THE ROLE AND DISCRETION OF JUDGE IN INSOLVENCY MATTERS UNDER ISLAMIC LAW

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ABSTRACT: *An effective insolvency regime consists of specialized courts established for dealing with the cases of insolvency and/or bankruptcy. Such courts are either specialized bankruptcy courts, or commercial courts. The judges administering insolvency cases are highly specialized and they are known for their high ethical and professional standards. These judges play a very significant role in adjudicating the insolvency matters. However, an important question faced by all legal systems in this connection is the discretionary powers that these judges may be given under the law. Every legal system in the world, and all individual countries looking to establish such bankruptcy courts, need to give such discretion to the judges involved. However, the question is the degree to which such discretion may be conferred upon the judges. Being a separate legal system with its own features, the Islamic law has also addressed this issue of courts' discretion in insolvency matters. The discretion of judge, called qadhi in the classical Islamic texts, has been well elaborated by the Muslim jurists of the previous centuries. The relevant literature on the issue of the discretionary powers of qadhi reveals that the Islamic law confers high powers of discretion upon the judge in insolvency related matters. This is mainly due to the fact that under Islamic law, a judge is an active participant in the entire adjudication proceedings. The duty of the judge is not restricted to the ascertainment of factual issues and the mere application of substantive laws. Instead, he/she is empowered under Islamic law to participate actively in the whole process and resolve the issue as much amicably as possible. In this article, we explore the issue of the discretionary powers of insolvency court/judge under Islamic law.*
KEYWORDS: *Insolvency, bankruptcy, discretion, judge, liquidator*

Introduction:

There are a number of issues that need to be addressed when designing an effective insolvency law. Generally speaking, insolvency procedures consist of two broad elements: a legal framework that sets forth the rights and duties of both creditors and debtors, and an institutional framework that implements such rights and obligations. Hence, the two elements can be described as the abstract set of laws and its practical application by the authorities. Due to the connection between these two elements, an important question in this context is the discretion which the law gives to this infrastructure when the law is applied. [1]

Since adjudication of disputes is the function of judiciary, insolvency proceedings are generally conducted under the authority of a court of law. The courts also need to appoint qualified administrators and liquidators for the process to complete. A judge sitting in the court is required to adjudicate disputes between the parties. The judge usually resorts to factual issues for such adjudication. However, he may need to interpret the law at times when required. This requires that the judges are independent and have high professional and ethical standards. [2] A good example of the discretionary powers of judge is to unwound those transactions of the debtor that took

place prior to the commencement of insolvency proceedings (known as claw-back actions). If a court deems fit, it may annul such transactions on the grounds that they were malafide and were detrimental to the interest of the creditors. [3]

This brings us to the important question of how much discretion the law should give to the judges. As a rule of thumb, if the insolvency law is precisely formulated and well elaborated and predictable, it avoids uncertainty and not only facilitates the insolvency proceedings but also reduces the costs of such proceedings. However, it is not always possible for the law to cover all aspects and answer all the questions pertaining to the complex insolvency proceedings. This requires that the courts be given a certain degree of discretion when resolving the disputes. However, the extent of such discretion is an important question because in such case, the courts is not merely responsible for ensuring the legality of the proceedings. Instead, it becomes an active participant in the process which has substantive decision-making powers regarding certain important issues, like the continuation or winding-up of a business.[4] However, a balance is needed between the mandatory and discretionary components of insolvency laws. The mandatory elements of the law provide a high degree of certainty and predictability. However, it may also result in rigidity. Therefore, the discretionary element allows the judge to consider various facts and circumstances, consider the community's interest, look into the precedents, and the market conditions etc. [5]

In any case, it is undisputed that discretion of the courts is an indispensable phenomenon. Insolvency matters have become far more complex particularly in these days due to the complex nature of businesses and the linkage between various businesses, entities, sectors and even countries. Therefore, such discretionary powers of a judge are now a universal requirement of the business world. However, various legal systems may disagree on the degree of such discretion. Hence, insolvency laws in the twenty first century need to answer the question of such degree rather than the discretion itself.

