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The Crescent and the Corporation: Analysis and Resolution of Conflicting Positions Between the Western Corporation and the Islamic Legal System

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THE CRESCENT AND THE CORPORATION: ANALYSIS AND RESOLUTION OF CONFLICTING POSITIONS BETWEEN THE WESTERN CORPORATION AND THE ISLAMIC LEGAL SYSTEM

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ABSTRACT: “The Crescent and the Corporation” identifies and analyzes points of conflict between both western corporate operations and western corporate financial practices and the Islamic legal structure. The article demonstrates why companies should be aware of Islamic law as it applies to the company, and the business advantage that compliance offers. With this as a backdrop, the article discusses the challenges of preserving a western-derived business structure and at the same time complying with Islamic law. In each particular situation, it proposes solutions that would enable the western company to avoid radically altering its practices or operations and yet still comply with Islamic law.

This article begins by laying out the theory and rules underlying the modern business corporation in the United States and the European Union, generally, the American Private Corporation, and the English Public Limited Company; the German Aktiengesellschaft; the Danish Aktieselskab; and other European country equivalents. From this point, it discusses the reasons for using models from those two regions and explores why a company operating in an Islamic environment or serving an Islamic market—domestic or abroad—should understand and may want to incorporate Islamic best practices. This section of the article discusses issues such as demographic shifts throughout the United States and the European Union, free trade, and increasingly global operations.

Next, the article discusses the theoretical corporate structure as it exists in the United States and Europe. Is there only one way to interpret this structure, and what are the realities of trying to apply a

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theoretical interpretation in the market place? From there, it attempts to define how the western corporation can operate under Islamic law, including financing the corporation, discussing interest implications of share dividends, debtor rights, and intra-company financing. Specifically, it addresses whether there is a conflict between a rigorously followed durable dividend policy, whether a bond that acts like a partnership interest gives the owner the same risks as a shareholder without commensurate protections, and whether secular legal distinctions encapsulate or are governed by Islamic law.

One of the most important parts of analyzing these aspects of the corporation in regards to Islamic law is that they can act as a barometer of how, and to what extent, a traditional western corporation will need to change in order to comport with Islam. Such compliance will allow the western corporation to operate more effectively in countries with Islamic legal systems, to better serve communities where Islam is the accepted moral or legal foundation, to better source capital, and to enable better cross-cultural cooperation and understanding.

The article concludes by proposing a method to guide corporations on *Sharia* compliance. The article suggests the creation of a particular international working group that would create an Islamic supplement to any particular state's relevant business act, keying that supplement to the act's articles on which they are based. This would enable uniform, relatively straightforward, and low cost compliance.

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I. INTRODUCTION²

Nowhere does classical Islamic law definitively address or define corporations or the corporate structure.³ This makes sense, as the “corporation”—legal entity, structure, purpose—is an outgrowth of Western economies.⁴ Nevertheless, as this article will demonstrate, to claim that corporations do not fall under the ambit of Islamic legal theory would not just be misleading, but would in fact be inaccurate. Theoretical definitions of a “corporation” aside, there are numerous aspects of a corporation that are governed by Islamic law, directly as well

² This article contains several transliterated words, for example “*Sharia*” that may be spelled in different ways.

³ IMRAN AHSAN KHAN NYAZEE, *OUTLINES OF ISLAMIC JURISPRUDENCE* 278 (Advanced Legal Studies Institute 2000) (“Corporations are not discussed in Islamic law, and their legality has to be judged in the light of general principles.”)

⁴ ROBERT W. EMERSON, *BUSINESS LAW* 331 (4th ed. 2003). In the 1500s, the English granted monopolies to individuals or groups. After independence, the United States created corporations by grant of charter. See generally Lee Drutman, *The History of the Corporation*, 1–3, <http://www.citizenworks.org/corp/dg/s2r1.pdf> (last visited Sept. 24, 2009) (politicizing but tracing the history of the corporation from the 1500s); Roy C. Smith, *Origins of the Corporation and Corporate Governance*, 1–2, http://w4.stern.nyu.edu/emplibrary/Smith.Roy_II.pdf (last visited Sept. 24, 2009) (the developing U.S. corporate landscape from the 1800s onwards). For more reading on the early development of the corporation in the United States, see generally JOSEPH STANCLIFFE DAVIS, *ESSAYS IN THE EARLIER HISTORY OF AMERICAN CORPORATIONS: EIGHTEENTH CENTURY BUSINESS CORPORATIONS IN THE UNITED STATES* (Harvard Univ. Press 1917).

as indirectly. For example, principal-agent relationships that exist in Western corporate law will be governed by Islamic agency rules on point;⁵ corporations engaging in financial transactions must abide by Islamic contractual restrictions;⁶ a corporation must structure its account receivables in a way that does not violate the *Sharia* prohibition on *riba* (interest);⁷ and a corporation that sources outside financing must be concerned with Islamic treatment of partnerships.⁸ On a more general level, a corporation must reconcile its purpose with what the Qur'an expects from the corporate officers on a personal level.⁹

If the purpose of this article was in and of itself to contrast one—or even several—particular aspects of Western business regulations to Islamic legal rules, then one could approach such analysis by distinguishing between the entity (corresponding corporate regulation) and the activity (corresponding securities regulations). Instead, this article aims to highlight large potential conflicts between two fundamental activities pertaining to the Western corporation—operating and raising funds—and Islamic Law.¹⁰ This article highlights potential conflicts within these two realms by analyzing specific scenarios of conflicts therein, and proposes several solutions to reconcile them. In fact, the only way to illustrate that there are large conflicts between

⁵ NYAZEE, *supra* note 3, at 228, 278.

⁶ *Id.* at 193.

⁷ See discussion *infra* Section III. E. 1.

⁸ See TONY RHODES, EUROMONEY ENCYCLOPEDIA OF DEBT FINANCE, 127–28 (Euromoney Books 2006); Muhammad Taqi Usmani, *Sukuk and their Contemporary Applications*, 9–11, http://www.failaka.com/downloads/Usmani_SukukApplications.pdf (last visited Sept. 11, 2009) (discussing partnership in bonding); see also discussion *infra* Section VI. A. 3.

⁹ See NYAZEE, *supra* note 3, at 86, 95–96 (discussing individuals' rights and duties that exist when the person has legal capacity); see also ZIAUDDIN SARDAR & MERYL WYN DAVIES, *THE NO-NONSENSE GUIDE TO ISLAM* 120–21 (Verso 2004) (explaining that all Muslims are subject to *Sharia* allegiance). Note that *Sharia* theoretically does not extend in its entirety to non-Muslims. See DANIEL E. PRICE, *Islamic Political Culture, Democracy, and Human Rights: A Comparative Study* 28 (Praeger Publishers 1999) (“Traditionally, Jews and Christians were given protected status (dhimmini) and were allowed to regulate the social and religious affairs of their communities.”).

¹⁰ There is a difference in terminology for United States and European publicly traded companies. Please refer to *infra*, note 14 and the relevant discussion in this article's main body. Please note that because of this difference, I use “corporation” and “company” (short for “public stock company”) interchangeably. Further, unless specified otherwise in this article, my use of “company” and “corporation” both refer to the “publicly traded stock corporation.” Interchangeability in the terms is also acknowledged in, RALPH HAUGHWOUT FOLSOM, RALPH B. LAKE, VED P. NANDA, *EUROPEAN UNION LAW AFTER MAASTRICHT: A PRACTICAL GUIDE FOR LAWYERS OUTSIDE THE COMMON MARKET* 523, n. 1 (Kluwer Law Int'l 1996).

the structures is by analyzing particular points of conflict, as rules that do not conflict with Islam can co-exist with Islamic law.¹¹

In this analysis, the article demonstrates why companies should be aware of Islamic law as it applies to the company, and the business advantage that compliance offers. Discussion of “corporate alternatives” that have developed in the Islamic world (which would also necessitate an activity versus entity based contrast), aside from their inclusion or use within the Western company as part of the company’s strategy to remain *Sharia* compliant—such as bond alternatives—also falls outside this article’s scope.¹² In sum, the article intends to illustrate the challenges of preserving a western-derived business structure and, at the same time, complying with Islamic law. This would be applicable to Western corporations that wish to expand into and source capital from “Islamic” countries and markets, or to entities from such markets that wish to utilize this business structure.

A constrained analysis of the Western corporation threatens to exclude from discussion some key elements of Islamic legal theory as it applies to the company. It would similarly be impossible to try to address all aspects of corporate operations, practices, and structure, as this would include more than just how the company operates, how the company is organized, the methods for raising investments, strategy of sales, metrics, and the large field of corporate governance.¹³ Some of these aforementioned topics in themselves would be of an unmanage-

¹¹ NYAZEE, *supra* note 3, 153, 160 (discussing the simultaneous existence of two legal systems).

¹² For example, *musharakah* and *mudharabah* partnership agreements. ANTHONY SHOULT, *DOING BUSINESS WITH SAUDI ARABIA* 218 (GMB Publishing Ltd. 2006) (“The contract of al-musharakah (joint venture profit sharing) is, in essence, similar to the conventional concept of a joint stock company”).

¹³ The Organization for Economic Cooperation and Development, *OECD Principles of Corporate Governance* 17–24 (2004), <http://www.oecd.org/dataoecd/32/18/31557724.pdf> (last visited Sept. 11, 2009) defines governance as follows:

Ensuring the Basis for an Effective Corporate Governance Framework: The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities. . .

The Rights of Shareholders and Key Ownership Functions: The corporate governance framework should protect and facilitate the exercise of shareholders’ rights. . .

The Equitable Treatment of Shareholders: The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights. . .

able wide scope, such as corporate governance, which includes the many rights of shareholders and the corporation's myriad of constituencies.¹⁴ Islamic legal theory would open the door even wider. Each of these aspects of corporate operations and structure could be analyzed under general Islamic law.¹⁵ For example, stakeholder rights may implicate property ownership laws. Or, shareholder rights in deciding direction of the company may lead to a corporate decision to launch in new markets (and necessitate analysis of how the company would structure its financing approach, say, outside versus inside) and investor relationship.¹⁶ Such a broad scope would derail any attempt to resolve the fundamental questions this article seeks to answer.

This article will lay out the theory and rules underlying the modern business corporation in the United States and the European Union, generally: the American Private Corporation, and the English Public Limited Company; the German Aktiengesellschaft; the Danish Aktieselskab; and other European country equivalents.¹⁷ The next

The Role of Stakeholders in Corporate Governance: The corporate governance framework should recognize [sic] the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the Sustainability of financially sound enterprises. . .

Disclosure and Transparency: The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company. . .

The Responsibilities of the Board: The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

¹⁴ DAVID E. SCHRADER, *THE CORPORATION AS ANOMALY* 141–42 (Cambridge Univ. Press 1993) (taking this principle one step farther, he argues that even the communities in which the corporation exists are intertwined with the corporate entity as interested parties in the corporation. He writes, “corporations can also legitimately be viewed as instruments of the society at large. One thing that seems to be perfectly clear about the corporation, speaking generally, is that any claim that it is the exclusive instrument of a single person or group is extremely likely to be wrong.”).

¹⁵ See NYAZEE, *supra* note 3, at 278.

¹⁶ For Islamic legal consideration of financing issues of banks, see M. Nasser Sulaeiman, *Corporate Governance in Islamic Banks*, http://islamic-world.net/economics/corporate_gov.htm (last visited Apr. 4, 2008).

¹⁷ In the United States, the term “corporation” implies “private,” as opposed to “public”; “public corporations” are meant to serve a government or public purpose. See EMERSON, *supra* note 4, at 335. EC law similarly draws a distinction between “public” and “private” company forms, though the implications are different; a Eu-

several pages will discuss the reasons for using models from those two regions; it will also explore why a company operating in an Islamic environment or serving an Islamic market, domestic or abroad, should understand and incorporate Islamic best practices.

