. The Common Law and "Difference" Contracts

At common law, a contract for the future delivery of a commodity—a forward contract—was valid, but only if the parties actually contemplated actual delivery of the commodity.[xii] The requirement that the parties contemplate actual delivery was instituted to preclude enforcement of contracts whose sole object was to speculate on the future prices of commodities. These contracts were condemned as "difference contracts." A "difference" is a contract that takes the form of a legitimate forward contract, but in fact is one in which the parties do not intend to settle the contract by delivery of a commodity. Rather, the parties intend to settle in cash based on the difference between the contract price and the spot price on the date of delivery specified by the contract.[xiii]

Courts recognized two exceptions to the rule prohibiting difference contracts. The first was where it could be shown that the contract served a legitimate hedging function.[xiv] A party seeking to enforce the contract would have to show that, at the time he entered the contract, he held an economic interest in a commodity that would be injured by the very same event that allowed him to profit on the contract. In this case, although the contract was a difference contract, it was enforced because it served only to indemnify against a loss, and was not a source of speculative profit.[xv]

The second exception was where the contract was executed in an organized futures market, regardless of the actual intention of the parties to the contract.[xvi] Here, the reasoning used to justify enforcement was slightly different. The courts began with the premise that organized futures markets are organized for the needs of producers and consumers, primarily to allow them to hedge price risks efficiently.[xvii] Accordingly, the practice in those markets for counter-parties to offset their delivery obligations by entering into another contract is the legal equivalent of delivery.[xviii] Thus, in the case of exchange-traded futures contracts, there was an irrebutable presumption that the parties contemplated actual delivery,[xix] whereas in the case of private futures contracts, the contract could only be enforced if the parties contemplated actual delivery, or one of the parties was hedging an actual economic interest.[xx]

3. Conclusion

The common law, like Islamic law, was suspicious of speculative contracts, condemning them as gambling or wagers. Insurance contracts, although they contain speculative elements, were allowed where the insured had an interest in the property covered by the contract of insurance, but on the condition that he could recover only the value of his loss. Accordingly, insurance contracts were excluded from the definition of gambling because the insured could not profit from the contract. Likewise, the common law was suspicious of futures contracts, allowing them only where the parties contemplated actual delivery of the commodities or one of the parties could show a legitimate hedging purpose for the contract. Otherwise, the contract was deemed unenforceable as a difference contract.

C. The Commodity Exchange Act and the Federal Regulation of Speculative Contracts

The Commodity Exchange Act of 1936 (CEA) was passed, at least in part, to fight what the United States Congress deemed to be the harmful effects of "excessive speculation" in commodity prices. In 1974, Congress established the Commodity Futures Trading Commission (CFTC or the Commission) to administer the CEA. Since that time, the CFTC has enjoyed exclusive jurisdiction over enforcement of the Act. The heart of the CEA is that any "contract for the purchase or sale of a commodity for future delivery" be "conducted on or subject to the rules of a board of trade which has been designated by the Commission as a 'contract market' for such commodity." Conversely, any contract for the purchase or sale of a commodity for future delivery that is not conducted on a legally recognized organized exchange is unlawful, and may generate criminal penalties.[xxi]

The United States Congress believed that organized trading in futures contracts was "affected with a national interest" because "[t]he prices involved in such transactions are generally quoted and disseminated throughout the United States… as a basis for determining prices.… Such transactions are utilized by… [persons] engaged in handling commodities and the products and byproducts thereof… as a means of hedging themselves against possible losses through fluctuations in price." In other words, organized futures markets furthered social welfare in two important ways. The first was by enhancing the accuracy of future pricing information, thereby allowing producers and consumers of commodities to plan future business decisions more reliably, a function known as *price discovery*. The second was to allow producers and consumers to hedge their market risks more efficiently.