Islamic Law of Insolvency: The Nature and Function of *Qāḍī* (Judge) under Islamic Law

An apparent difficulty and misconception that one might encounter about the role played by *qāḍī'* in such matters is drawing a parallel between the concept of *qāḍī* and the judge in the modern day courts. Therefore, it is important to first understand the nature and function of judge under Islamic law. In modern day context, the disputant parties (i.e. the creditors and the insolvent debtors) are hostile who want to prove at any cost the validity of their claim against the opponent. In this situation, the judge's responsibility is only to decide who is right and who is wrong, i.e. to discern facts and apply the relevant law only. It is outside his discretion to resort to reconciliation and compromise between the litigants. But this role of the modern day judge is in sharp contrast to the one outlined in Islamic law where *"… the purpose of the qāḍī and the law was more for mediation and conciliation than for the vindication of individual rights or the regulation of the parties' conflict of interests."* (p. 308) [6]

Under Islamic law, recourse to litigation is in fact the last course of action. It is amicable settlement that is the prescribed as the best option to resort to in all types of disputes including insolvency, a ruling which is derived from the Qur'ānic verse: "… and settlement is best." [7] This is in contrast to the modern Western litigation approach which is based on "winner-take-all" notion. This contrast between the two systems should be kept in mind because it will affect how the issue of distressed debtor is to be handled under an Islamic framework:

The winner-take-all approach of modern Western litigation is strongly inconsistent with Islamic norms. The primary goal of the *qāḍī* is to find a middle ground, to salvage what should inevitably be a close, on-going personal relationship between the disputants. (p. 27)[8]

In line with this reconciliatory role, amicable settlement was the foundation of the earliest Islamic society, which was a closely knit community whose members that took care of each other.[9] In matters pertaining to insolvency, the same reconciliatory role was played by *qāḍī* as portrayed by Warde[10] in the following words:

Islamic jurisprudence took a special interest in matters of insolvency… The judge (*qāḍī*) was the central figure in finding an appropriate resolution to the cases brought before him. What resulted was an ad hoc attempt at compromise as opposed to systematic receivership. Assuming good faith, both sides were expected to make concessions. Typically, there would be a reduction of debt and a change in terms based on the debtor's ability to pay… (p. 2)

This was his role in all matters of insolvency disputes too which is in contrast to the scenario of modern world litigation:

The fundamental institutional context of distressed debt in *shari'a*, then, involves a cohesive community with a *qāḍī* focused on conciliation, based in part on maintaining the personal relationship between the disputants. The Islamic law of distressed debt is not designed to be applied to modern, individualistic, impersonal debtor-creditor relations. (p. 28) [11]

That the modern day litigation environment is far away from the closely knit societal courts of earliest Islamic era is also endorsed by Hallaq:[12]

The highly formalized processes of the modern court and its structure of legal representation (costly and tending to suppress the individual voices of the litigants, let alone their sense of morality) were unknown to Islam. So were lawyers and the excessive costs of litigation that prevent the weak and the poor from pressing their rights. (p. 167)

The Discretion of *Qadhi* (Judge) in Insolvency Matters

In the above context, a judge or *qāḍī* under Islamic law, entrusted with the role of reconciliation first, automatically bears great responsibility as well as discretion in all matters of dispute including insolvency since any insolvency litigation has a particular context, parties, amount and type of debt, as well as other particular requirements of its own. It is, therefore, no wonder to find early Muslim jurists giving great authority and responsibility to the judge in insolvency disputes. The Muslim jurists applied this

discretionary power of *qāḍī* in almost all matters that are not to be solved through legal texts and cannot be based on sound *qiyās* or analogy. A few examples are enumerated below to clear the point.

In Islamic jurisprudence, the distressed debtor can either be (1) solvent but financially distressed, (2) penniless, or (3) his financial status is unknown. In the first case, if he refuses to pay his creditors, he should be imprisoned by judge according to the majority opinion of the Muslim scholars. In the second case, the judge is not supposed to imprison him according to the majority opinion. But the third case in which his financial condition is unknown (*mastūr al-ḥīl*), there is lengthy discussion among jurists as to whether he could be imprisoned or not? Leaving aside the arguments for their respective opinion, the jurists who allow imprisonment of the debtor have mentioned different time periods for his imprisonment which are all based on *qiyās*. However, the most appropriate opinion seems to be the one in which this matter is left to *the discretion of judge*. Following are some texts that shed light on the discretion of judge in this matter:

The Hanafi jurist, Fakhrud Din al-Zaylaʿī on the issue of how long a debtor should be imprisoned states that:

There is no fixed duration for imprisonment of debtor and this matter is at the discretion of judge. He can imprison the debtor till a point when he is sure that if the debtor had some property, he would have disclosed it by now. Thus, the matter may differ with respect to different people, time, place and property. With this in mind, it is not reasonable to fix the time and the fixation found in these cases like two or three months or less or more than that was based on specific situations and it is not a firm principle. (p. 169)[13]

The Maliki jurist, Abu Abdullah al-Muwaq,[14] opines on the imprisonment period of such a debtor that: "(The duration of imprisonment) should be such that makes known his condition and reveals his situation; it is something that will differ with a difference in (the type of) debt." Thus, it is the judge who enjoys discretion regarding the imprisonment period of a debtor.