Next, the article discusses the basic corporate structure as it exists in the United States and Europe. Is there only one way to interpret this structure, and what are the realities of trying to apply a theoretical interpretation in the market place? From there, it attempts to define how the Western corporation can operate under Islamic law. The article also examines financing the corporation, addressing interest implications of share dividends and debtor rights. Is there a conflict between a rigorously followed durable dividend policy and does a bond that acts like a partnership interest give the owner the same risks as a shareholder without commensurate protections, i.e., rights?

One of the most important aspects of analyzing these aspects of the corporation in regards to Islamic law is that they can act as a barometer of how, and to what extent, a traditional Western corporation will need to change in order to comport with Islam. Such compliance will allow the Western corporation to operate more effectively in countries with Islamic legal systems, such as Saudi Arabia and to some extent Malaysia, to better serve communities where Islam is the ac-

ropean private company may not be traded on a market, while a European public company, can be so traded. See Robert Drury, *The European Private Company*, 9 EUR. BUS. ORG. L. REV. 130–31 (2008). The “public stock company” is used to describe a European public company whose stock is traded on a market. See RICHARD M. STEERS & LUCIARA NARDON, *MANAGING IN THE GLOBAL ECONOMY*, 329 (M.E. Sharpe 2005). The Public Limited Company, or PLC, is an English/Irish entity. Most other European states have corporate forms that are more or less equivalent to the PLC or U.S. stock corporation. See ALAN GUTTERMAN, *INTERNATIONAL JOINT VENTURES* 59 (2001) (listing several stock corporation types by country); see also FRANK DORNSEIFER, *CORPORATE BUSINESS FORMS IN EUROPE: A COMPENDIUM OF PUBLIC AND PRIVATE LIMITED COMPANIES IN EUROPE* 112, 218–20, 394 (2005) (detailing different European stock companies, such as Germany’s AG (at 218), Ireland’s PLC (at 394), Estonia’s Aktsiaselts (at 112), etc.); Lett Law Firm, *Doing Business in Denmark – Company Law*, Nov. 2007, http://www.lett.dk/doing_business_in_denmark/company_law.aspx (last visited Apr. 4, 2008) (“3.1 Public Limited Companies (“Aktieselskaber”, abbreviated as “A/S”): The A/S is a limited liability company governed by the Danish Act on Public Limited Companies, which conforms to EU legislation by implementing the relevant directives in this area.”). For a basic European company comparison chart, see Lett Law Firm, *Doing Business in Denmark – Company Law*, Nov. 2007, <http://www.lett.dk/Default.aspx?ID=913> (last visited Sept. 11, 2009). For a basic international company comparison chart, see Types of Business Entity, Wikipedia, http://en.wikipedia.org/wiki/Types_of_companies (last visited June 14, 2009).

cepted moral or legal foundation, to better source capital, and to enable better cross-cultural cooperation and understanding.¹⁸

This article is a starting point, illustrating the many sources, influences, and considerations of Islamic law on the corporation—both for the success of the corporation and for the respect of its constituents.

II. LANDSCAPE

While both the U.S. and European landscapes are being remolded by laws that have been passed since financial scandals—like the Sarbanes-Oxley Act—the company has an established foundation in both the United States and the European Union.¹⁹

¹⁸ *Saudi Arabia Basic Law of Governance*, available at http://www.saudiembassy.net/about/country-information/laws/The_Basic_Law_Of_Governance.aspx (“CHAPTER ONE – GENERAL PRINCIPLES – Article 1: The Kingdom of Saudi Arabia is a sovereign Arab Islamic State. Its religion is Islam. Its constitution is Almighty God’s Book, The Holy Qur’an, and the Sunna (Traditions) of the Prophet (PBUH).”); see also CHARLES GLASSER JR., *INTERNATIONAL LIBEL AND PRIVACY HANDBOOK* 197 (2d ed. 2009); see also ANTHONY H. CORDESMAN, *SAUDI ARABIA ENTERS THE TWENTY-FIRST CENTURY* 134, vol. 1, (Praeger Publishers 2003); see also Peter W. Wilson, *Question of Interest: The Paralysis of Saudi Banking* 124 (Westview 1991); see also SANDRA MACKEY, *THE SAUDIS: INSIDE THE DESERT KINGDOM* 269 (Houghton Mifflin 1987) (providing writings on the use of *Sharia* in Saudi Arabia); see also Jamila Hassain, *Islam: Its Law and Society* 47 (2d ed. 2004) (providing writings on Malaysia). In MAMARINTA MABABAYA, *THE ROLE OF MULTINATIONAL COMPANIES IN THE MIDDLE EAST: THE CASE OF SAUDI ARABIA* 204–20 (Universal Pub. 2002), Mamarinta Mababaya discusses, through statistical analysis, the importance of cultural and religious awareness by multinational corporations in Saudi Arabia. Mababaya writes that “[t]he research findings are consistent with the view that both the MNC and managers and the other group of respondents agreed that Islamic cultural and ethical values are deemed important to be understood by multinational companies doing business or planning to invest in Saudi Arabia.” *Id.* at 204. Mababaya ends the analysis writing, “[a]s for the survey results, multinational customers are more concerned about the importance of the Islamic cultural and ethical values to be understood by multinational companies than the multinational managers themselves. This is not surprising as 62% of the customer respondents are Muslims who believe in the Qu’ranic verse that Islam is perfect and complete (Qur’an 5.3).” *Id.* at 220.

¹⁹ Sarbanes Oxley has changed the monitoring and reporting scheme for U.S. listed companies, including greater, arguably more frequent, disclosure in response to the 21st century financial scandals. As Mr. Michael G. Oxley put it, “Congress’s response to these scandals was the Sarbanes-Oxley Act, signed into law on July 30, 2002. With this legislation, Congress set about restoring investor confidence in our capital markets by strengthening the financial reporting and generally raising the bar in our public companies.” (*Sarbanes-Oxley at Four: Protecting Investors and Strengthening Markets, Hearing Before the Committee on Financial Services*, 109th Cong. 2 (2006) (statement of Michael G. Oxley, Chairman of the U.S. House of Representative’s Committee on Financial Services),

Two equally important reasons for U.S. and E.U. corporate analysis under Islamic legal theory is because of the entry of Islam into the European Union and the United States, and the entry of U.S. and E.U. companies into traditionally Islamic countries resistant to globalization.²⁰

available at <http://financialservices.house.gov/pdf/ArchiveHearing/109-121.PDF>). For particularly illustrative comments, see *id.* at 54–64 (statements of Maxine Waters and Christopher Cox on the benefits of Sarbanes-Oxley). Christopher Cox, Chairman of the SEC, states “Audit committee independence is another increasingly common theme around the world. United Kingdom, Hong Kong, Australia, Canada, and Mexico have all introduced reforms since 2002 requiring all members of the audit committee to be independent of management. A number of countries have even adopted requirements similar to the first half of the controversial Section 404 of Sarbanes-Oxley which requires management to do its own assessment of the company’s internal controls over financial reporting. Several countries, including the United Kingdom, Australia, and Hong Kong have adopted a comply-or-explain approach to a management assessment. Japan, France, and Canada all now have legislation or regulation requiring a management assessment of internal controls. Still others, such as Mexico, have corporate governance codes that recommend having a management assessment of internal controls.” *Id.* at 6–7. While some credit the new reporting requirements as good for protecting the U.S. investor, others cite this as imposing great costs, time investments, and burdens. See JERRY W. MARKHAM, *A FINANCIAL HISTORY OF MODERN U.S. CORPORATE SCANDALS: FROM ENRON TO REFORM* 467 (M.E. Sharpe, Dec. 30, 2005) (noting the huge cost of compliance with Sarbanes Oxley); EDWARD F. GREENE *UNITED STATES REGULATION OF THE INTERNATIONAL SECURITIES AND DERIVATIVES MARKETS*. (8th ed. 2005); Ulric J. Gelinis and Richard B. Dull, *Accounting Information Systems* 603 (8th ed. 2009) (“Current Environment for External Financial Reporting”); BENJAMIN MARK COLE, *THE NEW INVESTOR RELATIONS: EXPERT PERSPECTIVES ON THE STATE OF THE ART* 47–49 (Bloomberg Press 2003); see also JAN R. WILLIAMS, JOSEPH V. CARCELLO, *GAAP GUIDE LEVEL A, XXIX TO XXX* (2009). See generally NYAZEE, *supra* note 3, at 3 (giving more on the history of the British and American corporation); Caroline Fohlin, *The History of Corporate Ownership and Control in Germany, in A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS* 258–68 (Univ. of Chicago Press 2005) (tracing the history of Germany’s AG growth to the mid 1800s); Peter Hogfeldt, *The History and Politics of Corporate Ownership in Sweden, in A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS* 517 (Univ. of Chicago Press 2005); Abe de Jong & Ailsa Röell, *Financing and Control in the Netherlands: A Historical Perspective, in A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS* 467 (Univ. of Chicago Press 2005); Antoin E. Murphy, *Corporate Ownership in France: The Importance of History, in A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS* 185 (Univ. of Chicago Press 2005).

²⁰ Barry Rubin, *Globalization and the Middle East: Part One*, YaleGlobal Online <http://yaleglobal.yale.edu/display.article?id=744> (last visited Apr. 4, 2008) (“It is also important to remember that Islam is a religion with its own set of laws and a

A. *Western Demographics & Climate*1. *Europe*

The entry of Islam into Europe constitutes a large demographic shift.²¹ The growth can be attributed to both immigration and birth rate.²² It has been reported that “prior to World War II, the Muslim presence in Sweden was almost absent. In the last census that included statistical data on religious belief, in 1930, only fifteen individuals were recorded as Muslims.”²³ Though difficult to estimate, the Muslim population of Malmö, Sweden, for example, today likely stands at twenty percent, and Stockholm between sixteen and twenty-six percent.²⁴ In France, the Muslim population is estimated as high as ten

claim to provide the proper order for society. Thus, many elements of globalization can contradict, or be thought to conflict with, Islam, which is far less the case with Taoism, Buddhism, or Hinduism.”); see Thomson’s Fourth Quarter 2007 Mergers & Acquisitions Review, available at http://www.thomson.com/pdf/financial/league_table/ma/4Q2007/4Q07_MA_Financial_Advisory (noting that worldwide mergers and acquisitions in 2007 reached an all-time high of US \$4.5 trillion. During the year, there was “a flurry of cross-border investments by Middle Eastern and Asian investors” though this does not speak to investment from Western economies.); see discussion *infra* note 40 on the large increase of FDI into “Muslim Countries” in recent years.

²¹ CHRISTOPHER CALDWELL, REFLECTIONS ON THE REVOLUTION IN EUROPE: IMMIGRATION, ISLAM, AND THE WEST 12 (Doubleday 2009) (“Net migration into Europe from elsewhere is at record levels, at around 1.7 new arrivals a year. Europe’s future peace and prosperity depend on how easily these newcomers (and their children and grandchildren) assimilate into European life. In the middle of the twentieth century, there were virtually no Muslims in Western Europe. At the turn of the twenty-first, there were between 15 and 17 million Muslims in Western Europe, including 5 million in France, 4 million in Germany, and 2 million in Britain.”).

²² *Id.* at 12, 15–19; MARGARET K. NYDELL, UNDERSTANDING ARABS: A GUIDE FOR MODERN TIMES 136 (4th ed. 2005).

²³ See generally *Muslims in the EU: Cities Report*, Open Society Institute 8 (2007), available at http://www.eumap.org/topics/minority/reports/eumuslims/background_reports/download/sweden/index/edit/sweden.pdf.