Trading in futures contracts was not without harmful side effects, however, as "the transactions and prices of commodities on such boards of trade are susceptible to excessive speculation and can be manipulated, controlled, cornered or squeezed, to the detriment of… the national interest therein."[xxii] The Commission, in designing the substantive rules that are to govern exchange-traded futures, is required to make a determination whether futures trading in a particular commodity will promote the goals of price discovery and hedging while at the same time warding off the evils of "excessive speculation." Thus, before a futures contract can be legally traded on a board of trade, the advocate of a futures contract must demonstrate to the Commission that the contract is a response to a genuine market need for more efficient price discovery and/or hedging. Thus, even under the CEA, a futures contract is presumptively unlawful.[xxiii]

Recently, however, with the rise of the market in privately-traded over-the-counter derivatives (OTC derivatives), the regulatory framework of the CEA has come under attack as overly restrictive. In response to this criticism, the United States Congress passed the Futures Trading Practices Act of 1992.[xxiv] The 1992 legislation authorized the Commission to "exempt any agreement, contract, or transaction (or class thereof) that is otherwise subject to" the CEA's prohibition against trade in off-exchange futures contracts.[xxv] The Commission used this power in the early 1990s to exempt both swaps and hybrid instruments from the CEA's prohibition against off-exchange sales of futures contracts.[xxvi] In contrast to the approach of the CEA, under this exemption such contracts are given a presumption of legality, so long as the contracting parties meet certain objective criteria, i.e., are "appropriate persons."[xxvii] Partially as a result of this exemption, the market in OTC derivatives has exploded. It remains to be seen whether the decision to deregulate the OTC derivatives market will in fact serve the public interest.

III. CONCLUSION

With the exception of the recent decision by the Commodity Futures Trading Commission in 1992 to exempt certain "appropriate persons" from engaging in off-exchange futures contracts, Islamic law, the common law, and federal regulatory law (the CEA) all agree that speculation must be restricted. The difference is not so much in principle, but rather in technique. In Islamic law, there are certain categorical rules about the nature of property that substantially limit the ability of parties to engage in purely speculative contracts. On the other hand, these rules are clearly overbroad insofar as they will also deny enforcement to contracts where the speculative element is secondary to a valid commercial goal. Islamic law, however, solves the overbreadth problem of its rules on contract formation on the remedial side—because contractual rights can be enforced only by the parties to the contract themselves, so long as the parties are satisfied with the trade, no one can force them to undo their trade. In effect, this regulatory strategy may be a reflection of a perceived institutional inability to distinguish between contracts whose speculative elements are material and those that are not. Thus, in the event of a dispute, the court will simply not intervene to enforce a contract where the court cannot be *certain* that the speculative element is either *immaterial*, or *unavoidable*. Common law, on the other hand, appears to place more confidence in the fact-finding ability of judges to distinguish between contracts that are welfare enhancing and those that are simply tools for gambling. Because both systems depend upon a case-by-case method of decision-making, however, the difference between the legal rules of the two regimes might be a reflection of the greater experience common law judges have had with contracts such as insurance than Muslim jurists have. The same skepticism toward speculative contracts is also reflected in the CEA, with the difference that it vests authority to distinguish between "valuable" speculation and "mere" speculation in an expert agency, the Commodity Futures Trading Commission. The Commission's decision to exempt "appropriate persons" from limitations on speculation that apply to "normal" persons can also be viewed as simply a decision that "appropriate persons" are better positioned to distinguish between welfare-enhancing contracts containing speculative elements and those contracts that are simply vehicles for speculation. Thus, for "appropriate persons," modern American law establishes a conclusive presumption that their speculative contracts are not gambling, but rather further a legitimate business purpose.

The question Muslim jurists need to confront, then, is whether the traditional rules of Islamic law remain the most efficient means available to distinguish between those speculative contracts that are gambling, and therefore should be denied enforcement, and those that increase social welfare, and should, therefore, be enforced. In exploring this question, valuable lessons can be learned from other legal systems, including the common law and modern federal regulatory law.

[i] This difference should not be exaggerated. Modern legal historians tend to criticize the early common law as having been excessively formalistic at the expense of the pragmatic policy interests served by the law. It has only been in the last century that one can say that the pragmatic trend in the common law has triumphed over formalism.