Kilborn[15] provides another example regarding the discretion of judge in imprisonment period from the famous Ḥanafī jurisprudence book *al-Hidāyah* which he admires in the words below:

The Ḥanafī jurist Marghīnānī's explanation is the most honest and elucidating whereby he states: The debtor should be imprisoned, he says, "for two or three months," but he goes on to acknowledge that "[o]ther authorities fix it at one month, five months and at six months," until he finally capitulates and admits that "[i]n fact, this is a point which must be left to the discretion of the [*qāḍī*]. (p. 22)

Al-Ḥārithī [16] concludes the debate on this issue by preferring the view of leaving the matter of imprisonment to the discretion of judge as thus:

I prefer the opinion of not fixing the duration of imprisonment here, as suggested by majority of the jurists, and leaving the matter to judge as he deems fit in each case presented to him. This is because the purpose of imprisonment here is to ascertain the

condition of debtor and to know if he has some property in the first place. This is something that will differ with respect to different debtors and the price that the debtor pays for imprisonment, in addition to the difference in time and place as well as the circumstances surrounding each case. Therefore, fixation of this period is not possible in advance, rather the matter should be left to the judge [who would decide] as he deems fit in each case that if the debtor were to have some property the he was hiding, he would have revealed it [by this time]. (p. 170)

With such vast discretion of *qāḍī*, it would be apt to conclude this discussion on Kilborn's[17] comments regarding the role of *qāḍī* in insolvency disputes. The writer argues that:

But the system in general relies much more broadly on the *qāḍī*'s exercise of discretion, particularly before the parties come to loggerheads. We improperly impose a modern (or more accurately, Western) perspective on *sharia's* if we regard the *qāḍī*'s principal function as making all-or-nothing decisions in zero-sum disputes. (p. 27)

With no doubt in the accuracy of this writer's remarks, it is far from real to find a judge in this role in the modern day world. The entire legal systems today are undoubtedly based on "all-or-nothing" approach.

It is evident from the above examples that the matters pertaining to insolvency under Islamic law are subject to the wider discretion of judge. Such vast discretion is founded upon the "conciliatory" role of judge as envisioned in Islamic law; a judge's task is not "all-or-nothing" or "winner take all" approach. Instead, he is supposed to perform the role of keeping the social ties as close as possible by resolving the dispute in such a way that pacifies both parties and keeps social harmony intact. As stated before, litigation is the last resort under Islamic law and under the principle of keeping social harmony in Islam, the pillar of alternative dispute resolution is the starting point for resolving matters of insolvency.

What is confirmed from the foregoing discussion is the tremendous potential and room left for *ijtihād* in addressing the issues of insolvency and bankruptcy. This is particularly true in terms of the legal entities of the modern world. We must not shy away from confessing the fact that Sharīʿah texts dealing with insolvency are very few which provide us with general principles only. However, the general features of Islamic law, coupled with the discretionary powers of judge, do provide enough guidance to resolve complex issues. The detailed rulings can be derived from the general principles with the help of *ijtihād* and its supplementary tools. Under such circumstances, insolvency of modern day corporations is an area which needs the utilization of one's efforts and skills to arrive at the respective Sharīʿah rulings related to insolvency of corporate entities.