²⁴ *Id.* at 8. In Stockholm, there are 125,000–200,000. *Id.* at 5. The total population of Stockholm is 771,038. *Id.* at 43. There are over 50,000 Muslims in Malmö. *Id.* at 47. The report also notes that there is great difficulty in determining the number of Muslims in Sweden due to legislation specifically blocking collection of such numbers. *Id.* at 5. Numerical inconsistencies in the report are testament to this, though the report mentions that 55,550 Malmö Muslims are registered to a mosque or prayer house, *id.* at 48, which is the same number reported as to the number of Muslims in Malmö, *id.* at 5. The report also declares that only 5% of the Muslims in Malmö practice Islam. *Id.* at 47; see also Sweden: Euro-Islam, <http://euro-islam.info/pages/sweden.html> (last visited Apr. 5, 2008); Malmö, Wikipedia,

percent.²⁵ French Muslims have become increasingly outspoken about their political underrepresentation.²⁶

Muslims are becoming increasingly vocal about the importance of religion in their lives as well.²⁷ This is not surprising given the sentiments on religious incorporation into day-to-day life; an Al Jazeera poll shows that forty percent of British Muslims in Britain want *Sharia*.²⁸ In fact, it is a little known fact that *Sharia* courts, though limited in scope and number, currently operate in the United Kingdom.²⁹

There has been political reaction to this growing ethnic presence.³⁰ While some “traditional” Europeans have responded nega-

<http://en.wikipedia.org/wiki/Malmo> (last visited Apr. 5, 2008) (stating Malmö has over 290,000 inhabitants).

²⁵ Jim Bitterman, *French Muslims Seek Stronger Voice*, CNN.com, Mar. 6, 2002, <http://archives.cnn.com/2002/WORLD/europe/03/06/france.muslims/index.html> (last visited Aug. 12, 2008); see also *France Has the Largest Number of Muslim Inhabitants in Western Europe*, <http://www.enjoyfrance.com/content/view/74/36/> (last visited Aug. 12, 2008). The CIA World Fact Book puts the number of French Muslims at 5–10%, while the Department of State’s Bureau of European and Eurasian Affairs puts that number at an estimated 10%. CIA – THE WORLD FACTBOOK – FRANCE, <https://www.cia.gov/library/publications/the-world-factbook/geos/FR.html> (last visited Feb. 10, 2008); BACKGROUND – FRANCE, <http://www.state.gov/r/pa/ei/bgn/3842.htm> (last visited Feb. 10, 2008) respectively; see also DataFinder – Population Reference Bureau, <http://www.prb.org/datafind/datafinder7.htm> (last visited Dec. 20, 2007).

²⁶ EDWARD MOXON-BROWNE, *WHO ARE THE EUROPEANS NOW?* 138 (Ashgate Publishing, Ltd. 2004) (“Muslim communities within Europe are expanding due to increased immigration and simultaneously becoming more active politically as second and third-generation Muslim communities who have now consolidated their socioeconomic and legal positions in European society are showing an increased desire for a political voice.”); see also ROBERT J. PAULY, JR., *ISLAM IN EUROPE: INTEGRATION OR MARGINALIZATION?* 105 (Ashgate Publishing 2004) (discussing the greater interest of UK Muslims in having a political voice. Note that seeking greater political voice does not mean greater integration, further evidenced by the number of *Sharia* supporters in the UK).

²⁷ Cf. Gabriel Milland, *Muslims: ‘Ban’ Un-Islamic Schools*, DAILY EXPRESS, Feb. 21, 2007, available at <http://www.express.co.uk/posts/view/1985/MUSLIMS-BAN-UN-ISLAMIC-SCHOOLS>.

²⁸ *Poll: 40% of UK Muslims Want Sharia*, AlJazeera.net, <http://english.aljazeera.net/archive/2006/02/20084915451911371.html> (last visited Aug. 12, 2008).

²⁹ Vijay Dutt, *UK Already Has a Few Sharia Courts*, HINDUSTAN TIMES, Feb. 9, 2008, available at <http://www.hindustantimes.com/StoryPage/StoryPage.aspx?id=2a6e0551-2b00-4742-b541-c72f8f1de9cf&&Headline=UK+already=has+a+few+Sharia+courts+> (last visited Feb. 12, 2008).

³⁰ IMMIGRATION AND ASYLUM: FROM 1900 TO THE PRESENT 438 (Matthew Gibney & Randall Hansen eds., 2005) (“Coauthors writing about Muslim political identities have observed that ‘many discussions have taken place about the feasibility of the

tively, with politicians using this sentiment as a springboard for political gain, others have begun to try to appeal to the Muslim community.³¹ In response to the growing Muslim political voice in his home country of the Netherlands, Dutch Justice Minister Piet Hein Donner, a Christian Democrat, has argued for an open-minded approach to the implementation of *Sharia*.³² Mr. Donner was quoted as saying “[i]t is a sure certainty for me: if two thirds of all Netherlanders tomorrow would want to introduce Sharia, then this possibility must exist. Could you block this legally? It would also be a scandal to say ‘this isn’t allowed!’ The majority counts. That is the essence of democracy.”³³

2. United States

The face of the United States is also changing. Although the number of Muslims in the United States is still proportionately small, that number is established and continues to grow.³⁴ Just as notewor-

integration of Islam within the European social and political systems. Cabinet ministers established political parties and their representatives, in reaction to national and international events, have developed views about the nature of Islam, which are being crystallized in the policies of the national governments. Central issues in these discussions are, for instance, the compatibility of Islam and parliamentary democracy and human rights, the fear of religious fundamentalism. . .”).

³¹ HANS SLOMP, *EUROPEAN POLITICS INTO THE TWENTY-FIRST CENTURY: INTEGRATION AND DIVISION* 28 (Greenwood Publishing Group 2000) (discussing how some nationalist and racist groups decry the loss of European culture and history due to growing Islamic presence in Europe). See *British National Party*, Wikipedia, http://en.wikipedia.org/wiki/British_National_Party (last visited Aug. 12, 2008); see also *National Front (France)*, Wikipedia, http://en.wikipedia.org/wiki/National_Front_%28France%29 (last visited Aug. 12, 2008).

³² *Sharia could come via democracy: Dutch minister*, http://web.archive.org/web/20070929120452/http://www.expatica.com/actual/article.asp?subchannel_id=1&story_id=33017 (last visited Aug. 11, 2009); see also Rutger Van Santen, *Uproar at Minister's Remarks About Sharia*, RADIO NETHERLANDS WORLDWIDE, Sep. 13, 2006, <http://www.radionetherlands.nl/currentaffairs/ned060913>. Even religious leaders have legitimized calls for *Sharia* in the West: in February 2008, the archbishop of Canterbury suggested Muslim communities be allowed to use *Sharia* for certain civil actions. See *Sharia Law in UK Is "Unavoidable"* BBC NEWS, Feb. 7, 2008, <http://news.bbc.co.uk/1/hi/uk/7232661.stm> (last visited Aug. 12, 2008); see also *Archbishop: 'I'm Sorry For Misleading Sharia Comments'* http://www.metro.co.uk/news/article.html?in_article_id=98441&in_page_id=34 (explaining that the Archbishop attempted to defuse the ensuing controversy by stating instead that English law must accommodate *Sharia* law) (last visited Aug. 12, 2008).

³³ *Sharia could come via democracy: Dutch minister*, *supra* note 32.

³⁴ NYDELL, *supra* note 22, at 136 (referencing the established position of Muslim Americans). There have been various claims as to the actual level of growth of

thy is the increased formal religious participation of Muslims and, to a lesser extent, the reports of conversions to Islam by both non-Muslim immigrants and non-immigrants.³⁵

Islam in America from both immigration and birth rate. For example, <http://www.2muslims.com/books/printable/19-muslims%20in%20america.pdf> cites a 6% growth rate of Muslims in America every year. See also ARSHAD KHAN, *ISLAM, MUSLIMS, AND AMERICA: UNDERSTANDING THE BASIS OF THEIR CONFLICT* 28 (Algora Publishing 2003) (stating that Islam is the fastest growing religion in America, though citing no numbers as evidence). On the other hand, the February 2008 Pew report, PEW RESEARCH CENTER, U.S. RELIGIOUS LANDSCAPE SURVEY: RELIGIOUS AFFILIATION: DIVERSE AND DYNAMIC, 51 (2008) available at <http://religions.pewforum.org/pdf/report-religious-landscape-study-full.pdf>, states that Muslim immigrants do not comprise a large, or growing percentage of total number of immigrants (Islam has remained about 1 or 2 % of all immigrants over the years). However, the May 2007 Pew report, states that “[t]he available evidence suggests that it may be at least as difficult to get a reliable estimate of the growth rate of the Muslim population as it is to estimate the total population. A careful study in San Diego, California, found that the Muslim population there was capable of doubling every six years. But a more rigorous study in Illinois found the Muslim population in that state doubled every 17 years, or only about a third of the increase estimated in San Diego.” American-born converts to Islam also increase the U.S. Muslim population, and researchers say getting accurate estimates of this group may be the most difficult challenge of all. Data on conversion from another religion to Islam is virtually non-existent, and the estimates that do exist are based on conversion rates to other faiths that may not apply to the Muslim experience.” PEW RESEARCH REPORT, *MUSLIM AMERICANS: MIDDLE CLASS AND MOSTLY MAINSTREAM* 13–14 (2007) available at <http://pewresearch.org/assets/pdf/muslim-americans.pdf>; Andrea Elliot, *Muslim Immigration Has Bounced Back*, reprinted in SEATTLE TIMES, Sept. 10, 2006, available at http://seattletimes.nwsourc.com/html/nationworld/2003252072_911muslims10.html; see also MUSLIM MINORITIES IN THE WEST: VISIBLE AND INVISIBLE, v–vii, 3 (Yvonne Yazbeck Haddad & Jane I. Smith eds., Altamira Press 2002) (discussing Muslims in the United States). The current population statistics of Muslims in the United States is also conflicting, but the consensus is that U.S. Muslims number between two million and six million. See GEORGE BRASWELL, *ISLAM AND AMERICA: ANSWERS TO THE 31 MOST-ASKED QUESTIONS* 82 (Broadman & Holman Publishers 2005) (stating that the average estimate of Muslims in the U.S. is 5.65 million); *Muslim Statistics for the U.S.: Number of Muslims in America*, http://www.adherents.com/largecom/com_islam_usa.html (last visited Aug. 12, 2008). In respect to growth from domestic births, the Pew study PEW RESEARCH CENTER, U.S. RELIGIOUS LANDSCAPE SURVEY: RELIGIOUS AFFILIATION: DIVERSE AND DYNAMIC, 8 (2008) available at <http://religions.pewforum.org/pdf/report-religious-landscape-study-full.pdf>, shows that “Mormons and Muslims are the groups with the largest families; more than one-in-five Mormon adults and 15% of Muslim adults in the U.S. have three or more children living at home.”

³⁵ See Amy Green, *More U.S. Hispanics Drawn to Islam*, CHRISTIAN SCIENCE MONITOR, Sept. 28, 2006, <http://www.csmonitor.com/2006/0928/p03s02-ussc.html>. Strikingly, the PEW RESEARCH CENTER, U.S. RELIGIOUS LANDSCAPE SURVEY:

3. Europe and the United States

It has been claimed that the government's failure to address integration of Muslims in Western society is one side of the coin, but that concentrated areas of Muslims have also moved more towards self-isolation.³⁶ Statistics showing that significant numbers of Muslims do at least look favorably to *Sharia* leads one to the natural conclusion that companies operating in heavily Muslim communities in the West should take this into consideration.³⁷ Corporations are central to the economic structure and affect multiple aspects of society, from the social structure to consumer trends to leisure activities and pastimes.³⁸ Hence, even when a company does not operate directly in

RELIGIOUS AFFILIATION: DIVERSE AND DYNAMIC, 27 (2008) available at <http://religions.pewforum.org/pdf/report-religious-landscape-study-full.pdf>, states that out of the affiliated U.S. Muslim population, 40% converted to Islam, compared to 60% which were raised as Muslim. See also IHSAN BAGBY, PAUL M. PERL & BRYAN T. FROEHLE, THE MOSQUE IN AMERICA: A NATIONAL PORTRAIT, A REPORT FROM THE MOSQUE STUDY PROJECT (Council on American-Islamic Relations 2001), available at http://www.cair.com/Portals/0/pdf/The_Mosque_in_America_A_National_Portrait.pdf. While numerically small, the rate of conversion to Islam in the United States is high. On average, 29% of regular mosque participants in the United States are converts, see *id.* at 3,16, and 91% of mosques in the last year had at least 1 conversion to Islam, see *id.* at 20, with a total of approximately 20,000 converts annually, see *id.* at 22. The more important figure, with correspondingly greater affect on marketing and business strategies, is the increased participation of Muslims in "Islamic life". There has been a 25% increase in the number of mosques between 1994 and 2000; 94% increase in the attendance rate of Friday prayer during that same period; and a 300% increase in the number of people associated with a mosque between 1994 and 2000. See *id.* at 3.

