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CHARGING INTEREST IN THE ARABIAN PENINSULA

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The subject of charging interest in the Islamic World in general and in the Arabian Peninsula in particular is highly topical. It raises the delicate problem of the relationships between business law on the one hand and the traditional Islamic legal system, influenced by the precepts of the sharia, on the other. The sharia lays down the riba (interest) and usurious contracts are prohibited; that rule has been differently applied by the various Islamic countries.

In certain countries in the Middle East, particularly Egypt¹, Syria, Iraq² and Jordan³, it is permissible to charge interest. In most countries of the Arabian

*) This article has been adopted from part of the author’s Les contrats en Droit Musulman des Affaires, Economica, Paris, 1995.

1) Article 227 of the Egyptian Civil Code of 1949 stipulates that the legal rate of interest is 7 per cent and parties to contracts may not exceed this rate laid down by law. Any rate higher than 7 per cent will be reduced to this percentage and the excess will be repaid.

2) Article 629 of the Iraqi Civil Code takes up the provisions of Article 227 of the Egyptian Civil Code, while the interest rate is set at 9 per cent by Article 510 of the Syrian Civil Code; however, the latter article stipulates that interest may only be charged if the parties to the contract so stipulate, «in other words in the absence of a clear and written agreement as to the contractual rate of interest, the loan of money is deemed to be free of charge».

3) Articles 636 and onward and Articles 644 and onward of the Jordanian Civil Code require that loans be made free of charge; but Article 1448 of the Jordanian Civil Code refers to the Nizam al-murabahat al-Osmani as special laws which do not apply expressly to contractual loans. The first Article of the special law stipulates an interest rate of 9 per cent for contractual loans in this way interest is permitted. This interest begins to accrue from the time at which the creditor brings a legal action. Also, Article 59, subsection 1, of the Jordanian Commercial Code stipulates that contracts for sales, loans, insurance, and so on which have not been regulated by that Code are governed by the Civil Code and by customary law; failing this, they are governed by the regulations of the Jordanian Central Bank.
Peninsula, a rather stricter approach is adopted. The countries which are the subject of this article (Kuwait, the United Arab Emirates, Oman and Saudi Arabia) have remained faithful to the precepts of the *sharia*. In these countries the prohibition on *riba* is compulsory in civil matters.

However, if they were to meet the requirements of international trade, these countries could not afford to burden themselves with rigid rules. Because they have been involved with western partners in very large contracts, these countries have found a way around the problem, which is to adopt the distinction, initially borrowed from the French law of obligations, between civil law and commercial law. This is a practical approach, because it enables governments to respond to the new requirements of trade and the economy without committing a breach of religious and ideological beliefs.

The first part of this article looks at the state of the law and recent judicial practice in the countries which have allowed interest-bearing loans in commercial matters: Kuwait, the UAE and Oman. The second part looks at the case of Saudi Arabia, a country which strictly applies the prohibition on *riba*, as has been highlighted by recent judgments.

**A- THE STATE OF CURRENT LEGISLATION AND RECENT JUDICIAL PRACTICE COMMERCIAL MATTERS IN KUWAIT, THE UAE AND OMAN**

The study of the legislation and judicial practice with regard to commercial matters in the countries such as Kuwait, the UAE and Oman that strictly apply the rule prohibiting asury to civil matters reveals the desire of these *sharia* countries to be part of modern commercial and economic developments.

**1. KUWAIT**

The Kuwaiti legislature has taken the view that the rules which govern civil matters are not appropriate for commercial matters. As a result, the rules of the *sharia* in general, and the prohibition against *riba* in particular (Article 547 of the Civil Code of 1951), which are observed in civil matters, are not observed in commercial matters because it is judged that they are not appropriate to the world of business⁴.

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A- Positive law

The provisions of Law 32 of 1968 concerning currency, the Central Bank and the organisation of the banking profession, as well as the New Commercial Code of 15 October 1980 (Decree 68 of 1980), validate and even advocate the charging of interest in commercial transactions and in banking operations between banks and their customers\(^5\).

Thus Article 102, subsection 1, of the Commercial Code stipulates that the legal rate of interest is 7 per cent and enables contracting parties to stipulate interest rates for commercial loans; in the absence of an agreement as to the interest rate, the legal rate shall apply (Article 102, subsection 2). In banking transactions, term deposits earn interest as in all traditional banks\(^6\). Furthermore, under Article 364 of the Commercial Code, a customer who is granted a credit facility will be required not only to repay the capital, but also to pay the interest agreed in the contract or, failing this, the legal rate\(^7\). In addition, the Central Bank has the power to regulate and to set ceilings for interest rates for bank credits and loans.

Compensation for delay in settling a civil debt is permitted only if the delay has caused damage to the creditor\(^8\). On the other hand, compensation for delay in settlement of a commercial debt is not linked to the damage caused to the creditor; it is expressly stipulated that the creditor may receive damages over and above the interest on overdue payment that is awarded, without being required to prove the existence of fraud or gross negligence on the part of the debtor (Article 114 of the Kuwaiti Commercial Code).

