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Uddin, Md Akther

INCEIF, Kuala Lumpur, Malaysia

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Principles and Application of Preemption in Islamic finance: A critical analysis

Md Akther Uddin¹

Abstract

This paper discusses the concept of Al-Shuf'ah (pre-emption), literally means amalgamation, addition, subjunction or joining. In Islamic law, Al-Shuf'ah implies that a co-owner has the right to demand a pre-emption from his partner in a jointly owned property to purchase it at a certain price, before other people (Al-Zurqani, 1981). The study confirms (Al-Zuhayli, 2003) preemption is a weak right, fortified and confirmed by requesting its exercise; preemption was legalized to protect the preemptor's interests. All jurists agree that a partner in the property is a preemptor, but the Hanafis included neighbors as well, and preemption cannot result in a harm to the buyer by partitioning the sale. The study finds that in contemporary Islamic commercial law and transactions, the doctrine of Al-Shuf'ah might play an important role in partnership contracts, immovable real estate and can be drawn similar analogy in the context of venture capital and housing financing, moreover, many scholars argue for extending the principle of pure ownership rights in intangible assets, options and preemptive rights of the shareholders of a corporation.

Key words: Islamic finance, Al-Shuf'ah (Pre-emption), Al-Shafi (Preemptor), Ownership Rights

¹ **Corresponding author**, Graduate student in Islamic finance at INCEIF, Lorong Universiti A, 59100 Kuala Lumpur, Malaysia. Phone: +6 01112549795 Email: 1400225@student.inceif.org

1. Introduction

Shuf'ah means to combine, increase, or fortify and refers to the right of first refusal on the purchase of a jointly owned immovable property or neighboring property according to the Hanafi School. The pre-emptor combines what he owns by virtue of this right to his own property, thus increasing and fortifying it (Al-Zuhayli, 2003, p. 701). The foundation of the law is based on the social principle that all members of society should attempt to preserve the communal of their inherited property making for zoning and land use. The motive behind the law has been expediency and a desire to prevent the introduction of a stranger among co-sharers and neighbors of a specific locality likely to cause inconvenience or annoyance to the inhabitants and their privacy in use the enjoyment of their property rights. To resolve it Islam has introduced a way which is called Shuf'ah or pre-emption (Haqqi, 2009, p.165). Moving away from ownership rights of immovable property, Al-Shuf'ah plays an important role in partnership contracts and can be drawn similar analogy in the context of venture capital and housing financing, moreover, many scholars argue for extending the principle on partnership contract, property rights in intangible assets, options and preemptive rights.

The paper is divided into 4 sections, beginning with an introduction, followed by an overview of Shuf'ah in Shari'ah. In Section 3, contemporary applications and issues of Shuf'ah in commercial transactions are discussed. Finally, a conclusion is drawn up with reference to limitations and potential avenue for further research is suggested.

2. Al-Shuf'ah in Shariah

2.1. Definition of Shuf'ah

The Arabic term for preemption is derived from the verb shafaa, meaning to combine, increase, or fortify. This term is used for preemption since the pre-emptor combines what he owns by virtue of this right to his own property, thus increasing and fortifying it (Al-Zuhayli, 2003, p. 701).

Ayub (2012) defines Shuf'ah as the right of pre-emption in sale transactions, for example, a real estate sale in which some party possesses the right to force the seller to sell him all or part of the real estate in the event of a sale (Ayub, 2012, p.37).

Nadwi (1998) states in *Ma'jam Lughat ul Fuqahàa Shuf'ah* is defined as the right of a shareholder or a neighbor to take possession forcibly of a sold property (i.e. land or building) from the buyer at the price on which the agreement of sale was concluded.

2.2 Definition from different schools of Fiqh

Hanafi defined the term legally as the right to claim ownership of a sold immovable object, thus taking it from the buyer (with or without his consent) in exchange for its price and any expenses that he paid. It is legalized to avoid the harm caused by introducing new unwanted partners or neighbors. Thus, the Hanafis establish preemption rights for partners and neighbors of the owner of a property offered for sale.

The non-Hanafi jurists defined preemption as a contract-language based entitlement of one partner to take the portion of joint immovable property exchanged by his partner, and pay its price or value in exchange. In other words, it is a right established for an older partner over a new partner, to take ownership of his share with or without his consent, with fair compensation. Thus they established preemption rights only for partners and not for neighbors.