³⁶ See PAULY, *supra* note 26, at 84–85 (“[s]econd and third generation [Muslims] are more likely to choose to withdraw from [mainstream German society] rather than seek prosperity within the societal mainstream.”). The chapter on Germany does a particularly illustrative job of interlinking the government's failure and the Muslim community's move towards self-isolation by discussing the educational and employment shortcomings. *Id.* at 65–90. See also Jonathan Wynne Jones & Patrick Sawyer, *Muslims Must Do More to Integrate, Says Poll*, Telegraph.co.uk, Jan. 13, 2008, <http://www.telegraph.co.uk/news/main.jhtml?xml=/news/2008/01/13/nalien213.xml> (explaining a poll taken by the UK's Sunday Telegraph, revealing that a majority of Britons feel Muslims communities themselves do not do enough to integrate into what is, at least for now, mainstream society).

³⁷ *Poll: 40% of UK Muslims Want Sharia*, *supra* note 28.

³⁸ SCHRADER, *supra* note 14, at 141–42. A 2002 estimate places the number of individual U.S. stockholders at 84 million. More than four-fifths of household income gets pumped back into the U.S. economy as consumer spending, about 59% of which is on services. CAMPBELL R. MCCONNELL & STANLEY L. BRUE, MICROECONOMICS: PRINCIPLES, PROBLEMS, AND POLICIES 75 (McGraw-Hill Professional 16th ed. 2004). According to the 2005 census, there were over 116 million

a “Muslim community,” a company must be aware of *Sharia* and how to comply.

One must also remember that companies that choose to operate in Western markets, wholly or partly under *Sharia* principles, will concurrently operate under the United States or European regulatory framework.³⁹ Therefore, it is necessary to understand that underlying framework if one is to understand the difficulties and opportunities of operating a company in the West in accordance with *Sharia*.

B. Globalization

1. Entry of United States and European Union Companies into the Islamic World

Conversely, in the era of globalization, one can expect companies from the United States and the European Union, the two largest economic zones in the world, to be increasingly present in countries with significant Muslims populations.⁴⁰ If these companies have physically established themselves in these traditionally Muslim countries through branches and subsidiaries, the necessity to operate with “best *Sharia* practices” is evident. Similarly, a foreign company that does not establish a wholly or partially owned structure in the Islamic country but partners with a distribution company, importer, or third party sales representative, without having any corporate extension there, should also be mindful of *Sharia* compliance.⁴¹ This is also the case with a company that may look for investment abroad, such as floating

people employed by firms in the United States. 2005 Tabulations by Enterprise Size, U.S. Census Bureau, <http://www.census.gov/csd/susb/susb05.htm>.

³⁹ The company, in its Certificate of Incorporation or Bylaws, can set out that it will fulfill *Sharia* principles. See DEL. CODE. ANN. tit. 8, §§ 102(b), 109(b) (2006).

⁴⁰ WORLD BANK, INDONESIA: ECONOMIC AND SOCIAL UPDATE, Nov. 10, 2007, <http://siteresources.worldbank.org/INTINDONESIA/Resources/Country-Update/ecsos.update.nov2007.pdf> (describing the investment trend in Indonesia, the most populous Muslim country). “Foreign direct investment has been in a large surplus position in recent years, owing to strong gross inflows.” *Id.*; see Mohamed A. Ramady, *Foreign Direct Investment: A Saudi Score Sheet*, Sept. 11, 2006, <http://www.arabnews.com/?page=6§ion=0&article=86389&d=11&m=9&y=2006> (last visited Aug. 6, 2008) (“The Saudi Arabian government has sent some strong signals that it welcomes such a [foreign direct investment] inflow by establishing an empowered entity — the Saudi Arabian General Investment Authority (SAGIA) — to spearhead the FDI [foreign direct investment] effort.”).

⁴¹ ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, 1 GLOBALISATION AND SMALL AND MEDIUM ENTERPRISES (SMEs) 65–66 (OECD Publishing 1998) (discussing that in most SMEs, international expansion is often without sufficient strategy, and usually begins with exports; only 5–10% of SMEs set up operations or alliances abroad without first entering the foreign market through export).

stocks or bonds. So, too, should companies that export or provide services from their Western-based headquarters to Muslims in traditionally Islamic countries.

Though the U.S. or E.U. domestic corporation may be unable or unwilling to implement Islamic principles in their totality, the corporation may still be able to partially tailor their operations. This will enable the company to appeal to a broader client base, while concurrently minimizing liability potential under Islamic law.⁴²

2. Trade Cooperation

The number and scope of relationships the United States has with many countries with a sizable Muslim population in proportion to the entire country population or in absolute numbers has grown. Such countries include Jordan, Bahrain, Morocco, and Oman; and over the last several years, the United States has been conducting Free Trade Agreements with Malaysia.⁴³ Malaysian companies have implemented Islamic friendly products, comprising two-thirds of the world's Islamic Bond market, which one can assume will continue to grow.⁴⁴ Negotiated Free Trade Agreements could very well open up the Malaysian financial and services sector to United States corporations, and vice-versa, under an equal treatment provision, similar to what happened with the United States and Morocco.⁴⁵

⁴² This may be compliance to the degree necessary, or compliance enough to remain 'under the radar.' Such practices will be discussed more thoroughly in later sections of this article.

⁴³ U.S. Free Trade Agreements, Export.gov, <http://www.tradeagreements.gov/ExistingFTAs/index.htm> (last visited Apr. 5, 2008); see Doug Palmer, *U.S., Malaysia Plan to Resume Trade Talks Early 2008*, REUTEURS UK, Nov. 19, 2007, <http://uk.reuters.com/article/oilRpt/idUKN1933120320071119> (last visited Apr. 5, 2008); see also Background Note: Bahrain, Apr. 2009, <http://www.state.gov/r/pa/ei/bgn/26414.htm> (last visited Feb. 10, 2008) (stating that 98% of Bahrain's 708,000 population are Muslims); Background Note: Malaysia, Dec. 2008, <http://www.state.gov/r/pa/ei/bgn/2777.htm> (last visited Feb. 19, 2008) (stating that Malaysia has 60% Muslim population, but population of 27.5 million).

⁴⁴ Amadou Sy, *Malaysia: An Islamic Capital Market Hub*, INTERNATIONAL MONETARY FUND, SURVEY MAGAZINE: COUNTRIES & REGIONS, Sept. 18, 2007, available at <http://www.imf.org/external/pubs/ft/survey/so/2007/CAR0919A.htm>. For reference to other sukuks, see <http://www.zawya.com/sukuk/>.

⁴⁵ REPORT OF WORKSHOP ON MALAYSIA – US FTA, FTA MALAYSIA, Nov. 15, 2006, <http://www.ftamalaysia.org/article.php?aid=108> (last visited Mar. 11, 2008). See SEN. GRASSLEY OF COMM. OF FINANCE, UNITED STATES-MOROCCO FREE TRADE AGREEMENT IMPLEMENTATION ACT (TO ACCOMPANY S. 2677), S. REP. NO. 108-317, at 20 (2004) (including cost estimate of the Congressional Budget Office).

3. Searching for Investment Abroad: Pre-emptive Strategy

The United States sources a significant amount of funds from abroad, including from the Muslim world.⁴⁶ With the growing deficit and continued drop in the U.S. dollar, one would expect that eventually, U.S. companies would need another “edge” to continue to attract and retain foreign capital investment.⁴⁷ With societal attitudes as they are, U.S. companies must tailor offerings appropriately to maximize capital sourcing from Muslim countries.⁴⁸

⁴⁶ See BEA: FOREIGN DIRECT INVESTMENT IN THE U.S.: FINANCIAL AND OPERATING DATA FOR U.S. AFFILIATES, http://www.bea.gov/international/xls/mousa_selected_ctry.xls (last visited Feb 10, 2008); see also Tanya C. Hsu, *The United States Must not Neglect Saudi Arabian Investment*, Sept. 23, 2003, http://www.saudi-american-forum.org/Newsletters/SAF_Essay_22.htm (last visited Sept. 11, 2009); IslamOnline.net, *Saudi Investors Threatening to Pull Money out of U.S. Markets*, <http://www.islamonline.net/English/News/2002-08/20/article46.shtml> (last visited Dec. 20, 2007). For foreign direct investment in the United States, see generally ELENA NGUYEN, *THE INTERNATIONAL INVESTMENT POSITION OF THE UNITED STATES AT YEAREND 2006*, July 10, 2007, http://www.bea.gov/scb/pdf/2007/07%20July/0707_iip.pdf (noting specifically that the value of foreign owned assets exceeds U.S. owned assets abroad).

⁴⁷ *The Current Account Deficit and the US Economy: A Hearing Before the Budget Committee of the United States Senate*, 110th Cong. 1, (2007) (statement of C. Fred Bergsten, Director, Peterson Institute for International Economics), available at http://budget.senate.gov/democratic/testimony/2007/Bergsten_AcctDef020107.pdf (discussing the huge trade deficit that could cause a quick devaluation of the U.S. Dollar and impact on the U.S. trade position); see PAUL R. KRUGMAN, *CURRENCIES AND CRISES* 33 (Massachusetts Institute of Technology Press 1992) (explaining the drop in currency has not yet led to capital flight); see also *FX Crossroads: Will the Decline in the USD become Disorderly?* (2007), [http://danske-analyse.danskebank.dk/abo/FXC14112007/\\$file/FXC_14112007.pdf](http://danske-analyse.danskebank.dk/abo/FXC14112007/$file/FXC_14112007.pdf) 1 (last visited Aug. 11, 2009); see also Basic Chart for USD/EUR, Yahoo! Finance, <http://finance.yahoo.com/q/bc?s=USDEUR=X&t=5y> (last visited Dec. 20, 2007) (setting forth the U.S. dollar to euro conversion rate); Currencies Center, Yahoo! Finance, <http://finance.yahoo.com/currency/convert?from=USD&to=CAD&amt=1&t=5y> (last visited Dec. 20, 2007) (setting forth the U.S. dollar to Canadian dollar conversion rate); Currency Converter, Yahoo! Finance, <http://finance.yahoo.com/currency/convert?from=USD&to=CHF&amt=1&t=5y> (last visited Dec. 20, 2007) (setting forth the U.S. dollar to Swiss franc conversion rate).

⁴⁸ There is a generally negative Muslim perception of the West. See generally EUROPE'S MUSLIMS MORE MODERATE - THE GREAT DIVIDE: HOW WESTERNERS AND MUSLIMS VIEW EACH OTHER, The Pew Global Attitudes Project, June 22, 2006, <http://pewglobal.org/reports/pdf/253.pdf>. But see Anthony Weiss, *Attachment to Israel Declining Among Young American Jews*, <http://www.forward.com/articles/11550/> (last visited Aug. 13, 2008) (explaining that a new study indicates that American Jews connection to Israel is declining).