In civil matters, however, interest on overdue payment which constitutes serious damage begins to accrue on the date on which the legal action is brought\(^9\). Similar interest on commercial debts begins to accrue on the maturity date, unless otherwise stipulated in the contract\(^10\). Article 482 of the Kuwaiti

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5) The current position of judicial practice in Kuwait confirms that interest may be charged under commercial law. The judgments relating to this question will be detailed below.
6) Article 397 of the Kuwaiti Commercial Code.
7) Article 111 (subsection 1) of the Kuwaiti Commercial Code stipulates that the contractual rate of interest may sometimes exceed the rates by the Central Bank.
8) See Article 302 and 306 of the Kuwaiti Civil Code.
9) See Article 297 and 298 of the Kuwaiti Civil Code.
10) See Article 113 of the Kuwaiti Commercial Code.
Commercial Code stipulates that the interest on a bill of exchange begins to accrue on the due date and not on the date on which the legal action is brought. This solution has been adopted in recent judgments\textsuperscript{11}.

However, under the influence of the fundamentalist movement, an open letter signed by 39 of the 50 members of the Chamber of Deputies was sent to the President of the Council of Ministers, Sa’dallah as-Sabah, seeking to have Article 2 of the Kuwaiti constitution repealed. Article 2 states that the precepts of the sharia are one source of Kuwaiti law. The Members of Parliament demanded that a new Article should state that the sharia is the principal source of law\textsuperscript{12}. In 1991 the President of the Council of Ministers sent this proposal for examination by a special commission charged by Emir Jabir as-Sabah with studying the possibilities of Islamising the laws of the state. This open letter coincided with the Islamists’ demands that the practice of charging interest in the banking sector be prohibited as contrary to the precepts of the sharia. These claims appeared in the journal \textit{al-Mugtama‘}, which is the mouthpiece of the Islamic Constitutional Movement\textsuperscript{13}.

Nevertheless, charging interest in commercial matters has been accepted in Kuwait, where several judgments have specified the ways in which legal interest applies with regards to commercial contracts and banking transactions.

**B- Judicial practice**

Examining recent judgments of the Commercial Division of the Kuwaiti Court of Cassation enables one to infer a number of general rules relating to the date from which legal interest or interest on overdue payments in the case of commercial contracts and banking transactions begin to accrue, the possibility of demands for interest by way of damages caused to the creditor, and the disclaiming of interest.

(1) \textit{Date on which the legal interest on overdue payment begins to accrue.} Several cases heard by the Kuwaiti Court of Cassation have specified the date on which legal interest on overdue payment should begin to accrue. In one case\textsuperscript{14} the dispute concerned a maritime transport contract in which the goods had been

\textsuperscript{11} Appeal to the Court of Cassation, Commercial Division (20/85), dated 13 November 1985.
\textsuperscript{12} In an-Nahar 26 July 1994 which quotes the Article from the Arab Times of 23 July 1994.
\textsuperscript{13} In \textit{al-Mugtama‘} of 29 July 1994.
\textsuperscript{14} Commercial Division of the Court of Cassation 19/79, 25 June 1980.
damaged. The question was to establish the date on which the interest on overdue payment began to accrue. Was this the time the maritime transport policy was signed by the parties or the date of the final judgment?

The Commercial Division of the Court of Cassation based its decision on Article 165 of the Commercial Code which stipulates:

In the absence of any stipulation to the contrary by the parties or commercial customs in the matter, if the debtor does not settle his debt on the due date, he is required to pay interest for this delay, this legal interest on overdue payment being of the order of 5 per cent in commercial matters and beginning to accrue:

a. on the date of commencing proceedings if the value of the subject-matter of the obligation concerning a sum of money is fixed at the time the contract is signed

b. on the date of the final judgment in the event that no sum of money was fixed.

In the case in question, the Commercial Division of the Court of Cassation decided that the interest on overdue payment began to accrue only on the date of the final judgment and not on the date of signing the transport policy. It took this decision on the grounds that it was for the judge to set the level of compensation having regard to the damage caused and that is was possible to determine the value of the damage to the goods only on their arrival at the port of destination.

This same solution has been ratified by other judgments. The decision of the Commercial Division of the Court of Cassation is clear is clear on this matter: interest on overdue payment of 5 per cent is permitted by law on condition that

15) The Code applicable was the earlier Commercial Code 2 of 1961 since the proceedings were brought under that Code.

16) (1) Judgment 108/81 of 30 December 1981 of the Commercial Division of the Court of Cassation. In this case the court, applying Article 165 of the Kuwaiti Commercial Code, decided that the interest on overdue payment should begin to accrue on the date on which proceedings were commenced because the sum agreed, which was the subject-matter of the obligation, was known and fixed at the time the contract was signed; (2) judgment 1/82 of 30 June 1982 of the Commercial Division of the Court of Cassation. This judgment related to a loan which was not repaid on the due date. The Court of Cassation ruled that interest on overdue payment at 5 per cent is only payable if the creditor-plaintiff brings an action to claim it as compensation for the debtor's failure to settle the debt on the agreed due date; (3) a similar judgment of the Commercial Division of the Court of Cassation: Judgment 20/85 of 13 November 1985.
the subject-matter of the obligation is precisely determined in order to allow a
decision as to the quantum of the compensation for the damage cause on which
the interest on overdue payment can accrue. In its various judgments the Court
of Cassation has taken into account the exact determination of the subject-matter
of the obligation in order to protect the contracting parties from any injury
resulting from the hazard which has materialised and which would benefit one
of the parties to the prejudice of the other and would thereby disturb the
equilibrium of the contract.