[ii] This difference also may be more apparent than real when one takes into account the Islamic legal doctrine of *siyāsa sharʿiyya*. Under this doctrine, the government is allowed to promulgate rules of decision that differ from the formal rules of the jurists, within the one constraint that the government's rule does not command disobedience to God.

[iii] The reasons for this perception were many. First, judges as legal specialists were not perceived to have the adequate expertise to understand the complex changes in the economic life of the United States; consequently, there was fear that their decisions would be erroneous. Second, because of the peculiar structure of the American federal system, combined with the structure of stare decisis, there was the perceived threat that a business could face up to fifty different legal rules. Federal regulation had the perceived advantage of providing businesses with one set of rules with which to comply.

[iv] There can be no dispute that Muslim jurists perceive their rules as welfare enhancing: al-Sawi, in commenting on the goals of the law of sales, states that its purpose is "to allow [one] to acquire, by means of agreement, that which is in the possession of another, and [as a result] conflict, violence, theft, betrayal, and cheating are reduced, as well as [leading to benefits] other than these."

[v] Qur'an 2:188 provides, "And do not consume one another's property [using means that are] unjust, and then go before judges so as to consume property of others sinfully, knowing [the property is not yours]." Qur'an 4:29 provides, "O you who believe! Do not consume one another's property unjustly, [but instead use legitimate means of] trade with mutual consent."

[vi] If a material post-exchange event occurs, known as *fawāt*, the obligation is usually transformed into a duty to compensate the other party for the monetary value of his property.

[vii] 7 Samuel Williston, A Treatise on the Law of Contracts § 17:1 at 542 (4th ed. 1997) ("Wagers and gaming transactions, except where authorized by statute, are generally held illegal.") [hereinafter Williston on Contracts]; id., § 17:8 at 611 ("In this country, by legislation and judicial decision, the hostility to wagers of every nature has been marked. Wagers are inconsistent with the established interests of society, are in conflict with the morals of the age, and, as such, are generally void as against public policy.").

[viii] Id., § 17:1 at 542.

[ix] Id., § 17:5 at 576 ("The requirement of an insurable interest in insured property is for the purpose of preventing the use of insurance as a means of wagering.").

[x] "[O]nce . . . an insurable interest exists, the [insurance] policy is a wagering contract only if the interest of the insured is grossly disproportionate to the value set by the parties." Id., § 17:5 at 576-77.

[xi] Stout, Lynn A. Why the Law Hates Speculators: Regulation and Private Ordering in the Market for OTC Derivatives. 48 Duke L.J. 701, 725 (1999).

[xii] A forward contract is permissible according to Muslim jurists so long as the buyer pays at least some of the purchase price at the time of contracting. This contract is known as *bayʿ salam*.

[xiii] "The generally accepted doctrine in this country is . . . that a contract for the sale of goods to be delivered at a future day is valid, even thought the seller has not the goods, nor any other means of getting them than to go into the market and buy them; but such a contract is only valid when the parties really intend and agree that the goods are to be delivered by the seller and the price is to be paid by the buyer; and, if under guise of such a contract, the real intent be merely to speculate in the rise or fall of prices, and the goods are not to be delivered, but one party is to pay to the other the difference between the contract price and the market price of the goods at the date fixed for executing the contract, then the whole transaction constitutes nothing more than a wager, and is null and void." Irwin v. Williar, 110 U.S. 499, 508-09 (1884).

[xiv] Stout at 718-19.

[xv] "The traditional difference between hedging and gambling is that the hedger has a legitimate interest to protect *apart* from the hedging transaction, while the gambler has no interest except in the transactions, depending on the rise and fall of the market." (Emphasis added). Williston on Contracts § 17:10 at 627.

[xvi] Stout at 720.