Islamic Law and the Functions and Duties of Administrator/Liquidator

The potential of classical Islam law to address the complexities of modern day bankruptcies is also evident from another example, i.e. the administrator. In modern times, the important role of a bankruptcy judge, especially in the U.S., cannot be

denied. However, a judge alone is not sufficient to take the bankruptcy proceedings successfully to the end. Therefore, in most jurisdictions the judge is aided by an official administrator/liquidator appointed specifically for this purpose. His main rights and duties include, but are not limited to, the following:

a. to be appointed by the court
b. to protect property and take control of the company's affairs
c. to be paid remuneration for his/her services as receiver
d. The official receiver retains his/her duty to:
    - investigate;
    - report to creditors; and
    - report on the company officers' conduct.
e. initial duties as liquidator include identifying, collecting, securing and protecting the assets of the company,
f. As a liquidator of a company, the official receiver's general functions are to secure the assets, realize them and distribute the proceeds to the company's creditors, and, if there is a surplus, to the persons entitled to it

If we analyze the above points, it can be seen that the sole function of the administrator/liquidator is to derive the maximum possible value from the assets of the bankrupt debtor. The assets of a bankrupt debtor are already less than his liabilities and, therefore, it is essential that whatever assets are left should be utilized to the maximum possible limit. This is where an administrator/liquidator comes into play.

It is interesting to note that the Muslim jurists in the past elaborated on the role and functions of not only the judge, as explained above, but also the administrator/liquidator. Although the legal proceedings pertaining to insolvency were taken care of by the judge, the administrative procedures, consisting of recovering the debtor's assets, or liquidation etc. were to be performed by another party assisting the judge in this regard. So the judge would be assisted by other general administrators or trustees who were well versed in the relevant areas of insolvency. The question of liquidation of the debtor's assets as addressed by the Muslim jurists is elaborated below to explain the point.

One of the main steps in insolvency proceedings is the sale of a bankrupt debtor's assets. For this purpose, there are some principles that need to be observed by the judge or his assisting administrator / liquidator / trustee etc. The purpose of this is, first, to preserve the value of the assets of debtor and, second, to prevent fire sale of the assets. Fire sale is a modern term used for the destruction of debtor's assets if they are to be sold on urgent basis. Below are some examples of how the Muslim jurists discussed all aspects of modern day insolvency proceedings.

According to the famous ×anbalÊ jurist al-BuhËtÊ [18] the person in charge of assets / administrator / judge should follow a proper procedure to sell the assets of the debtor. He states that although it is not mandatory for the administrator to take permission from the debtor prior to the sale of his assets, it is recommended that the judge should

make sure the presence of debtor or his agent at the time of sale of the assets (v. 3, p. 432):

(ولا يحتاج) الحاكم (إلى استئذان المفلس في البيع) لأنه محجور عليه يحتاج إلى قضاء دينه. فجاز بيع ماله بغير إذنه كالسفيه (لكن يستحب) للحاكم (أن يحضره) أي المفلس. (أو) يحضر (وكيله) وقت البيع لفوائد.

This example shows that the Muslim jurists not only laid down the obligations of the judges and/or administrator, they also highlighted the corresponding recommended acts for them too. The writer then elaborates the different benefits that can possibly be obtained from this ruling which include: his knowledge about the value of his assets, his consolation, keeping record of the sale item/price and the like:[19]

منها: أن يحضر ثمن متاعه ويضبطه. ومنها أنه أعرف بالجيد من متاعه. فإذا حضر تكلم عليه. ومنها: أنه تكثر فيه الرغبة. ومنها: أن أطيب لنفسه. وأسكن لقلبه

He further recommends that the creditors should also be present due to the potential benefits involved in their presence. For instance, they may be interested in some assets and may offer a higher price for it, or they may claim their own assets found therein. However, the judge still has the discretion to go with the sale without the presence of either:[20]

(و) يستحب للحاكم أيضاً أن (يحضر الغرماء) لأنه لهم، وربما رغبوا في شتى فزادوا في ثمنه. وأطيب لقلوبهم وأبعد للتهمة. وربما يجد أحدهم عين ماله فيأخذها (وإن باعه) الحاكم (من غير حضورهم كلهم) أي المفلس والغرماء (جاز)

Al-BuhËtÊ further suggests that both creditors and debtors should appoint an announcer (liquidator/marketer) to inform the people about the sale process and ask them to participate in it. The writer explains how to appoint the announcer and what to do in case of disagreement i.e. the debtor wants to appoint one liquidator while the creditors want another: [21]

(ويأمرهم) أي المفلس والغرماء (الحاكم أن يقيموا منادياً ينادي على المتاع) لأنه مصلحة (فإن تراضوا بثقة أمضاه) الحاكم وإن تراضوا بغير ثقة رده . . . (وإن اختار المفلس رجلاً) ينادي (واختار الغرماء آخر، أقر) الحاكم (للثقة) من الرجلين (فإن كانا ثقتين قدم) الحاكم (المتطوع) منهما. لأنه أخف (فإن كانا متطوعين ضم) الحاكم (أحدهما إلى الآخر) جمعاً بين الحقين (وإن كانا بجعل قدم أو ثقهما وأعرفهما) لأنه أنفع (فإن تساويا) في ذلك (قدم) الحاكم (من يرى) منهما. لأنه لا مرجح لأحدهما على الآخر