The four major Sunni schools restricted preemption rights to immovable properties. Only Zahiris allowed it also for movable objects, such as animals.

This practice existed during the time of *Jahiliyah*. With some modifications, our beloved Prophet (pbuh) allowed it to remain.

2.3 Technical Terms Used in Al-Shuf'ah

- 1) *Shafi'*: The person who exercises the right of *Shuf'ah* (i.e. pre-emptor)
- 2) *Mashfu'*: The property over which the right is exercised (pre-empted)
- 3) *Mashfu' bihi*: The part of the land or building belonging to the pre-emptor which gives him as its owner the right of pre-emption.
- 4) *Jar Mulàhiq*: A neighbor whose building is fully joined to the property

2.4 The Grounds of Al-Shuf'ah in Shari'ah

It is reported that there was a consensus among the ulama in legalization of *shuf'ah* but al-Rafi'i has quoted that Jabir ibn Zaid of the *tabi'ins* denied it. However, proofs of the legality of preemption (*Al-Shuf'ah*) is taken from the *Sunnah*, and consensus:

2.4.1 Proof from the Sunnah is Established by Numerous Hadiths

It was narrated on the authority of Jabir (mAbpwh) that the Prophet (pbuh) ruled that preemption rights are established for undivided properties. If boundaries are delineated, and roads are paved and delineated, then there is no preemption any more. In another narration, this ruling was applied to land, homes, and orchards.

In another Hadith narrated by Jabir (mAbpwh):

“A neighbor is more worthy of buying his neighbor’s property. Thus, his decision must be awaited, even if he is absent. This is legalized since they share a road”.

Samurah (mAbpwh) narrated the Hadith:

“the neighbor of a house is more worthy of buying it than a third party”.

Abu Rafi (mAbpwh) states that: “A neighbor has a first right to buying adjacent property”.

Ahadith narrated in Shahih Muslim (vol.III, p.1229, hadith no. 1609):

“Whosoever has a co-share in a house or palm grove should not sell it till he has the permission of his co-sharer, who if he is willing to take may empty it, but if does not like (to take it) he should leave it. “

2.4.2 Proof is Provided by the Consensus (Ijma)

In this regard, ‘ibn Al-Mundhir (cited in al-Zuhayli, 2003, p.702) said that all scholars are in agreement regarding preemption rights for a partner who has not engaged in delineation of the boundaries of his property, be it land, a real estate, or an orchard.

Al-Asamm (cited in al-Zuhayli, 2003, p.702) who disagreed with the above consensus by arguing that it causes harm to property owners as buyers will be discouraged from trying to buy any property for which preemption rights are established, as a result, owner may not get the appropriate price for his property.

However, his opinion was rejected as it contradicts the well-established Hadiths in this regard, as well as the consensus that was reached prior to his dissent.

2.5 Wisdom (Hikmah) of Legalizing Preemption

1. To prevent the harm caused to a property owner by introducing a permanent relationship of partnership or neighborhood (worse in case of new partner act poorly/badly or has enmity)
2. To avoid transaction costs and harm caused by dividing the property (All Sunni Schools support); moreover, forbidden on the basis of the Hadith: "No harm is allowed in Islam".
3. A good partner or neighbor should protect the benefits of another partner or neighbor.

In short, of the merits of Shuf'ah Qadi Zadah(d.988H) mentioned by Haqqi (2009) said, "is to remove harm to the neighborhood."

In addition to that, when we talk about partners or neighbors right, the Prophet (PBUH) said to the effect:

"The Angel Gabriel always directs me to pay attention to the neighbor which made me to think that he will consider him as heirs" (Shahih Muslim, vol IV, p.2025, hadith no 2624; ibn Majah, Sunan, vol. II, p.1211, hadith no. 3673-4)

And he also said to the effect:

"Whosoever believes in Allah and the Hereafter he should honor his neighbor" (Shahih Muslim, vol.I, p68, hadith no. 47).