[xvii] "There is no doubt that the large part of those [futures] contracts is made for serious business purposes. Hedging, for instance, as it is called, is a means by which collectors and exporters of grains or other products, and manufacturers who make contracts in advance for the sale of their goods, secure themselves against the fluctuations of the market by counter-contracts for the purchase or sale, as the case may be, of an equal quantity of the product, or of the material of manufacture. . . . It seems to us an extraordinary and unlikely proposition that the dealings which give its character to the great market for future sales in this country are to be regarded as mere wagers . . . . A set-off is in

legal effect a delivery. We speak only of the contracts made in the pits [of organized exchanges], because in them the members are principals." Board of Trade of Chicago v. Christie Grain & Stock Co., 198 U.S. 236, 249-50 (1905).

[xviii] It should be noted that with respect to exchange-traded futures contracts, a legal obligation to make delivery (if one is long on the commodity) and to accept delivery (if one is short on the commodity) exists in the absence of an offsetting transaction.

[xix] "Where it is shown that the transactions were actually executed according to the rules of a legitimate exchange as required by statute, the contract is valid as against the argument that it is a mere gamble." 7 Williston on Contracts § 17:12 at 635-36.

[xx] The treatment of exchange-traded futures contracts stands in sharp contrast to the prohibition of so-called "bucket shop" operations. "Bucket shops" allowed persons to enter into "sham 'purchases and sales' . . . where no delivery is *ever* made or expected." (Emphasis added). There is no doubt that, under American law, these contracts are "gambling. This is because the parties cannot, under the guise of a contract that has the appearance of validity, make a valid contract where the real intention is merely to speculate on the rise and fall of the market without any purpose that any property shall be delivered or received, but with the understanding that, at the appointed time, the account is to be adjusted by paying or receiving the difference between the contract and the current price." Id., § 17:12 at 633-35.

[xxi] "[I]t shall be unlawful for any person to offer to enter into . . . any transaction in, or in connection with, a contract for the purchase or sale of a commodity for future delivery . . . unless such transaction is conducted on or subject to the rules of a board of trade which has been designated by the Commission as a 'contract market' for such commodity." § 4(a), CEA.

[xxii] Section 3 of the Commodity Exchange Act.

[xxiii] See generally, Revised Guideline on Economic and Public Interest Requirements for Contract Market Designation, Comm. Fut. L. Rep. ¶ 6147, 6073.

[xxiv] Act of October 28, 1992 (Futures Trading Practices Act of 1992), effective October 28, 1992, Sec. 502(a), P.L. 102-546, 106 Stat. 3590, 3629-3631.

[xxv] Section 4(c)(1), CEA.

[xxvi] *Exemption for Certain Swap Agreements*, 58 Fed. Reg. 5587 (1993) (to be codified at 17 C.F.R. Part 35); *Regulation of Hybrid Instruments*, 58 Fed. Reg. 5580 (1993) (to be codified at 17 C.F.R. Part 34).

[xxvii] These include, *inter alia*, (1) banks or trust companies; (2) savings associations or credit unions; (3) insurance companies; (4) investment companies; (5) commodity pools (provided that is not formed solely for the purpose of entering into a swap agreement); (6) a corporation or other entity (provided that it is not formed solely for the purpose of entering into a swap agreement), if it has total assets exceeding $10,000,000, or if its obligations pursuant to the swap agreement are backed by a corporation or other business entity whose assets exceed $10,000,000, or if its obligations are backed by any other eligible swap participant, or if it has a net worth of $1,000,000 and enters into the swap in its line of business, or if it has a net worth of $1,000,000 and enters into the swap agreement to manage the risk of an asset or liability it owns or incurs or is reasonably likely to be owned or incurred in the course of its business; (7) an employee benefit plan subject to ERISA whose total assets exceed $5,000,000 or whose investment decisions are made by a bank, insurance company, investment advisor, or commodity trading advisor; (8) any governmental entity or subdivision thereof; (9) a broker-dealer, unless she is a natural person or proprietorship, in which case she must also independently satisfy the requirements of both those categories; (10) a futures commission merchant acting on its own behalf, provided that it independently meets the requirements either of a natural person or a business entity; and (10) any natural person with a net worth exceeding $10,000,000. 17 C.F.R. § 35.1 (2).