(2) *Bank interest.* In a decision concerning the charging of bank interest, the
Commercial Division of the Court of Cassation adopted the same solution as that
adopted for interest on overdue payment, ruling that the amount of the
compensation must be specified in order for the interest at 5 per cent to apply.
This interest would begin to accrue on the date of filing the proceedings or
otherwise on the date of the final judgment\(^\text{17}\).

(3) *An agreement which would increase the rate of interest on overdue
payment laid down by law is void because it is contrary to public policy.* In a
judgment given in 1985, the Commercial Division of the Kuwaiti Court of
Cassation voided an agreement by which the parties provides for interest on
overdue payment in excess of the legal rate laid down by Article 110 of the
Kuwaiti Commercial Code, judging it to be contrary to public policy. In this
case, the court ruled that the amount of the cheque signed by the insolvent debtor
in favour of his creditor on 22 September 1982 could not exceed the principal
debt maturing on 22 August 1983. According to the Court of Cassation, the new
amount constituted interest on overdue payment which exceeded the principal
debt and therefore the ceiling laid down by the law in Article 110 of the
Commercial Code. The agreement was voidable because it was contrary to
public policy. According to the court, the agreement was void and it was the
principal debt that the debtor had to honour\(^\text{18}\).

(4) *Conditions for applying interest awarded by way of damages.* This
interest will be awarded to the creditor in addition to interest on overdue
payment only when the damage caused is the result of fraud or gross negligence
on the part of the debtor. In a Court of Cassation case, the Commercial Division

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17) Commercial Division of the Court of Cassation: Judgment 8/82 of 7 July 1982.
18) Two appeals to the Commercial Division of the Court of Cassation: 59 and 63 of 9
did not accept that there had been fraud or gross negligence on the part of the
defendant bank; therefore only interest on overdue payment was allowed\(^9\).

(5) **Conditions for renouncing legal interest.** Renouncing interest in
commercial matters must be express: no tacit renunciation is allowed. The
Commercial Division of the Court of Cassation has ruled that a request for an
expert evaluation does not presuppose renunciation of the request for legal
interest\(^20\).

From examination of recent judicial practice it seems that in commercial
matters Kuwait allows all kinds of legal interest, whether on overdue payment
or by way of damages, provided the interest does not exceed the limit laid down
by the commercial laws in force. If it does exceed this limit then it is contrary to
public policy. It is clear from the foregoing that Kuwait has moved into line with
modern developments.

**2. The United Arab Emirates**

As recently as 1993 the UAE did not have a Commercial Code. The charging
of interest in commercial matters had been regulated by Federal Law 10 of 2
August 1980, the purpose of which was to reorganise the Central Bank, the
banking profession and the banking system. Article 96 of that law stipulates that
the Central Bank has the power to set the interest rates paid by commercial banks
on deposits and the interest rates and commissions that they charge their
customers\(^21\). The interest rate must not exceed 12 per cent and compound interest
is prohibited. In this way the charging of interest, which is expressly prohibited
in civil matters, has been allowed for the requirements of commerce in banking
matters in the UAE.

In January 1994, the Code of Commercial Transactions promulgated by the
Federal Law of 7 September 1993 and published in the Official Gazette of the
same year provided for the charging of interest, and regulated commercial and
banking transactions. The most relevant Articles of this Code as regards interest
are mentioned below.

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19) Commercial Division of the Court of Cassation 8 of 7 February 1982.
20) Commercial Division of the Court of Cassation 48/81 of 28 December 1981.
Article 34 subsection 2 of this law mentions an interest rate in accordance with the objectives of
monetary and credit policy.
Article 76 relates to the obligations of the parties to commercial contracts. It stipulates that: «the creditor is entitled to charge interest on commercial loans according to the interest agreed in the contracts. If the rate of interest is not specified in the contract, the rate prevailing on the market at the time of the agreement will apply, on condition that it does not exceed the ceiling of 12 per cent at the time of repayment».

Article 399, paragraph 1 relates to current accounts and stipulates: «interest on current accounts is not paid to customers unless otherwise agreed by the parties. The interest is then calculated on the basis of the official rate. However, if the interest rate is not set, it should be calculated on the basis of the price prevailing on the market but it may not exceed the rate of 12 per cent».

Articles 440 and 441 relate to commercial securities and stipulate in substance that «the bank’s commission is set on the value of the commercial securities deposited by the beneficiary. In addition to this commission, the bank charges interest on the total value of the document. In the absence of agreement to the contrary, the interest is calculated from the date of deposit of the commercial security until the due date».

Charging interest has been openly allowed in the UAE since 1994. No further measures are necessary in commercial matters. Given that this Code only recently came into force, it has not been possible to study judicial practice.

3. Oman

The Sultanate of Oman does not have a Civil Code and therefore applies the sharia in civil matters. A commercial Code has recently come into force\(^{22}\).