2.6 Preemption Conditions

According to Al-Zuhayli (2003), jurists had some differences over the following five major conditions of preemption:

- 1) *Negation of all seller ownership* rights in the preempted, with no options established
- 2) *The contract must be a commutative* financial contract, such as a sale or equivalent
- 3) *The contract must be valid*
- 4) *The preemptor must have ownership from the sale time* to the time of ruling that he has the right of preemption.
- 5) *The preemptor must be objecting to the sale*

In addition to above give conditions, the following conditions were stipulated by some jurists (Al-Zuhayli, 2003; Hassan, 1986):

- 1) The non-Hanafis stipulated further that the preemptor must be a partner in the sold property, thus excluding preemption by neighbors and also object of sale to be an unidentified share in a divisible property.
- 2) All jurists agreed that the preemptor must take the entire sold part of the property, to avoid harming the buyer by portioning his contract. This follows from the principle that one harm can not be removed by imposing another.
- 3) Property must be immovable
- 4) Property cannot be owned by the preemptor prior to sale

In brief, the instigating factor for preemption is partnership or neighborhood, and its condition is that the object of sale and preemption is an immovable property (which may be only the upper or lower portion of a building). Mailiks stipulated four cornerstones for preemption while Shafis and Hanbalis enumerated three cornerstones for preemption:

In the following section, some of the important terms conditions of Al-Shuf'ah are going to be discussed briefly.

2.7 Object of Pre-emption

The four major Sunni schools agreed that no preemption rights are established for movable properties, such as animals, clothes, etc (Al-Zuhayli, 2003; Hassan, 1986). They based this ruling on this Hadith narrated by Muslim, Al-Nasai, and Abu Dawud:

“Muslims are in agreement that preemption rights are established in immovable objects such as homes, land, orchards, wells, buildings, trees, etc. However, there are differences over preemption rights for other properties”.

Al-Zuhayli (2003) further explains the issue of object of Al-Shuf'ah in vertical neighborhood, easement rights, preemption rights in ships, and preemption in crops, fruits, and trees (Al-Zuhayli, 2003, pp. 705-709)

2.8 Al-Shafi (the Preemptor)

Al-Zuhayli (2003) confirms that the Hanafis ruled that a preemptor may be a partner or a neighbor, while the non-Hanafis ruled that only a partner can be preemptor.

2.9 Degrees of Priority

Degree of priority in *Shuf'ah* are debated among different school (Nadwi, 1998; Zuhayli, 2003), however following priority order can be established as summarized by Nadwi.

1. The first right belongs to the shareholders in the property; if they do not take up the option then those who share in the benefit; and if they do not take it up then the neighbors. And a neighbor who shares in the benefit will have priority over one who does not.
2. If in a double-storey building the ground floor belongs to one person and the upper floor belongs to another, then each is *Jàr Mulàhiq* to the other.
3. If two houses share a common wall, then they both are regarded as sharing a common property. That is to say, each will have first right of *Shuf'ah* over the other. But if one neighbor has fixed his rafters or joists on to his neighbor's wall, or is resting his slab on it, and the neighbor has not objected, this does not make them shareholders. They will only be regarded as neighbors.
4. If several persons have a right of *Shuf'ah*, but their shares in the property are not equal, even so they will all have an equal right of *Shuf'ah*. For example, there are three share-holders in a property. One has a half share, one has a third, and one has a sixth. So, if the person with the half share sells his share, then both of the other two shareholders will have an equal right of *Shuf'ah*. And if they take up the right then they will both pay an equal amount and have equal shares in that part. The difference in their shareholdings will not affect the matter.

In the same way that a Muslim can exercise his right of *Shuf'ah* over another Muslim, in an Islamic state a non-Muslim neighbor will have the same right to pre-empt a property from a Muslim. The writer of *Hidàyah* explains this on rational grounds that since the purpose of this law is to avoid harm and in this Muslim, non-Muslim, just, and unjust are all equal, so also in this right they are also equal.

Hassan (1986) pointed out that in addition to the above order of priority, the right of creditor must be considered. He further argued that the creditor may have more right than all of above preemptors, when the borrower is unable to pay the debt in movable or immovable property. It was reported that the Prophet (pbuh) had decreed preemption in debt.

2.10 Legal Status Rulings

The Hanafis ruled that preemption rights are established after any sale, including defective sales that were not voided for some reason, or sales including a buyer-option but seller-options is not established, as such options preserve the seller's ownership.