III. INTERACTION OF THE STRUCTURES

A. *Interpreting Without a Specific Set of Corporate Rules*

The four primary sources of law in Islam are the *Quar'an*, the *Sunnah*, *ijma*, and *qiyas*.⁴⁹ In the pursuit of judging corporations "in the light of general principles," the logical next question would be whether rules governing corporations could still be derived by analogy through *qiyas*, hence creating some "definitive" Islamic corporate law.⁵⁰ For example, one may reasonably, though incorrectly, try to analogize the partnership of a man and woman to the merger of two companies to apply those marital laws.⁵¹

There are three elements of Islamic rule of law.⁵² These three elements are *Allah* the lawgiver, the act to which a command is connected, and the individual who must fulfill that command.⁵³ An individual's obligation to act stems from duties prescribed by the lawgiver.⁵⁴ Such obligations are binding on all Muslims who possess the legal capacity to comply.⁵⁵ Some examples of individuals relieved from action due to lack of legal capacity are children under a certain age, or individuals who are sick and cannot fast.⁵⁶ Aside from these narrow exceptions, being a Muslim means that one must fulfill the prescribed obligations.⁵⁷ As such, one must pray five times a day, fast during Ramadam, and pay *Zakat*, amongst other duties.⁵⁸

Since the corporation is a legally fictitious entity, a juridic construct of Western law, and since a fictitious person does not exist in Islamic law, the corporation has no specific rights or obligations.⁵⁹ Hence, using *qiyas* to extend the law that applies to individuals to something not recognized would seem inapplicable.

Though there is nothing directly on point for corporations, there are legal bounds that may constrict corporate operation.⁶⁰ As individual relationships, the law governs both active partnerships

⁴⁹ NYAZEE, *supra* note 3, at 124.

⁵⁰ *Id.* at 278.

⁵¹ Note that any real comparison would be ill-conceived, as the orientation of the rules governing marriage appears to be strictly "corporeal-centric," for lack of a better description. *See Id.* at 102, 291 (discussing the lack of acknowledgement of the fictitious person and "[c]onsent in marriage (legal capacity)").

⁵² *Id.* at 86.

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ NYAZEE, *supra* note 3, at 90, 95, 96.

⁵⁶ *Id.* at 97, 101-03.

⁵⁷ *Id.* at 95, 100 (providing a brief outline of when complete capacity attaches).

⁵⁸ *Id.* at 90, 91, 95, 100.

⁵⁹ *Id.* at 102, 287; *see* discussion *supra* Section I. Corporations.

⁶⁰ NYAZEE, *supra*, note 3, at 278.

(where work comes from both sides) and passive partnerships (where work comes from one side).⁶¹ The corporation never engages itself in any type of prohibited behavior because not being a corporeal person, it is not able to do so.⁶² Rather, Islamic law applies to the company through the individuals who make the decisions that bind the company, employees that carry out associated duties, and customers which support the company with their funds. Taken to its strictest level, Islamic law could even apply to “corporate life”; for example, employee dress code, interaction and separation of men and women, etc.⁶³ Share ownership is the enabling mechanism and silence is tacit acceptance at best, approbation at worst. Overall, involvement makes for culpability.

Difficulties in implementing Islamic governance of corporate operation will also depend on the social structure and economic and political environment. The Saudi Commission’s Capital Market Authority’s Capital Market Law passed in 2003 is secular. In fact, there is not one reference to any Islamic law or other Islamic code in the Capital Market Law.⁶⁴ However, the Capital Market Authority’s Capital Market Law is not exhaustive and it is assumed a company will still have to comply with general Saudi laws. The Basic Law of Governance of Saudi Arabia in Article 1 states that “[t]he Kingdom of Saudi Arabia is a sovereign Arab Islamic State. Its religion is Islam. Its constitution is Almighty God’s Book, The Holy Qur’an, and the Sunna (Traditions) of the Prophet (PBUH).”⁶⁵ Article 17, addressing economic principles, states that “[o]wnership, capital and labor are basic components of the economic and social entity of the Kingdom. They are personal rights which perform a social function in accordance with the Islamic *Sharia*.”⁶⁶ Even if the corporation is not operating in a *Sharia* jurisdiction, investors may be. Such investors may demand that they are protected under Islamic law, for example, from their in-

⁶¹ *Id.*

⁶² NYAZEE, *supra* note 3, at 102.

⁶³ Cf. JON ARMAJANI, DYNAMIC ISLAM: LIBERAL MUSLIM PERSPECTIVES IN A TRANSNATIONAL AGE 108 (Univ. Press of America, Inc. 2004) (addressing veiling and segregation of women in Islam, and its relationship with the instruction of modesty); MUHAMMAD BAQIR BEHBUDI, THE QURAN: A NEW INTERPRETATION 211 (Colin Turner trans., Curzon Press 1997) (translation of the Qur’an’s statement on modesty); JOHN L. ESPOSITO, WHAT EVERYONE NEEDS TO KNOW ABOUT ISLAM 95–98 (Oxford Univ. Press, 2002) (discussing modesty and female dress).

⁶⁴ KINGDOM OF SAUDI ARABIA CAPITAL MARKET LAW (Capital Market Authority trans.), http://cma.org.sa/cma_cms/upload_sec_content/dwfile20/Capital%20Market%20Law.pdf (last visited Dec. 21, 2007).

⁶⁵ *Saudi Arabia Basic Law of Governance*, *supra* note 18.

⁶⁶ *Id.*

vestments being used for *haram* activities or securing profits through *haram* means.

In sum, there will be substantial cross-over. Islamic corporate governance must use Islamic legal theories that apply to individuals and superimpose that on the corporate practices and corporate officers.⁶⁷

B. Operating Under the State's Legal Framework in the U.S. Environment

A U.S. corporation is normally described as an entity organized under state law that is subject to the corporate law and regulations of that state.⁶⁸ Such state rules address issues ranging from shareholder reporting, voting, and information rights to rules concerning corporate mergers.⁶⁹ While the various states all have incorporation laws and allow any individual to incorporate or any company to re-incorporate,

⁶⁷ NYAZEE, *supra* note 3, at 278 (“Corporations are not discussed in Islamic law, and their legality has to be judged in the light of general principles.”)

⁶⁸ ROBERT I. LANDAU & JOHN E. KRUEGER, *CORPORATE TRUST ADMINISTRATION AND MANAGEMENT* 6–7 (5th ed. 1998) (“A corporation is the creature of the state and exists only by virtue of a charter granted by the state [. . . and] because a corporation is a creature of the state, it can exercise only those powers specifically granted to it by the state.”. . . “A corporation is subject not only to the limitations contained in its charter but also to all the laws and regulations promulgated by the legislature or regulatory authority of the state of incorporation, in addition to those of any federal agency having jurisdiction over the corporation or its business activities.”); see also EMERSON, *supra* note 4, at 331–32, 339 (stating that state corporate commissions create corporations under statute); JEFFREY S. RUSSELL, *SURETY BONDS FOR CONSTRUCTION CONTRACTS* 69 (ASCE Publications 1999) (defining a corporation); EDWARD E. SHEA, *THE MCGRAW-HILL GUIDE TO ACQUIRING AND DIVESTING BUSINESSES* 372 (McGraw-Hill Professional 1998) (“In the United States, business corporations are organized under state statutes, commonly called general corporation laws or business corporation laws. Few corporations are organized under federal laws, the most common being national banking associations organized under the National Banking Act administered by the U.S. Comptroller of the Currency.”).

⁶⁹ For rules on voting, see DEL. CODE. ANN. tit. 8, § 211 (2006). For information rights, see DEL. CODE. ANN. tit. 8, §§ 220–21 (2006). For rules concerning corporate mergers, see DEL. CODE. ANN. tit. 8, §§ 321–30 (2006). It is important to note that while the Revised Model Business Corporation Act has shareholder reporting requirements, though arguably toothless, the Delaware General Corporation Law lacks any such requirements. Compare MODEL BUS. CORP. ACT § 16.20, with DEL. CODE. ANN. tit. 8 §§ 220–21 (2006). Note also that the Securities Exchange Act of 1934 also establishes certain rules pertaining to shareholder list access. See Securities Exchange Act of 1934, 17 C.F.R. 240.14a-7 (2008).

a large number of publicly traded companies are incorporated in Delaware.⁷⁰

Corporations can be owned by one or more individuals, or can be publicly traded on the stock exchange.⁷¹ If owned by just a few individuals, such a “close corporation” may be regarded under the scrutiny of partnership treatment rather than traditional corporate treatment, the rationale being that parties to a close corporation can more easily come to an agreement with each other on particular issues rather than having to rely on the courts to enforce rights.⁷² Once a firm is traded on the stock market, it becomes more subject to highly uniform federal laws and regulations, such as the Sarbanes-Oxley Act⁷³; these requirements exist in addition to state laws, and focus heavily on financial reporting, disclosure and certification.⁷⁴ In addition, firms that list publicly are also subject to requirements placed on them by the various trading organizations, such as the New York Stock Exchange.⁷⁵

Incorporation is not the only way to structure a business. There are other options, such as Limited Liability Corporations (LLCs), General Partnerships (GPs), Limited Partnerships (LPs), and

⁷⁰ ROGER E. MEINERS, AL H. RINGLEB & FRANCES L. EDWARDS, *THE LEGAL ENVIRONMENT OF BUSINESS* 401 (West Publishing Co. 1994) (“Every state has laws concerning some aspects of corporation and partnership formation, operation, and dissolution”); Delaware Division of Corporations – How to Incorporate in Delaware, <http://www.corp.delaware.gov/howtoform.shtml> (last visited Apr. 6, 2008).

⁷¹ PETER J. EISEN, *ACCOUNTING* 386 (5th ed. 2007); see also EMERSON, *supra* note 4, at 337; MICHAEL SPADACCINI, *BUSINESS STRUCTURES: FORMING A CORPORATION, LLC, PARTNERSHIP, OR SOLE PROPRIETORSHIP* 114–15 (Entrepreneur Press 2007); CHRISTOPHER C. NICHOLLS, *CORPORATE LAW* 118–21 (Emond Montgomery Publication 2005).

⁷² NICHOLLS, *supra* note 71, at 120. SPADACCINI, *supra* note 71, at 114–15.

⁷³ *ECONOMIC SURVEY OF EUROPE*, ECONOMIC COMMISSION FOR EUROPE 108 (United Nations Publications 2003) (stating that once firms are publicly traded, they are subject to highly uniform federal laws); AMERICAN BAR ASSOCIATION, SECTION OF ANTITRUST LAW, *ANTITRUST COMPLIANCE: PERSPECTIVES AND RESOURCES FOR CORPORATE COUNSELORS* 37 (2006) (pointing out that “the effect or application of Sarbanes-Oxley is [not] limited to publicly traded companies. Although, on its face, the statute seems to target public companies, private firms are increasingly realizing that prudence dictates that they too comply with the statute’s stringent regulations.”).

⁷⁴ See Sarbanes-Oxley Act of 2002, §101; see also Securities Exchange Act of 1934 Rules, 17 C.F.R. 240.12–13 (2008).

⁷⁵ See Securities Exchange Act of 1934, 17 C.F.R. 240.19 (2008); *ECONOMIC SURVEY OF EUROPE*, *supra* note 73, at 108; NYSE RULES, <http://rules.nyse.com/NYSE/NYSE> (last visited Feb. 11, 2008).

Professional Corporations such as the Professional Association (PA).⁷⁶ In 2004 there were approximately 3.8 million LLCs in the United States; however, in 2005 there were nearly 9 million corporations, of which approximately 6,400 were listed in the New York Stock Exchange, NASDAQ, and American Stock Exchange, with a total market capitalization of approximately \$15 trillion.⁷⁷ By the first quarter of 2008, foreigners owned over \$2.5 trillion of U.S. equities.⁷⁸

C. Operating Under the Pan-European and National Framework in the European Environment

The European company faces a different regulation structure than the American publicly-listed corporation. While the bulk of the regulation stems from national law, the European company is also regulated by European Community law (assuming the company is located within the European Union or the European Economic Area (E.E.A)).⁷⁹

⁷⁶ Delaware Division of Corporations - How to Incorporate in Delaware, <http://www.corp.delaware.gov/howtoform.shtml> (last visited Dec. 20, 2007); see EMERSON, *supra* note 4, at 296, 339.