A- Positive law

Article 1 of the Commercial Code stipulates that its provisions apply to merchants and to commercial activities that may be undertaken by any individual; including individuals who do not have the status of merchant. Article 5 lays down that, in the absence of statutory provisions, precedence is accorded to customs, special or local custom is to be preferred to general custom, and in the absence of these the sharia will apply. Where none of these exist, the rules of equity will apply.

\(^{22}\) The Omani Commercial Code was promulgated by Decree 55/90 (Decree of the Sultan Qabus) and was put into effect on 11 May 1991. Previously, several decrees had regulated some aspects of commercial activity, for example the laws governing the Commercial Register (3/74), Commercial Companies (4/74), Foreign Business and Investment (5/74), Banking (7/74), and so on.
This Commercial Code follows the example of western codes and regulates all commercial and banking activities (documentary credits, cheques, bills of exchange, bankruptcy and so on) as well as commercial loans. Article 80 of the Omani Commercial Code grants the lender the right to receive a return as consideration for the debtor having obtained a loan or a commercial facility. The rate of this return is set by agreement between the two parties within the limits laid down each year by the Minister for Trade and Industry after agreeing with Oman’s Chamber of Commerce and Industry and having regard to the loan’s maturity date, its purpose and its risks. In a case where the debtor delays settling his debt after maturity date, the creditor will be entitled to the return agreed for the delay. The creditor may claim complementary damages to be added to the return agreed in the loan or commercial facility if the delay has caused the creditor damage in excess of the return. The court will assess those damages.

The agreed return must be paid at the end of the year if the loan has to be reimbursed after one year or more, or on the due date if less than one year, unless commercial customs or banking usage specify otherwise. Thus the solution that the Sultanate of Oman has adopted is the distinction between civil law—that is, the sharia- and pliant westernised commercial law, to meet the requirements of economic and commercial development.

The significance of this distinction is even greater in the light of the fact that the new Omani Commercial Code has extended the scope of commercial law to include all commercial activities and transactions undertaken by an individual, including those undertaken by individuals who do not have the status of a merchant. The wide-ranging and liberal approach which was adopted in drawing up the provisions of the Omani Commercial Code has enabled the Sultanate to be at the forefront of economic development in the Middle East.

Commercial disputes are brought before the Authority for the Settlement of Commercial Disputes, which has legal personality and financial and administrative independence. Its functions are to render arbitration awards and

23) Article 79 states in substance that a loan is commercial if it is obtained by a trader for the requirements of his business or if the purpose of the loan is to be used for commercial transactions.

24) See Article 81 of the Omani Commercial Code.

resolve commercial disputes\textsuperscript{26}. The decisions of the Authority are \textit{res judicata}\textsuperscript{27} and have all allowed the charging of interest in commercial matters.

Oman has adopted the distinction between civil law and commercial law to ensure that its economy remains open to the western world. Oman does not have a civil code and therefore applies the precepts of the \textit{Sharia} to civil transactions. In both its legislation (Commercial Code of 1991 which includes all modern legal techniques) and the approach adopted by the judiciary, Oman deals with commercial matters in a way that is diametrically opposed to that in which it deals with civil law: Oman has established that interest can be charges in commercial and banking transactions:

\textbf{B- Judicial practice}

Examining recent judgments rendered by the Authority for the Settlement of Commercial Disputes provides an understanding of the mechanism for charging interest in Oman, and in particular the date on which interest begins to accrue and the interest rate on loans in domestic currency and foreign currency.

(1) \textit{The date on which interest begins to accrue on bank loans}. In a case settled on 24 September 1986, the Authority for the Settlement of Commercial Disputes deemed that the interest on a loan agreement ceased to accrue from the time the debts were split into instalments and those instalments paid regularly, but that it would begin to accrue again if a single payment were not paid on the due date. The balance of interest would be recalculated from the date on which payments ceased to be made\textsuperscript{28}.

Interest on bank loans in foreign currencies may be charged in the Sultanate provided that the rate does not exceed the ceiling of 1.5 per cent per annum above the interest rate charged on bank loans on the London market\textsuperscript{29}. The Omani Authority for the Settlement of Commercial Disputes has specified that the parties to a contract are free to enter into private transactions provided these are not contrary to public policy; any rate of interest charged on a loan in domestic currency which exceeds the ceiling laid down by the regulations of the

\textsuperscript{26} Sultan's Decree 32/84 of 12 April 1984 established the possibility of bringing requests for arbitration, as well as other legal actions, before the Authority for the Settlement of Commercial Disputes (Decree 79/81).
\textsuperscript{27} Article 4 of Sultan's Decree 38/87.
\textsuperscript{28} Authority for the Settlement of Commercial Disputes, Case 108/86, 24 September 1986.
\textsuperscript{29} Ibid., Case 51/86, 28 September 1986.
Central Bank of Oman will be void. For the same reason, interest charged on a bank loan in foreign currency which exceeds the ceiling of 1.5 per cent above the interest rate allowed for bank loans by the London stock exchange on the date on which the loan is granted will be void\textsuperscript{30}.