All schools agree that preemptor can own the property in one of two ways: (i) the buyer may give it to him voluntarily, or (ii) through a court order, even before taking possession of the property. On the other hand, the Malikis ruled that ownership through preemption may be established in three ways: (i) through a court order, (ii) payment of the price to the buyer, and (iii) declaring before witness that he took the property through preemption, even in the buyer's absence (Al-Zuhayli, 2003). Different terms and conditions of compensation in Al-Shuf'ah have been discussed thoroughly by Al-Zuhayli in the second volume of his classical book *Financial Transactions in Islamic Jurisprudence*.

2.11 Preemption Procedures

The jurists classified preemption as a "weak right". Thus, they ruled that it can only result in ownership if the preemptor abides by its specific procedures, including requesting to exercise his right immediately upon unknowing of the sale.

Al-Zuhayli stated that the majority of jurists require the preemptor to request the exercise of his preemption right immediately, in part based on the Hadith:

"Preemption is like unwrapping a head-dress"

They also based this ruling on their view that buyer may be harmed if the preemptor is allowed to take a long time to demand exercising his right, since his ownership of what he bought will remain uncertain for that long period.

On the other hand, the Malikis granted a preemptor a whole year to request exercising his right. They based their ruling on the view that silence does not invalidate a legal right for a Muslim, unless other factors require such a dropping.

In brief, the Hanafis ruled that three requests are required in preemption: i) immediate request to exercise the preemptors right, ii) request of witnessing that he wishes to exercise his right, and that the seller and buyer recognize that right, and iii) request of taking ownership of the sold property.

2.12 Changes in the Object of Preemption

Al-Zuhayli argues that status of the object of preemption may change while in the buyer's possession, before the preemptor's right is legally established. Therefore, it may have been resold, given as a gift, leased or loaned. Alternatively, additions to it may have been made, e.g. buildings or trees, or it may have suffered diminution. The effect of all such changes on preemption has been discussed in details (Al-Zuhayli, 2003).

2.13 Dropping Preemption Rights

There are various means of dropping preemption rights: (i) preemptor sale of his property; (ii) voluntary dropping of the right; (iii) guaranty of the price; iv) division of the object of preemption; and v) Death of a preemptor.

In summary, the Hanafis ruled that preemption rights are not inherited, even if the preemptor died after making the request, while the Malikis, Shafis, Hanbalis, and Zahiris ruled that they are inherited in that case. This difference in opinion only applies in the case where the preemptor died prior to a court order establishing his preemption. On other hand, all jurists agree that if he died after a court order gives him the right, but prior to paying the price and receiving the object of preemption, the sale is still binding for his heirs.

Zuhayli concluded the discussion of Shuf'ah by highlighting the following three points regarding preemption rights: a) preemption is a weak right, fortified and confirmed by requesting its exercise; b) preemption was legalized to protect the preemptor's interests. All jurists agree that a partner in the property is a preemptor, but the Hanafis included neighbors as well; and c) preemption cannot result in a harm to the buyer by partitioning the sale, e.g. if the preemptor requests to take only part of the object of sale and preemption (Al-Zuhayli, 2003, pp. 749-750).

3. Al-Shuf'ah, Application in Business and Issues

3.1 Al-Shuf'ah in Contemporary Land Law

Pre-emption is considered as the key Islamic land consolidation tool. Gulaid argued (cited in Sait and Tempra, 2015) that an Islamic Development Bank publication on land tenure asserts that in cases of land fragmentation "execution of pre-emption rights (shuf'ah) may in most cases, resolve such bottlenecks".

Sait and Temptra (2015) found that the doctrine of Shuf'ah has been elaborated by jurists through the history, for example, the Mughal legal treatise of the seventeenth century Fatawa Alamgiri, a compendium of Hanafi fiqh (Islamic jurisprudence), contains the Kitab al-Shufa (The book of Pre-emption). They also confirmed that the Ottoman Civil Code 1877 (Majalla), for example, had provisions (articles 960 and 1008-1044) dedicated to the right of pre-emption. The doctrine was part of laws of the Safavid, the Sokoto and other Islamic dynasties as well as Spanish Cordoba administration. Pointing out the weakness, they further argue that from the British in Asia and Africa to the Italians in Libya, the right of pre-emption mostly continued through colonial rule, despite general colonial impressions of the non-contractual pre-emption right, being a limitation on individual ownership, was a sign of backwardness of Shari'a law.