⁷⁷ *Failure to Identify Company Owners Impedes Law Enforcement: Hearing Before the Permanent Subcomm. on Investigations of the S. Comm. on Homeland Security and Governmental Affairs*, 109th Cong. 1 (2006) (statement of Sen. Levin, Member, Sen. Comm. on Homeland Security and Governmental Affairs); GOVERNMENT ACCOUNTABILITY OFFICE, FINANCIAL RESTATEMENTS: UPDATE OF PUBLIC COMPANY TRENDS, MARKET IMPACTS, AND REGULATORY ENFORCEMENT ACTIVITIES 12 (2007); DIMITRIS N. CHORAFAS, THE MANAGEMENT OF EQUITY INVESTMENTS 97–98 (Elsevier 2005). However, note that according to the Securities Industry and Financial Markets Association's research report dated Dec. 31, 2006, "[g]lobal equity markets capitalization reached \$43.6 trillion in 2005 and is expected to top \$49 trillion by the end of this year. The U.S. accounted for 50% of the total value of the world's equity markets in 2001 but has been steadily declining since, accounting for 38.9% last year. In 2006, the U.S. share is expected to fall further despite relatively strong price performance in the second half of this year, thanks to the combination of: record stock buybacks producing negative net issuance; a falling dollar, which is increasing the valuation of non-dollar denominated markets in dollar terms; and an increased number of firms delisting or going private." SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, RESEARCH REPORT 21 (Dec. 13, 2006), <http://www.sifma.org/research/pdf/RRVol1-3.pdf> (last visited Apr. 6, 2008).

⁷⁸ Federal Reserve System Release, 67, table L.107, line 18, <http://www.federalreserve.gov/releases/z1/Current/z1r-4.pdf>.

⁷⁹ ECONOMIC SURVEY OF EUROPE, *supra* note 73, at 108; see Company Law Directives 2004/25/EC (takeover bids), 2005/56/EC (cross-border mergers, amended), 2006/43/EC (statutory audits, amended), 82/891/EEC (divisions, amended), 68/151/EEC (formation, signature and information, amended), 77/91/EEC (capital, amended), 78/855/EEC (mergers, amended), 78/660/EEC (annual accounts, amended). For national law examples, The Danish Company Act, http://www.eogs.dk/graphics/selskaber/AS_en.html, and Germany's Aktiengesetz, http://www.eogs.dk/graphics/selskaber/AS_en.html.

European Community laws are passed in the form of either directives or regulations.⁸⁰ Regulations are directly binding on individuals, without need for country action.⁸¹ Directives, on the other hand, are adopted by the European Council, often in cooperation with the European Parliament.⁸² At that point, countries usually have a certain amount of time to implement the directive.⁸³ The country can implement the directive either through new legislation or through construing already-existing national law. Directive provisions, however, are not necessarily compulsory, as is the case with Article 12 of Council Directive 2004/25.⁸⁴

While a directive harmonizes the laws of all 28 member states on the directive's subject matter, there have traditionally remained other factors one must take into consideration; principally, the uncertainty of which European country will recognize the company and govern its internal affairs. While the internal affairs of American companies have traditionally been governed by laws in the state in which they are incorporated, the E.U. member state's laws that applied to the company's internal affairs have, until recently, depended on either where the company is incorporated or where it had its "seat."⁸⁵

www.bundesrecht.juris.de/aktg/. Note that the EEA has adopted approximately "95% of all EU internal market directives." MARIUS VAHL & NINA GROLIMUND, INTEGRATION WITHOUT MEMBERSHIP: SWITZERLAND'S BILATERAL AGREEMENTS WITH THE EUROPEAN UNION 77 (CENTRE FOR EUROPEAN POLICY STUDIES 2006).

⁸⁰ RALPH H. FOLSOM, EUROPEAN UNION LAW IN A NUTSHELL 37-40 (Thomson West 4th ed. 2005).

⁸¹ *Id.* at 37-40, 88-89.

⁸² ALEXANDER HEINRICH TÜRK, THE CONCEPT OF LEGISLATION IN EUROPEAN COMMUNITY LAW: A COMPARATIVE PERSPECTIVE 223 (Kluwer Law Int'l 2006). Note that the Article 251's "co-decision" procedure does not apply to every type of legislation, but the scope of Parliamentary involvement has consistently expanded over the years. See FOLSOM, *supra* note 80, at 43-45. For general background on the Three Pillar structure of EU governance, see WALTER VAN GERVEN, THE EUROPEAN UNION: A POLITY OF STATES AND PEOPLES 12-13 (Stanford Univ. Press 2005).

⁸³ FOLSOM, *supra* note 80, at 38-39.

⁸⁴ *Id.* at 89-90; see Council Directive 2004/25, art. 12, 2004 O.J. (L 142) (EC); EUROPEAN INDUSTRIAL RELATIONS DICTIONARY: INDIRECT EFFECT, <http://www.eurofound.europa.eu/areas/industrialrelations/dictionary/definitions/indirecteffect.htm> (last visited Apr. 6, 2008).

⁸⁵ Treaty Establishing the European Community, art. 48, Nov. 10, 1997, 1997 O.J. (C 340) 3 (EC; LANDAU & KRUEGER, *supra* note 68 at 6-7. Compare Case 79/85, Segers v. Bestuur van de Bedrijfsvereniging, 1986 E.C.R. 2375 and Case C-212/97, Centros Ltd v. Erhvervs-og Selskabsstyrelsen, 1999 E.C.R. I-1459, with Case 81/87, *Ex parte* Daily Mail and General Trust PLC., 1988 E.C.R. 5483. There is a sacrifice in reducing this seat versus incorporation statement in one line with one footnote, as the statement carries broad implications. These cases center around

The financial environment is also different across Europe. Whether inside or outside the European Union, liquidity and capitalization in European stock markets has historically been lower than in the United States in the aggregate.⁸⁶ Aggregate European market capitalization, as well as the number of traded companies, now exceeds the United States.⁸⁷ Still, individual European markets remain far

Freedom of Establishment in Article 43 of the EC Treaty that, by way of Article 48, mandates that legal persons must be recognized if they are formed according to the laws of a Member State and have their registered office or main seat within the EU. Article 43 establishes the base rule, declaring that “[r]estrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited.” *Überseering v. Nordic Construction Company and Baumanagement GmbH*, clarifies this rule. Case C-208/00, *Überseering v. Nordic Construction Company and Baumanagement GmbH*, 2002 E.C.R. I-09919. In *Überseering*, Dutch company *Überseering*, incorporated in the Netherlands, moved its seat to Germany where it was embroiled in a legal conflict. Germany denied *Überseering* standing; as *Überseering* had its seat in Germany, it was subjected to German company law, and its failure to be incorporated in Germany meant that German courts would not recognize the company’s legal capacity. The European Court of Justice (ECJ) declared that the German government’s refusal to recognize *Überseering* as a valid company under German law violated freedom of establishment, contravening the EC Treaty. The result, that a Member State cannot apply the seat rule to determine whether it will recognize a company established under Article 48 of the EC Treaty, was upheld in *Inspire Art*, Case C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd*, 2003 E.C.R. I-10155. The case law of *Überseering*, *Inspire Art*, and *Centros*, Case C-212/97, *Centros Ltd v. Erhvervs-og Selskabsstyrelsen*, 1999 E.C.R. I-1459 (2000), has raised important concerns as to the subjection of a company, which had been expressly treated as a “foreign company,” to the law of the state where the company has its seat. For more information on the collision between incorporation theory and seat theory, see Benjamin Angelette, *The Revolution That Never Came and the Revolution Coming — De Lasteyrie Du Salliant*, Marks & Spencer, *Sevic Systems and the Changing Corporate Law in Europe*, 92 VA. L. REV. 1189 (2006), available at <http://www.virginialawreview.org/content/pdfs/92/1189.pdf>.

⁸⁶ CHORAFAS, *supra* note 77, at 98; see *Europe tops US in stock market value*, FINANCIAL TIMES, Apr. 2, 2007, available at http://www.ft.com/cms/s/bf6a00e4-e14b-11db-bd73-000b5df10621_i_rssPage=6700d4e4-6714-11da-a650-0000779e2340.html (last visited Apr. 6, 2008).

⁸⁷ It is important to differentiate between the European Union and Europe. According to Thomson Financial Data, the combined capitalization of European stock markets (including Russia and Eastern European markets) exceeded the capitalization U.S. markets in early 2007 – \$15,720 billion as compared to \$15,640 billion respectively. See *Europe tops US in stock market value*, FINANCIAL TIMES, Apr. 2, 2007, available at http://www.ft.com/cms/s/bf6a00e4-e14b-11db-bd73-000b5df10621_i_rssPage=6700d4e4-6714-11da-a650-0000779e2340.html (last visited Apr. 6, 2008). However, as of February 2008, Western European markets (excluding Eastern Europe) still have a combined capitalization of 10,378 billion euro, which exceeds United States levels at the April 6, 2008 exchange rate. See Federation of

smaller than the U.S. markets.⁸⁸ Ownership also differs. By the end of 2005, about one-third of shares listed on the E.U. markets were held by foreigners in comparison to fewer in the United States.⁸⁹ It is worth noting that while the capital markets in the United States and European Union have now reached parity, the European Union corporate bond market is undergoing a dramatic change.⁹⁰ It has increased from €475 billion in 1999, or 13% of the world market for non-financial corporation private debt securities, to €1,500 billion, or twenty nine percent of the world market.⁹¹ This shifted the EU share comparatively from twenty five percent of the value of the U.S. market to seventy four percent.⁹² The numbers indicate that while the U.S. corporate bond market grew thirty percent in value in these five years, the EU corporate bond market grew by two hundred and sixteen percent.⁹³

European Securities Exchange, Statistics & Market Research – Statistics, T. 2–3, <http://www.fese.be/en/?inc=art&id=3>.

⁸⁸ See FEDERATION OF EUROPEAN SECURITIES EXCHANGE, EUROPEAN EXCHANGE REPORT 2006, http://www.fese.eu/_lib/files/RA_FESE_European_Exchange_report_31_Jan08.pdf; Federation of European Securities Exchange, Statistics & Market Research – Statistics, Table 2, <http://www.fese.be/en/?inc=art&id=3>.

⁸⁹ FEDERATION OF EUROPEAN SECURITIES EXCHANGES, SHARE OWNERSHIP STRUCTURE IN EUROPE 4, 8, Feb. 2007, http://www.fese.eu/_lib/files/FESE%20Share%20Ownership%20Structure%20in%20Europe%202006.pdf. Note that this survey includes financial markets from three European Free Trade Association (EFTA) countries: Norway; Iceland; and Switzerland, but excludes Eastern European exchanges, including Russia.

⁹⁰ For similarities in stock market size and activity, see *supra* Sections III. B. & C. See also *Developments in the European Bond Market*, May 23, 2006, <http://www.gtnews.com/article/6357.cfm> (last visited Apr. 5, 2008) (stating that the E.U. bond market is double the size of the U.S. bond market).

⁹¹ JEAN-PIERRE CASEY, KAREL LANNON, CENTRE FOR EUROPEAN POLICY STUDIES, EUROPE'S HIDDEN CAPITAL MARKETS: EVOLUTION, ARCHITECTURE AND REGULATION OF THE EUROPEAN BOND MARKET 26–30 (CEPS 2006).

⁹² *Id.* See also PIPAT LUENGNARUEMITCHAI AND LI LIAN ONG, AN ANATOMY OF CORPORATE BOND MARKETS: GROWING PAINS AND KNOWLEDGE GAINS 3–6 (International Monetary Fund 2005).

⁹³ LUENGNARUEMITCHAI & ONG, *supra* note 92. Note that among EU countries, there is a large variance in the value of outstanding bonds in relation to GDP. Further, including the value of bonds issued by banks and financial intermediaries, the value of outstanding bonds in 2004 was €4, 600 billion, or 70% of Eurozone GDP. Comparatively, the U.S. was 60% of GDP. See Bruno Biais and Fany Declerck, *Liquidity and Price Discovery in the European Corporate Bond Market*, Jan. 2006, http://www.inquire-europe.org/project/under_development/biais_%20declerck%20proposal%202006.doc.