Furthermore, each asset of the debtor should be sold in its respective market place because it has a certain advantage; there are more chances to find a potential buyer for it in its respective market, though it is also permissible to sell it in another market if it is more beneficial in terms of getting a higher bid for the assets. However, it must be sold at the market price minimum and any sale below that would be impermissible:

(ويستحب) للحاكم أو أمينه (أن يبيع كل شيء في سوقه) لأنه أحوط، وأكثر لطلابه (ويجوز) بيعه (في غيره) أي غير سوقه. لأن الغرض تحصيل الثمن كالوكالة (وربما أدى الاجتهاد إلى أنه) أي بيع الشيء في غير سوقه (أصلح) من بيعه في سوقه (بشرط أن يبيعه بثمن مثله المستقر في وقته) أي وقت البيع. فلا اعتبار بحال الشراء (أو أكثر) من ثمن مثله. فإن باع بدون ثمن المثل لم يجز،

Additionally, al-BuhËtÊ[22] also suggests that once a sale is conducted with option and a third party increases on the price during the option period, the trustee should cancel the earlier sale due to the advantage in doing so. Even if an increase in price sale is offered after the sale without any option to cancel is concluded, the trustee should

offer *iqÉlah* (mutual cancellation of contract) to the first buyer which should be accepted by him. Although a third party is not allowed to offer a higher price over the price of another person, his, according to the author, is an exceptional case whereby a third party is allowed to offer an increase in the price between two parties already concluding/bargaining a sale. This exception is allowed based on the need to maximize the value of the assets of the debtor (v. 3, p. 433):

(فإن زاد في السلعة أحد في مدة الخيار لزم الأمين) أي أمين الحاكم (الفسخ) لأنه أمكنه بيعه بثمن فلم يجز امضاؤه بدونه، كما لو زيد فيه قبل العقد (وإن كان) زاد في السلعة (بعد لزومه) أي البيع (استحب له) أي لأمين الحاكم (سؤال المشتري الإقالة. واستحب للمشتري الإجابة) إلى الإقالة. لأنه معاونة على قضاء دين المفلس، ودفع حاجته. وتقدم في البيع: يحرم البيع على بيع المسلم والشراء على شرائه. فهذه الصورة إما مستثناة للحاجة أو محمولة على ما إذا زاد غير عالم بعقد البيع

Thus, the bankruptcy trustee was a known phenomenon to the Muslim jurists centuries back and they did elaborate on his role and functions accordingly.

It can be derived from the above example that the Muslim jurists were well aware of the important function of a receiver/administrator in bankruptcy and this is why they elaborated his role with such interest. It shows the maturity of Islamic law which was compiled centuries ago but which did cater for the specificities and needs of all the ages, including the modern age.

Conclusion:

Many Muslim majority countries today are modifying their laws and undergoing the process of implanting Islamic laws into their respective legal systems. This is particularly the case with commercial, business or finance laws which are undergoing modification due to the rapid growth of Islamic banking and finance. Since Islamic financial institutions are unique, they need different legal infrastructure. For this purpose, the existing laws of these countries need to be modified to a considerable extent. Insolvency and bankruptcy is one area of Islamic commercial law which has received minimum attention in this connection. There are two fundamental reasons for this trend. First, there are only individual default cases of some *sukuk* instruments and we have not yet seen a widespread collapse of numerous Islamic financial entities. Therefore, the stakeholders pay least attention to designing some effective and efficient insolvency regimes for Islamic finance. Second, it is usually thought the Islamic insolvency law mainly dealt with individuals while the contemporary world is a world of corporate entities. Therefore, it is misunderstood that Islamic insolvency law cannot be applied in the modern context. However, as we have discussed in this paper, the Islamic insolvency law is well elaborated and it covers all the contemporary aspects of insolvency. Therefore, it is needed that this law be studied extensively and detailed rulings about corporate bankruptcy be derived from the classical jurisprudential texts and be applied though the process of *ijtihad*. Only then can a comprehensive legal infrastructure be designed for Islamic financial institutions.

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