Sait and Temptra (2015) gave a detailed description on current practice of Shuf'ah in many Muslim countries:

Though the civil codes of most Muslim countries underwent modernization through codification or secularization mainly from British, French or Swiss sources, the institution of pre-emption (Shuf'ah) persisted. Under Article 936 of the Egyptian Civil Code 1949, a neighboring owner has the right to substitute himself instead of the purchaser in the sale of property, provided the various conditions are satisfied. The Turkish Civil Code 1926 (amended 2002), the Iranian Civil Code 1928 (amended 1982), the Lebanese Civil Code 1948, Iraqi Civil Code 1951, the Jordanian Civil Code of 1976 are among those recognizing pre-emption. Syria does not recognize pre-emption. The right is found in several other jurisdictions from Sudan to Nigeria in Africa, in the Middle East, United Arab Emirates to Saudi Arabia and all of South Asia. (Sait & Temptra, 2015, p.13)

3.2 Al-Shuf'ah and Intangible Asset

The AAOIFI Standard has also stated some intangible assets discussed in the classical books of *fiqh*. Among these intangible assets, the right of pre-emption (*Íaqq Al-Shuf'ah*) is one of them. According to AAOIFI, it is the right to take possession of the sold property from the buyer at its sale price, even without his consent. The right of pre-emption is established for the partner in property or for a neighbor (AAOIFI, 2012, Article 7/1).

AAOIFI gave more specific conditions for trading an intangible asset. They first differentiated between intangible rights established to the respective people to avoid harm such as the right of pre-emption (*Áaqq al-shufÑah*) where the person is permitted to dispose it but not to sell it, whereas the intangible rights and assets established initially as legitimate rights such as the right of vacating the premises (*Áaqq al-khuluww*) and easement rights (*Áaqq al-irtifeq*) can be traded and exchanged. They mentioned some rulings on compensation for rights (*al-I'tiyed Ñale al-Áaqq*) such as the prohibition of selling rights in the form of options (Boucheraoua et al., 2014)

3.3 Al-Shuf'ah and Venture Capital financing

Obaidullah (2005) argues that the process of Venture Capital (VC) financing involves granting of specific rights through covenants and agreements. Some of these rights have a clear parallel in Shariah and it is always possible for an Islamic VC to use such covenants as long as these are "fair and just." For example, some typical rights demanded by VCs in order to protect their investment, such as, the right of first refusal on sale of shares, tag-along rights (follow founder sale on pro rata basis) are quite similar in essence to the right to Shuf'ah granted by Shari'ah to co-owner of a joint property. The right embodies the Shari'ah norm of freedom from darar or detriment.

3.4 Al-Shuf'ah and the issue of Options

Kamali (2007) argues that most of the rules relating to the contract of sale, such as those pertaining to sanity, adolescence and consent of the contracting parties without which no contract can come into existence also apply to ijarah. Other rules of sale that apply to ijarah include options (*khiyarat*) such as *khiyar al-ru'yah* (option of viewing), *khiyar al-'ayb* and *khiyar al-shar'i* (option of defect, and option of condition), revocation (*faskh*), and *iqalah* (termination by mutual agreement), but not pre-emption (*shuf'ah*).

While arguing the validity of sale and exchange right to option, Bashir (2008) and Arbouna (2007) stated the Muslim scholars are of the opinion that the right of Shuf'ah cannot be exchanged. Because such a right is allowed in principle to prevent a harm or darar, which may be inflicted on the beneficiary of the right of Shuf'ah whether either due to presence of a disliked (troublesome) neighbor or to any other harm related to neighborhood. Therefore, by requesting an exchange for the transfer of this right to a third person, it is clear that the beneficiary will not be suffering any harm from this deal and as a result he should be prevented from making profit from this right. However,