Furthermore, on 22 January 1986 the regulations of the Central Bank of Oman set a ceiling of 10.5 per cent for interest to be charged on loans and advances made in domestic currency. The interest would begin to accrue on the date on which these regulations came into force, that is, 1 February 1986\textsuperscript{31}. Exceptionally, fixed loans concluded before 1 February 1986 and whose maturity date is later than 1 February 1986 will still be charged with the agreed interest even if it is higher than 10.5 per cent\textsuperscript{32}.

(2) \textit{Conditions for charging interest on overdue payment}. The Omani Authority for the Settlement of Commercial Disputes has ruled that interest on overdue payments stipulated by law or by the agreement of the parties should begin to accrue on the date on which the debt falls due but is not repaid. However, if there is no statutory provision to the matters and no agreement between the parties, the creditor will be entitled to such an interest only if he provides proof of the debtor’s fault, as well as of the causal connection between this fault and the damage he has suffered\textsuperscript{33}.

In another similar case relating to the opening of a documentary credit, the Authority ruled that the contractual interest at 6 per cent would be converted into interest on overdue payment until payment. No higher interest could be required\textsuperscript{34}.

(3) \textit{Interest on current accounts}. Interest on transactions in a current account accrues automatically. However, the Authority for the Settlement of Commercial Disputes accepted, by its Judgment 365/86 rendered on 18 March 1990, the possibility that the total amount of compound interest charged on

\textsuperscript{30} In case 51/86 the interest agreed by the parties was 15 per cent. The Authority for the Settlement of Commercial Disputes reduced it to 11.5 per cent from the date of indebtedness and then to 10.5 per cent from 1 February 1988 until Settlement, these rates being the ceiling set by the Central Bank for loans in domestic currency.

\textsuperscript{31} Ibid., Case 7/87, 18 May 1988.

\textsuperscript{32} Ibid.

\textsuperscript{33} Ibid., Case 711/87, 8 November 1988.

\textsuperscript{34} Ibid., Case 622/91, 16 April 1992.
transactions in a current account may exceed the capital. This liberal judicial approach to commercial and banking matters contrasts sharply with the extreme conservatism of a country which does not have a civil code.

**B. THE CURRENT POSITION OF LEGISLATION OF JUDICIAL PRACTICE IN COMMERCIAL MATTERS IN SAUDI ARABIA**

The countries of the Arabian Peninsula take a different approach to charging interest on certain commercial contracts (construction contracts, sales contracts, transport contracts, and so on) and certain banking transactions. These countries apply the precepts of the sharia and thus forbid the practice of usury in civil transactions. As has been seen in Kuwait and Oman this prohibition has been abolished, in commercial matters, by legislation which has been confirmed by recent judgments. This is not the case in Saudi Arabia where the approach to charging interest is still strict. In the absence of legislation, recent judgments in this field underline the prevalence of the moral rule of Islamic law as regards interest on loans.

1. **Positive Law**

Saudi Arabia is the only country which has not adopted regulations governing interest rates in commercial matters. On the one hand, this is because all interest is considered as riba and, on the other, because in the absence of a civil code, the sharia takes the place of a constitutional civil code and is therefore the basis of all rules of law.35

Commercial law is considered to be a special branch of law which governs the affairs of a particular category of persons: it therefore has an ancillary role in respect of the general law, which is the sharia.36 This means that, in the absence of an express statutory provision in commercial matters, it is the provisions of the sharia that apply because the sharia is the common law. In the absence of express provisions of the sharia, commercial customs and practices apply, and in the absence of the latter, judicial practice and the fiqh.

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35) «Why a constitution?», asked King Faisal. He added: «the Koran is the oldest and most efficient of all the constitutions in the world». See also Le Monde of 24 June 1966: «Even today, the Koran remains the only constitution of Saudi Arabia».

As a consequence, and in contrast to the other countries of the Middle East, which have adopted the distinction between civil law and commercial law in order to render the rules of interest more flexible, Saudi Arabia has maintained the prohibition on usury in commercial matters in accordance with the general principles of the sharia\textsuperscript{37}.

However, several sets of regulations governing commercial activity in the kingdom have been promulgated by royal decrees. These regulations are, however, no more than a series of special laws that lay down certain rules to be followed in given areas of commercial activity; their aim is to facilitate commercial transactions and promote trade while respecting Islamic traditions\textsuperscript{38}. No mention or allusion has ever been made to interest, an increase or a related income, limited in respect of a debt, to a given due date.

Some of the regulations promulgated by royal decree in the different sectors of commercial life are the following:

- Royal Decree regulating the Saudi Monetary Fund (1371 Hegira, 1950);
- Royal Decree regulating the Commercial Register (1375 Hegira, 1954);
- Royal Decree regulating the Saudi Central Bank SAMA (Saudi Arabian Monetary Agency) (1377 Hegira, 1956).

In Article 2 of Royal Decree 23 of 1957, which created SAMA, the Central Bank, it is stipulated that «SAMA is prohibited from paying or receiving interest; it is authorised only to collect fees for the services it provides to the public or the Government in order to cover its costs». Further information on these commissions for services rendered is given in Article 6 of the aforementioned decree, which stipulates that «SAMA is prohibited from undertaking any work that contravenes the precepts of Islamic law, and it is not allowed to charge or pay interest for any service provided».