D. Operating Under Allah's Framework

For purposes of this analysis, it is assumed the company is operating in a secular environment. A corporation that operates under, or in accordance with, Islamic principles in such a jurisdiction faces two sets of regulations. First, the company will have to comply with the secular corporate laws and market regulations of the country in which it is based. Even the 2003 Saudi Arabian Capital Market Law, which created a government agency responsible for securities in the Kingdom, makes no reference to Islamic Law, though it does create a venue for Saudi companies to release *sukuks*, or "Islamic" interest-free bonds, and potentially paves the way for further compliance with *Sharia*.⁹⁴

Second, the company must operate in accordance with the Lawmaker's regulations.⁹⁵ One practical concern is how to apply Islamic legal principles to a corporation operating in a secular environment. The best way to approach this would be to analyze the effectiveness of the Lawmaker's rules under two situations. The first situation would be one in which the employees as a whole wish to comply with Islamic law on a theological level. This may not be too unrealistic considering that a subsidiary may operate in a semi-secular nation with a majority Muslim population, such as Malaysia, or even a non-secular nation such as Saudi Arabia.⁹⁶ The second situation is one in which the company incorporates a *Sharia* compliant structure, meaning the company has established internally-assigned disciplinary actions for particular offenses.

To judge the effectiveness of the Islamic corporation's regulation under all scenarios, we should contrast the outcome with the effectiveness of a Western secular regulatory structure. Under the first situation, the theological level, issues concerning jurisdiction and applicable law are straightforward. Western notions of corporate regulation by the state are jurisdictionally dependent: that is, corporate

⁹⁴ Nahed M. Taher, *Corporate Governance & the Saudi Capital Market Law*, ARAB NEWS, Nov. 3, 2003, <http://www.arabnews.com/?page=6§ion=0&article=34535&d=3&m=11&y=2003> (last visited Apr. 6, 2008). The importance of these bonds is discussed in greater detail in Section IV. See also KINGDOM OF SAUDI ARABIA CAPITAL MARKET LAW, *supra* note 64.

⁹⁵ Abdul Awwal Sarker, *Islamic Business Contracts, Agency Problem and the Theory of the Islamic Firm*, 1 INT'L J. ISLAMIC FIN. SERVICES 12, available at <http://www.iiibf.org/journals/journal2/art2.pdf>.

⁹⁶ CHEAH BOON KHENG, MALAYSIA: THE MAKING OF A NATION 240 (Institute of Southeast Asian Studies 2002) (stating that Malaysia does incorporate Islam into the Constitution, but does not make *Sharia* the law of the land). *But see* CIA World Factbook—Malaysia, <https://www.cia.gov/library/publications/the-world-factbook/geos/my.html>; CIA World Factbook—Saudi Arabia, <https://www.cia.gov/library/publications/the-world-factbook/geos/sa.html>.

actors (e.g., officer, employee, board member) are governed and must comply with the particular law of incorporation.⁹⁷ The company would also be governed by U.S. federal securities laws and listing rules if the shares are publicly traded in U.S. securities markets.⁹⁸ Islamic jurisdiction is limitless, as Allah sees everything that everyone does, everywhere they are.⁹⁹ Therefore, no matter in which state or country one operates, regardless of its size, no matter whether the corporation is a wholly-owned subsidiary or publicly-traded corporation, the laws laid down by Allah will apply. After death, Allah will also hold a trial, so to speak, and enforce judgment on compliance with His laws.¹⁰⁰ Thus, even though the corporation may be able to take advantage of the least restrictive secular rules by shifting their state or country of incorporation, the stakeholders will never avoid Allah's jurisdiction.¹⁰¹

⁹⁷ See *supra* note 68.

⁹⁸ See ANGELA SCHNEEMAN, *THE LAW OF CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS* 334–41, 336–37 (3d ed. 2002). Note, however, that “[n]ot all securities and transactions involving securities are subject to the registration requirement of the Securities Act.” *Id.* at 350; see *ECONOMIC SURVEY OF EUROPE*, *supra* note 73, at 108 (stating that publicly traded firms subject to Securities Act of 1933 and the Securities Exchange Act of 1934); see also DEL. CODE. ANN. tit. 8, §101(b) (2006) (stating that a corporation can be organized under Delaware law); *id.* at § 102(3) (stating that corporations must not violate any Delaware law).

⁹⁹ See *THE HOLY QUR’AN*, 3:29, 35:38, 31:28 (Abdullah Yusuf Ali trans., Wordsworth Editions 2000). For a good online reference, see *Multiple English Qur’an Translations*, <http://www.multimediaquran.com/quran/index1.htm> (last visited Aug. 7, 2008).

¹⁰⁰ *THE HOLY QUR’AN*, *supra* note 99, at 7:167.

¹⁰¹ SEBASTIAAN PRINCEN, *EU REGULATION AND TRANSATLANTIC TRADE 2* (Kluwer Law Int’l 2002) (stating how a race to the regulatory bottom exists in theory, but empirically such a theory is not conclusive); see *THE EVOLUTIONARY ANALYSIS OF ECONOMIC POLICY*, 205 (Pavel Pelikán & Gerhard Wegner eds., Edward Elgar Publishing 2003) (“A state’s incentive to engage in charter competition is the raising of the ‘franchise tax.’”); *THE POLITICS OF REGULATION: INSTITUTIONS AND REGULATORY REFORMS FOR THE AGE OF GOVERNANCE* 97–98 (Jacint Jordana & David Levi-Faur eds., Edward Elgar Publishing 2004) (relating the opposing race to the top view as compared to race to the bottom). In 1971 nearly 25% of Delaware’s budget was due to the Franchise tax. Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J. L., ECON. & ORG. 225 (1985). In 1998 the corporation revenues were approximately \$400 million, still a quarter of the state’s budget; see KLAUS HEINE UND WOLFGANG KERBER, *EUROPEAN CORPORATE LAWS, REGULATORY COMPETITION AND PATH DEPENDENCE* 8–9, <http://www.isnie.org/ISNIE00/Papers/Heine-Kerber.pdf> (“Whether this competition leads to a ‘race to the bottom’ or to a ‘race to the top’, is vehemently disputed. Legal Scholars following the ‘race to the bottom’ hypothesis argue that charter competition among corporate laws would lead systematically to ‘degradation of corporate law’. . . Followers of the ‘race to the top’ hypothesis do not deny that competition in corporate law has forced a liberalization of corporate laws. They deny, however, that this development runs against

Let us compare the effectiveness of Islamic theological compliance with Western secular compliance, using the Sarbanes-Oxley Act.¹⁰² There are three principal ways in which the Sarbanes-Oxley Act protects shareholders. First, it seeks to ensure auditor independence.¹⁰³ Second, it expands disclosure requirements through greater breadth and depth.¹⁰⁴ Finally, it makes the principle executive officer or officers sign off on this report, validating its accuracy, “based on the officer’s knowledge.”¹⁰⁵ If any reporting is knowingly false, the officers are liable, and may face civil and criminal penalties.¹⁰⁶

The Islamic company is also under the eye of a constant monitor, One who sees and hears everything.¹⁰⁷ However, unlike preparation of correct reports, every action is known—there is no spot-checking.¹⁰⁸ Thus, whatever a corporate officer does, Allah sees. Further, while the Sarbanes-Oxley Commission has the discretion to pursue an action against a company, or may even be unaware of a company violation, there is always judgment by Allah.¹⁰⁹ One can in-

the interests of the investors.” The authors contend that the higher net value and returns of Delaware incorporated corporations, comparative to other states, leads “to the conclusion that this kind of regulatory competition results in the selection of efficiency-increasing rules.”)

¹⁰² See 15 U.S.C. Chapter 98 (2002). There are also regulatory statutes that address civil liability and other rules and penalties that bear down upon the corporation. See, e.g., Securities Act of 1933, 15 U.S.C. § 77(k)(4) (2008) (stating that assuming certain conditions are met, a security holder may sue “every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement”); see also 10 U.S.C. § 78j (2002); 17 C.F.R. § 240.10b-5.

¹⁰³ 15 U.S.C. §§ 7211–19, 7231–34 (2002). See also D. LARRY CRUMBLY & REZAEI ZABIHOLLAH, U.S. MASTER AUDITING GUIDE 87–92 (CCH 2004).

¹⁰⁴ 15 U.S.C. §§ 7214, 7261–66 (2002).

¹⁰⁵ 15 U.S.C. § 7241(a)(2) (2002). Under Section (a)(4)(A), the signing officer remains responsible, however, “for establishing and maintaining internal controls.” *Id.* at § (a)(4)(A)

¹⁰⁶ STEPHEN M. BAINBRIDGE, THE COMPLETE GUIDE TO SARBANES-OXLEY: UNDERSTANDING HOW SARBANES-OXLEY AFFECTS YOUR BUSINESS 120–21 (Adams Media 2007). See also Final Rule: Management’s Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports; Rel. No. 33-8238, <http://www.sec.gov/rules/final/33-8238.htm>; see also 28 U.S.C. § 1658 (2002). For the criminal code itself inserted by Sarbanes-Oxley, see 18 U.S.C. § 1350 (2002).

¹⁰⁷ THE HOLY QUR’AN, *supra* note 99, at 31:28, 31:34.

¹⁰⁸ *Id.*

¹⁰⁹ *Id.* at 3:185.

terpret this as a mandatory adjudication, a full bench trial with one judge sitting for every case and every party.

Another distinguishing factor is that the Sarbanes-Oxley Act requires a corporate officer to have actual knowledge of a particular item; when a CEO signs off on a report, he or she certifies that information “based on the officer’s knowledge.”¹¹⁰ If irregularities are found during the Commission’s review of the company’s disclosures, the issue may then be the merit of the officer’s factual “knowledge” defense.¹¹¹ A secularist could argue that a company in which consequences are meted by government authorities will more likely be managed to comply with the mandated rules. Sarbanes-Oxley expands criminal and civil liabilities, subjecting the senior officer or officers to criminal punishments for knowing and willful incorrect certifications.¹¹² The Securities Acts, along with state-made law, subjects appropriate actors who engage in fraud, or even just corporate mismanagement and bad faith, to civil liability.¹¹³

Like the most far-reaching Western secular laws and regulations, the Islamic system also applies prohibitions and punishments on all those who help perpetuate any violation; employees who permit fraud through complacency will be charged alongside CEOs. After all, under Allah’s watch, every action, regardless of whether it is publicly exposed or not, is witnessed.¹¹⁴ Because Allah knows the truth, a person’s intent is important, even if his or her dishonesty does not come to fruition and remains hidden from the world.¹¹⁵ Therefore, a company

¹¹⁰ 15 U.S.C. § 7241(a)(2) (2002).

¹¹¹ *Id.* See also BAINBRIDGE, *supra* note 106, at 120–21.

¹¹² See EDWARD F. GREENE, ET. AL., U.S. REGULATION OF THE INTERNATIONAL SECURITIES AND DERIVATIVES MARKETS, vol. 1 3–66, 15–83, 15–84 (8th ed. 2005); JOHN T. BOSTELMAN, THE SARBANES-OXLEY DESKBOOK 26–1–27–19 (Practising Law Institute 2005) (stating that the certifying officers are subject to penalties for incorrect certifications; this also addresses the tension between willful and knowing incorrect certifications).

¹¹³ 18 U.S.C. § 1350 (2002); DEL. CODE ANN. tit. 8, § 102(b)(7) (1996) (allowing a provision in the certificate of incorporation “eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as director” provided that the director’s duty of loyalty to the corporation or shareholders, or “acts or omissions not in good faith or which involve intentional misconduct or knowing violation of the law” are also not eliminated.); see Securities Exchange Act of 1933, 15 U.S.C. § 77(k)(4) (2002) (providing that all actors can be sued); PETER A. HUNT, STRUCTURING MERGERS & ACQUISITIONS: A GUIDE TO CREATING SHAREHOLDER VALUE 497–504, 512–14 (Aspen Publishers 2004) (discussing director liability under the business judgment rule). For a brief view of the reach of the Securities Acts, see CRUMBLY & ZABIHOLLAH *supra* note 103, at 114–18.

¹¹⁴ THE HOLY QUR’AN, *supra* note 99, at 31:28, 31:34, and 3:29.