the Malikis did not see any objection in selling this right after receiving it, because it is an established right, then, it could be exchanged like any other right. This opinion has also been reported from Abu Ishaq Ibrahim Ibn Ahmad al-Mirwazi, one of the leading Shafi scholars. Therefore, he argues that, to claim that a pure right like the right of Shuf'ah cannot be exchanged is just the opinion of some scholars while others consider it as a right, which can be sold. So, the argument, that the right of option is similar to that of Shuf'ah, and since the right of Shuf'ah cannot be exchanged, the right of option also cannot be exchanged in unfounded. In contrast, it will be argued that the right of option in the conventional option trading is similar to the right of Shuf'ah, which can be exchanged according to the Maliki School and Abu Ishaq Ibrahim Ibn Ahmad al-Mirwazi from the Shafi School, then, the right to option in the conventional options can be exchanged. Moreover, it is not only the opinion of some Muslim jurist, but it also in line with the general principle that all things, including contracts and conditions, are permissible and, there is no text from the Quran and Sunnah to prohibit the sale of such right. Therefore, it is incumbent upon those who prohibit the sale of such a right to provide evidence (Al-Bashir, 2008; Arbouna, 2007).

3.5 Al-Shuf'ah and the issue of joint seller in housing finance

While discussing Liquidation of Mortgage in Decreasing Partnership, Alsayed (2009) and Sadique (2012) confirm that the sale of an undivided share of an asset to a third party could involve rules of Al-Shuf'ah or pre-emption according to all schools of Islamic law. However, since the whole property, including the client's share, would normally be sold in this instance, this factor may not become pertinent, as the client would no longer remain a co-owner after the sale. In view of the above, transfer of legal title to the property in the name of the client, followed by the bank securing a legal mortgage over the same, does not appear to reflect the underlying transaction of co-purchase in an adequate manner.

3.6 Al-Shuf'ah and the issue of preemptive right share

Pre-emption right is the right of existing shareholders to acquire new shares issued by a company in a rights issue, a usually but not always public offering. This is the right, but not the obligation, of existing shareholders to buy the new shares before they are offered to the public. In this way, existing shareholders can maintain their proportional ownership of the company, preventing stock dilution (Brigham & Ehrhardt, 2013). In many jurisdictions, subscription rights are automatically provided for by statute, for example the UK, but in other jurisdictions it only arises if provided for under the

constitutional documents of the relevant company, for example the US. In such countries shareholder rights are often violated leading to proceedings at the Court of Justice of the European Union (Grechenig, 2007).

Obaidullah (2005) commenting on the article "Characterizing the Stock-Exchange from an Islamic Perspective" by Seifuddin I. Tag el-Din, brings the issue of al-Shuf'ah (Pre-emption) in Freedom from darar (detriment) and explains:

Freedom from darar refers to the possibility of a third party being adversely affected by a contract between two parties. If a contract between two parties executed with their mutual consent is detrimental to the interests of a third party, then it may enjoy certain rights and options. A case in point is the pre-emptive right (al-Shuf'ah) of a partner in joint ownership. This pre-emptive right may be extended by analogy, to a situation where existing minority shareholders are being adversely affected by any decision of the controlling shareholders, such as, to sell additional stocks to the public, to effect a change in management, asset sale, mergers and acquisitions etc.

Moreover, Akbar (1988) stated as most jurists agree that the right of a pre-emptor in a property owned by more than two members is proportionate to his share in the property. This principle increases the share of the member who holds a large number of shares. It can be argued that, over time, the owning party will be composed of one individual in whom responsibility is unified.

4. Conclusion

Shuf'ah means to combine, increase, or fortify and refers to the right of first refusal on the purchase of a jointly owned immovable property or neighboring property according to the Ḥanafī School. The pre-emptor combines what he owns by virtue of this right to his own property, thus increasing and fortifying it. According to the Maliki, Shāfi, and Ḥanbali schools the right of pre-emption applies only to a partner and not a neighbor. Ḥanafīs argue that this right is to prevent harm caused to a property owner and thus this extends to beyond the owner to include neighbors. Pre-emption is established if the immovable property is given by the owner in a commutative contract equivalent to sales (including a gift with compensation, or exchange for a debt). The doctrine of Al-Shuf'ah can be applied in contemporary land consolidation, in the context of venture capital and housing financing,

moreover, many scholars argue for extending the principle on partnership contract, property rights in intangible assets, options and preemptive right shares where further research is required to support these arguments.

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