The Saudi Government has also empowered SAMA to set down general regulations concerning the conditions that a bank must observe when performing banking transactions with its customers. This is what led SAMA to set a general tariff for banking services (commissions) for the following transactions:

\textsuperscript{37} M. Shafiq, al-Wagiz fi-l qanun at-tigari, Dar an-Nahdat al-arabiyyat, Vol. 1, 1967, at 66, paragraph 3 which states that, for legislation to be valid in the Islamic countries, it must not contravene a principle or a ruling of the fiqh. State laws must not conflict with the principles of the sharia.

\textsuperscript{38} M.-H. Gahbr, Note 36 above, at 20.
- documentary credits;
- local money orders;
- collections returned owing to non-payment;
- collection of the proceeds of bills of exchange or promissory notes;
- scale of charges for guarantees.

Transactions and services for which SAMA has not expressly set a tariff are regarded as being tainted by *riba*. The banks, while respecting these prohibitions, charge commissions for the services listed. Some economists regard these commissions as disguised interest\(^\text{39}\). In Saudi Arabia, disputes that arise between banks and their customers are settled by a Commission called the Banking Commission, which has a conciliation role. This means that almost all disputes arising out of banking transactions are settled amicably and the outcome of the settlements cannot be published.

The following are some other important decrees:
- Royal Decree regulating the general Petroleum and Metallurgy Company (1392 Hegira, 1961);
- Royal Decree regulating the banks (1386 Hegira, 1965);
- Royal Decree regulating foreign investments (1399 Hegira, 1978);
- Royal Decree establishing the Commission for the Settlement of Commercial Disputes (1401 Hegira, 1980);
- Royal Decree establishing the Commercial Register (1403 Hegira, 1982).

Under the terms of a Royal Decree of 1407 Hegira, the *Diwan al-Mazalim* (Board of Grievances), previously a purely administrative court, was given powers to settle commercial disputes\(^\text{40}\).

All this constitutes a body of commercial law which has its own courts\(^\text{41}\), its own rules of evidence, rules relating to the joint and several obligations of debtors and rules relating to bankruptcy. All these rules contain a very important

\(^{39}\) an-Nasir, l’Organisation bancaire de l’Arabie Saoudite, University of Dijon thesis, 1984, at 545: «SAMA tacitly accepts that banks set the price of their services, that is to say the interest rate, in the light of interest rates prevailing on the world money markets».

\(^{40}\) Article 2 of Decree 360 of the year of the Hegira 1407 provides for the transfer of the powers attributed to the Commission for the Settlement of Commercial Disputes to the Diwan al-Mazalim.

\(^{41}\) The Diwan al-Mazalim is the competent court for the resolution of commercial disputes. However, the civil, shari’i courts have full jurisdictional power; they are equally competent to settle civil or commercial disputes.
criterion distinguishing between civil transactions and commercial transactions in Saudi Arabia. For example, under civil law, the judge may in certain circumstances grant periods of time for the settlement of a civil debt. In commercial matters, on the other hand, he must apply the specific time-limits without any delay. Hence, Article 63 of the regulations relating to Saudi commercial papers stipulates that no period of time must be allowed for the settlement of bills of exchange\textsuperscript{42}. The same applies to cheques and other commercial paper\textsuperscript{43}.

However, despite these factors, Saudi commercial law must at all times yield to the general principles of law drawn from the Koran. This is why the civil courts have full jurisdictional power and, therefore, have a general power of jurisdiction; they may be requested to settle commercial disputes according to the rules of the sharia.

2. JUDICIAL PRACTICE

Saudi Arabia is the only country in the Middle East that has maintained in law the prohibition against charging interest in commercial matters. The regulations relating to commercial activity promulgated by royal decrees and the judgments rendered by the Board of Grievances, the Saudi commercial court, as well as those of the civil courts invested with full jurisdictional power, highlight the clear observance by the Saudi courts of the rules of the sharia as regards the prohibition against interest, against any chance transaction that results in a profit which is not earned by work and against compensation for loss of earnings.

A. THE JUDGMENTS OF THE BOARD OF GRIEVANCES IN DISPUTES CONCERNING THE PERFORMANCE OF CONSTRUCTION CONTRACTS

The Board of Grievances’ commercial division has dealt with several cases relating to compensation for damage arising from the performance of construction contracts and has formulated the following general rules:

(1) To be compensated, the damage caused must be certain, direct and capable of being assessed by the judge. The compensation will cover the

\textsuperscript{42} A. al-Khawly, Durus fi-l qanun at-tigari as-sa’udi; Riyadh, Civil Service Institute, 1973, at paragraph 16.

\textsuperscript{43} M. Mullal, al-Wagiz, fi-l qanun at-tigari, Alexandria, Munsaa’at al-Maafir, 1974, at paragraph 89.
increase in prices during the period the work has been halted, and the bank commissions and charges paid to guarantee the contract during the period the work has been halted. The compensation must, therefore, be exactly equal to the damage \(^{44}\).

(2) The loss of earnings claimed by the contractor as a result of failure to carry out the work constitutes a risk which cannot form the basis for any compensation \(^{45}\).

(3) The compensation is awarded to remedy the damage caused and not to be a source of enrichment of the contractor who has suffered the damage. This is why the compensation must be exactly equal to the damage \(^{46}\).

The judgments rendered by the Saudi Board of Grievances in these cases underline the importance of the moral rule of Islamic law founded on fairness and the balance between counter-values in commercial contracts. No reference is made to charging interest as consideration for the damage caused. The Board of Grievances has only awarded a contractor who suffers damage compensation equal to the damage caused, and the damage must be certain, actual and not a source of enrichment.

Therefore loss of earnings is not compensated, since no profit can be paid which is not the counterpart of work actually carried out. Even a penalty clause which granted the contractor compensation for potential damage was not accepted by the Arbitration Commission of the Jeddah Chamber of Commerce in Case 60 of 12 August 1412 (1992) on the ground that contractual compensation stipulated in a penalty clause cannot be granted for potential damage, in this case non-performance of the work. Reparation of potential damage is the same as future earnings. It cannot be compensated, even if the contract is unlawfully terminated.

In the absence of the damage and of the casual link between the non-performance and the damage, the contractor loses his right under the contractual penalty clause. This judgment is in line with the hanbali fiqh which does not allow reparation of an uncertain damage or a damage assessed beforehand \(^{47}\).

\(^{47}\) This case concerned a contract involving contract work which included a contractual penalty clause in the amount of 657,000 Saudi riyals.
B- THE JUDICIAL PRACTICE OF THE CIVIL COURTS IN MATTERS OF COMMERCIAL CONTRACTS

In a judgment of 1410 (1990) concerning a contract for the purchase of commercial equipment, the civil court of Riyadh settled the case by ordering the debtor to pay the principal of a debt that had fallen due six years earlier but did not award the creditor any default interest or any other form of compensation for the delay.

The events underlying that case took place on 14 December 1983. A contract for the sale of agricultural tractors with a total value of 575,000 Saudi riyals was concluded. According to the terms of this contract, the buyer paid for the goods by cheque and took delivery of the tractors. The cheque had been drawn without sufficient funds in the account. The seller therefore brought a legal action against the buyer before the civil court of Riyadh for non-payment of the goods. The judgment given after six years required the buyer to pay the principal debt. However, there was no question of damages for the creditor. Payment of any interest on overdue payment or by way of damages is prohibited by the *sharia* and to date has not been allowed in commercial matters. In Saudi Arabia the judges are *fuqaha’* (religious men of law), who cannot envisage the application of precepts that are contrary to God’s law.\(^{48}\)

This decision was confirmed in another case in 1993 by the *shar‘i* court of Riyadh. This was a similar case concerning a commercial debt for a total amount of 41 million Saudi riyals. The buyer had made an advance payment of 23 million riyals for delivery of caterpillar tracks at the time the contract was signed. He subsequently refused to pay the further instalments. Eight years later, the Riyadh court gave its decision in which it ordered the debtor to pay the balance of the price of the equipment that is, the principal debt. Once again, the court made no reference to damages or interest on overdue payments.\(^{49}\) This position adopted by the Riyadh court emphasises, if that were necessary, the impact of the moral prohibition against *riba*, which is omnipresent, even in commercial contracts involving millions of dollars.

In another judgment, the Riyadh court allowed a debtor who had failed to honour his commercial debt on the due date to split the debt into several instalments payable according to his financial means with no interest on overdue


\(^{49}\) Ibid., 1413 (1993).
payment or by way of damages\(^{50}\). The same was true of a debt of 32 million Saudi riyals relating to a contract for commercial equipment.

Eight years after the due date, the court required the debtor to pay the principal of the debt, and expressly stated in its judgment that any demand for interest constituted a usurious profit which was haram (unlawful, forbidden) and therefore prohibited by the sharia\(^{51}\).

It is worth repeating that the judges in the sharia courts are religious men who apply the law according to the precepts of the religion. In each case the judge is free to give his own interpretation of the dispute, since Islamic law is essentially casuistic. It is therefore impossible to speak of consistent judicial practice in Saudi Arabia, except insofar as concerns the application of the mandatory principles of Islamic law. It is equally difficult to talk of the authority of res judicata in a country where, in certain extreme cases, judgments are not enforced because the king may order otherwise at any time\(^{52}\); this last statement is true of the UAE, Kuwait and Oman.

Nevertheless, there can be no doubt that the moral rule of Islamic law that is omnipresent in Saudi Arabia in commercial transactions ensures that contracts conform to the strict rules of the sharia. This is also ensured by the judgments of the courts made with the object of preserving perfect equilibrium in the counter-values provided by the parties. While this application of restrictive rules is clear at the domestic level, because it is dependent on the fiqh, the same is not true at international level. The wide diversity of contracts at the international level and their ramifications require a set of new laws and regulations which would allow the application of Saudi law when it is expressly stipulated by the parties that the contract will be subject to Saudi law. The difficulty lies in the fact that the exact tenor of Islamic law is not easily accessible, bearing in mind that the moral rule imposes restrictions on contractual freedom.

The Saudi-S dispute is set out below; this dispute, on which the author has worked, has not yet been settled. It is an arbitration case, submitted to the International Chamber of Commerce, between a Lebanese-Saudi company and an Italian-Saudi company (SARL). The former was subcontracted by the latter to carry out a contract to construct buildings to shelter pumping stations during

\(^{50}\) Ibid., 1407 (1987).
\(^{51}\) Ibid., 1412 (1992).
the installation of pipelines. The Lebanese-Saudi company was obliged, in order to honour the contract, to undertake additional work the quantity, specification and nature of which had not been precisely determined at the time the contract was signed.

When the Italian-Saudi company refused to pay for these additional works, the other party brought a case before the International Chamber of Commerce against the Italian-Saudi company and its Italian parent company. In order to do this, and because Saudi law applied, it based its actions on two arguments:

- *gharar* (uncertainty), because it had had to build more installations than provided for, which disturbed the equilibrium of the contract, thus giving rise to the damage;

- the Italian parent company had been present at all the negotiations although it did not sign the contract. Therefore, according to hanbali law, it is jointly and severally liable; it must therefore pay the cost of the installations that the Saudi-Italian company, SARL, has failed to pay. This point of law was based on the *niyya* or the internal will of the parties accepted by hanbali law.

The International Chamber of Commerce, which has to settle the dispute on the basis of Islamic law, is faced with serious difficulties, since this law is casuistic. The following is another interesting case: the Commission for the Settlement of Commercial Disputes (which has been replaced by the Board of Grievances) in Dammam (Saudi Arabia) decided in 1977 that following the loss of a container of watches transported by air it was necessary to repay the exact value of the goods lost. The Commission based its judgment on the *hadith* which states: «a person who is the guardian of another person’s property is obliged to return it as such». This decision runs counter to the Warsaw Convention, ratified by Saudi Arabia in 1969, according to which reimbursement for goods lost is assessed at $20 per kilogram unless fraud or gross negligence is proven. The Commission did not take account of the Warsaw Convention since it did not mention it in the grounds in law for the decision. It was content with basing its decision on its interpretation of the *sharia*.

Islamic law can also be unclear in cases for which the sharia makes no provision or which are not the subject of any regulation in the country concerned. The *Aramco* case is an interesting example which illustrates the gaps just mentioned. This was a case referred to international arbitration in 1965. The arbitration decision stated, in Article 4, that the tribunal should settle the dispute:
- in accordance with the Saudi law indicated in the agreement, that is, the Islamic *sharia* according to the teaching of the imam Ahmad Bin-Hanbal, for matters falling within the jurisdiction of Saudi Arabia;

- according to the law that the arbitration tribunal judged applicable for matters falling outside that jurisdiction.

In its award the arbitration tribunal ruled that the law applicable to the concession agreement was Saudi law, that is, the Islamic *sharia*. In its reasoning the tribunal stated:

The legal regime for mining concessions, and therefore oil concessions, has remained in embryonic form in the schools of the Islamic *fiqh*, although the totality of the principles proposed by the different schools of the *fiqh* could suffice if one took the initiative of gathering them and unifying them with a view to establishing the basis for a law for the oil sector. However, this task falls outside the competence of the arbitration tribunal, which has a judicial, and not a legislative role.

Besides that, the hanbali teaching doctrine which is applied in Saudi Arabia does not include any special rules that define mining concessions in general and oil concessions in particular. As a consequence, the arbitration tribunal ruled that Saudi law was not sufficient and must be complemented by other sources of law53.

Since this case, no international arbitration to which one of the parties is the Saudi state may be submitted to the court without the approval of the Saudi Council of Ministers; this has reduced the number of international arbitration cases in Saudi Arabia in particular, and in general in the Gulf countries that have opted for the same policy.

In a similar arbitration case between the Emir of Qatar and the International Marine Oil Company Ltd, the sole arbitrator made his award in the following terms: «Several arguments support the view that Islamic law should apply as being the most appropriate... but this law in no way contains principles or rules that are sufficient for contracts of this type»54. It seems that gaps in the

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54) A. A-H Sus, Note 53 above, at 100.
legislation of countries which apply only the *sharia* have led directly to that law not being applied.

The application of Islamic law to contracts subject to international arbitration proceedings remains a thorny problem. There have been calls for the laws to be modernised. The President of the Saudi Council of State submitted a request to the council recommending a revision of numerous pieces of current legislation on the grounds that this would be in the interests of citizens. In the Saudi journal *al-Yamamat*, a high-ranking judge stated that many laws could no longer be applied and that it was necessary to revise and amend them, adding missing provisions and deleting provisions that are no longer relevant, and to legislate to meet the new requirements of citizens' lives. Saudi Arabia has not yet reconciled the *sharia*, which advocates fairness and equity, with the laws that regulate the world economic order.

**CONCLUSION**

The distinction between civil law and commercial law has provided the safety valve which has enabled the most conservative countries of the Middle East not to apply the strict and obligatory rules to interest-bearing loans under commercial law. By this means Kuwait, the United Arab Emirates and Oman have move into line with the modern approach of western legal systems in contractual matters, and particularly as regards the charging of interest. As for Saudi Arabia, a conservative country *par excellence*, charging interest is still prohibited by law even in commercial matters. This does not mean that, in this area, a significant number of contracts have not followed the western model. To date, disputes that have arisen, particularly in the field of banking, have been settled by conciliation.

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55) as-Safir, daily newspaper, 2 September 1993.