¹¹⁵ *Id.* at 3:29.

officer will always be responsible for his actions, regardless of whether the regulators catch his false reporting, and certainly the punishment of eternal fire in hell is worse than several years in jail.¹¹⁶

With the law extending to everyone in the organization engaged in every minute action, no matter how secret, the more individuals refusing to cover up a fraud will make it much more difficult for an officer to carry out a fraud. This closes any potential gaps, such as Sarbanes-Oxley's "based on the officer's knowledge."¹¹⁷ Hence, one could conclude that "theological" Islam is at least as effective as secular law in preventing fraud.

Under the second situation, even without an explicit adoption and implementation of *Sharia*, Islamic rules and prohibitions may still be given effect when state and federal laws are enforced. In American companies, board members and officers have a fiduciary duty, and a breach may be redressed by suit.¹¹⁸ Deceit by a company officer or director may subject the violator to civil as well as criminal penalties.¹¹⁹ With a *Sharia* control mechanism in place, the shareholders will be able to take corrective actions accordingly. Defrauding shareholders through a deceitful act is similarly prohibited under Islamic law.¹²⁰ It is unnecessary to prove a shareholder-company contractual relationship, as the Islamic prohibition against deceit extends to any

¹¹⁶ Harun Yahya, *Belief: Six Pillars*, ISLAM ONLINE, Aug. 14, 2003, <http://www.islamonline.net/english/introducingislam/topic01.shtml> (last visited Apr. 9, 2008) (stating that if you are in hell, you are staying there forever); see THE HOLY QUR'AN, *supra* note 99, at 100 (stating that those who do not follow Allah's guidance are led to hell), at 4:168–4:169 (including a specific illustration of the eternity of hell).

¹¹⁷ 15 U.S.C. § 7241(a)(2) (2002).

¹¹⁸ DEL. CODE. ANN. tit. 8 § 102(b)(7); see JOHN H. MATHIAS, MATTHEW M. NEUMEIER, JERRY J. BURGDOERFER, *DIRECTORS AND OFFICERS LIABILITY: PREVENTION, INSURANCE, AND INDEMNIFICATION* 123 (Law Journal Press 2000); HUNT, *supra* note 113, at 497–504, 512–14 (discussing director liability under the business judgment rule); LEN YOUNG SMITH ET AL., *SMITH AND ROBERSON'S BUSINESS LAW* 819 (West Publishing Co. 7th ed. 1988) (stating that the business judgment rule standard applies to the actions of directors as well as officers).

¹¹⁹ STEPHEN M. KOHN, MICHAEL D. KOHN & DAVID K. COLAPINTO, *WHISTLEBLOWER LAW: A GUIDE TO LEGAL PROTECTIONS FOR CORPORATE EMPLOYEES* 76–78 (Greenwood Publishing Group 2004) (discussing fraud and deceit addressed by the Sarbanes-Oxley and Securities Acts, as well as shareholder recourse through class actions).

¹²⁰ PERSPECTIVES ON ISLAMIC LAW, JUSTICE, AND SOCIETY 21 (R.S. Khare ed., Rowman & Littlefield 1999) (discussing the prohibition against contractual deceit applies to all, non-contractual relationships); see CHARLES LE GAI EATON, *ISLAM AND THE DESTINY OF MAN* 131 (State University of New York Press 1985) (stating that Mohammed's last instructions to his followers were to avoid acts of treachery or deceit).

type of human relationship.¹²¹ The advantage of trying to establish the contractual relationship between the offender and the violated party may be that it would specifically allow for consequential and punitive damages.¹²²

As stated above, one can give effect to some Islamic prohibitions by using the tools available under Western secular law. One should not assume that because, on its face, there is an apparent lack of conflict between Islamic rules and the protections that the secular law seeks to confer, there will necessarily be congruence between the two systems. This is due to the potential breadth of Islamic rules' applicability. To effectively apply these two legal codes in tandem depends on the extent to which the corporation gives those rules effect. Hence, corporations/shareholders considering adoption of a *Sharia* framework must define the boundaries of that framework as implemented, whether limited or not. Specifically, will the corporation abide by *Sharia* underpinnings? Should it adopt a full *Sharia* system? Should it merely comply with basic *Sharia* tenets?

Stemming from the above issue, advocates for limited or complete *Sharia* adoption must also define how they expect the corporation to accommodate or give effect to other, potentially more draconian rules.¹²³ One can make abstract comparisons of the prohibitive power of a belief system compared to a secular system, but can a company implement *Sharia* as a corporate governing structure? This analysis is difficult in several respects. Even if one identifies the prohibitions and assigns various punishments, these cannot depart from the immutable *Qur'anic* penal laws, such as the rule that applies to theft.¹²⁴ An example of this may be theft as embezzlement by the CFO.¹²⁵ Perhaps

¹²¹ PERSPECTIVES ON ISLAMIC LAW, *supra* note 120, at 21.

¹²² NYAZEE, *supra* note 3, at 223.

¹²³ CRIMINAL JUSTICE IN ISLAM: JUDICIAL PROCEDURE IN THE SHARI'A 18–22 (Muhammad Abdel Haleem, Adel Omar Sharif & Kate Daniels, eds., I.B.Tauris 2003); *see* PAUL R. POWERS, INTENT IN ISLAMIC LAW: MOTIVE AND MEANING IN MEDIAEVAL SUNNĪ FIQH 189–90 (Brill 2005) (comparing *hudūd* as strict liability, with intention or circumstances taken into account, and the punishments immutable); ALI AKRAM KHAN SHERWANI, IMPACT OF ISLAMIC PENAL LAWS ON THE TRADITIONAL ARAB SOCIETY 46–63 (M.D. Publications Pvt Ltd. 1993) (discussing the various penalties, and delving into detail on *hudūd* crimes).

¹²⁴ CRIMINAL JUSTICE IN ISLAM, *supra* note 123, at 19 (giving an overview of immutable *hudūd* punishments); TERANCE D. MIETHE & HONG LU, PUNISHMENT: A COMPARATIVE HISTORICAL PERSPECTIVE 169–70 (Cambridge Univ. Press 2004) (stating that possession and value of the object must be satisfied for *hadd* penalty of theft to be applied).

¹²⁵ SHERWANI, *supra* note 123, at 46–47; *see* THOMAS PATRICK HUGHES, A DICTIONARY OF ISLAM 284 (Asian Educational Services 1995) (detailing theft of property in custody by place or by personal guard, which would seem to apply to a CFO); *see*

a more questionable example would be management-sanctioned “slamming” of features onto customer accounts by Mobile Telecom sales agents. Hence, one must determine the extent of the corporation’s responsibilities to enforce these rules, whether the corporation will at all, and the methods by which to do so (that is, plain dismissal or penalties). After all, the corporation is not the state or a politically governing body, but a collection of lay co-workers.

In sum, due to inseparability of the theological underpinnings from prescribed rules governing behavior in Islam, comparison between Western secular rules and *Sharia* as a regulatory scheme may not allow comparative analysis to complete resolution.¹²⁶

E. *Interpreting the Corporate Structure Alternately*

The corporation cannot create and be bound in a religious covenant with Allah. It cannot satisfy the basic obligations as required by the Lawgiver.¹²⁷ While it is true that the corporation would not be capable, in the literal sense, of satisfying all five pillars of Islam (*Shahada*, *Salat*, *Zakat*, *Sawim*, and *Hajj*) as a corporeal individual otherwise would, one arrives at a different conclusion when one takes a more abstract, piecemeal look at the corporate “entity.”¹²⁸

1. *Contracted*

Up to this point, this article has implicitly assigned corporate officers with the responsibility of corporate compliance with *Sharia*

also JOHN N. PADEN, MUSLIM CIVIC CULTURES AND CONFLICT RESOLUTION: THE CHALLENGE OF DEMOCRATIC FEDERALISM IN NIGERIA 148 (Brookings Institution Press 2005) (stating that the scholars in the province of Kano, Nigeria, have officially equated embezzlement with theft); *Issue Papers, Extended Responses and Country Fact Sheets*, http://www.irb-cisr.gc.ca/en/research/publications/index_e.htm?docid=69&cid=0&version=printable&disclaimer=show (last visited Apr. 9, 2008) (“In their September 2001 publication, *The Reintroduction of Islamic Criminal Law in Northern Nigeria: A Study Conducted on Behalf of the European Commission*, Peters and Barends provide a list of all offences under *Sharia*, and their corresponding punishment. These are: [e]mbezzlement of public funds or of funds of a bank or company by officials and employees [Kano Penal Code only] . . . [is] punishable by amputation”).

¹²⁶ AMANDA RORABACK, *ISLAM IN A NUTSHELL* 34 (Enisen Publishing 2004). Remember that the Qur’an has the theological underpinnings, and acts that escape punishment will still be judged. See *THE HOLY QUR’AN*, *supra* note 99, at 3:29, 96.

¹²⁷ NYAZEE, *supra* note 3, at 106, 287.

¹²⁸ *UNDERSTANDING ISLAM: BASIC PRINCIPLES* 24–29 (Ithaca 2001). The corporation could arguably satisfy two of these requirements – *Zakat* and the *Shahidah* “statement” through paper form, in line with the form of other corporate statements, but one cannot readily imagine a non-corporeal entity could satisfy the other Islamic obligations.

based on their actions and management. Corporate compliance, however, can also be assessed by looking at the company as a nexus of contracts between individuals.¹²⁹

American corporate law theorists Jensen and Meckling have proposed that the corporation is a nexus of contracts between individuals.¹³⁰ This argument may seem to diverge from the realities of corporate existence such as filings, insurance on an organizational level, a general recognition of the bureaucracy as an entity, and, perhaps, directly related to *Sharia* restrictions, the “corporation’s” legal violations.¹³¹ Nevertheless, if one does accept Jensen and Meckling’s argument that the interactions within and without the business are contractual agreements, then, Islamic contract law would govern corporate activity in its totality.¹³² Freedom to contract is virtually absolute (and strictly enforceable under *Sharia*), except that contractual objectives must not clash with the rules of the Lawgiver.¹³³ Thus, the contract is governed by four general principals.¹³⁴

The first principal is the prohibition against *riba*, or interest.¹³⁵ We can readily imagine this application to day-to-day operations, such as interest on a loan, but what about explicit interest stemming from a contract for the sale of goods where the sale is made

¹²⁹ Michael C. Jensen & William H. Meckling, *The Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305, 310–11 (1976).

¹³⁰ *Id.* at 310 (“It is important to recognize that most organizations are simply legal fictions which serve as a nexus for a set of contracting relationships among individuals.”) (Emphasis added).

¹³¹ BRENT FISSE & JOHN BRAITHWAITE, *CORPORATIONS, CRIME AND ACCOUNTABILITY* 75–76 (Cambridge Univ. Press 1994) (“[T]he picture they [Meckling & Jensen] paint of corporate action is distorted,” as it “is rooted in methodological individualism, and hence fails to account for the reality of corporate action and corporate responsibility as phenomena that cannot be explained simply in terms of the performance of individual actors.”).

¹³² Jensen & Meckling, *supra* note 129, at 310; see NYAZEE, *supra* note 3, at 194 (defining the contract in two ways, first, narrowly, as “the union of the declaration of one of the contracting parties with that of the other in a [legal] manner, the result of which is reflected in their subject matter,” and second, more broadly, as “any statement or word that has the effect of legally binding a person to fulfill an obligation or to perform a duty.” This does not extend to mere promises of future actions). See *id.* at 199.

¹³³ WILLIAM M. BALLANTYNE, *ESSAYS AND ADDRESSES ON ARAB LAWS* 261 (Routledge 2000); see ROBERT FRANK CUSHMAN, *2 CONSTRUCTION LAW HANDBOOK* 1821 (Aspen Publishers Online 1999); see NYAZEE, *supra* note 3, at 193, 197.

¹³⁴ NYAZEE, *supra* note 3, at 193.

¹³⁵ *Id.* at 201.

on credit?¹³⁶ In *Structuring Islamic Finance Transactions*, the authors Abdulkader S. Thomas, Stella Cox, and Bryan Kraty, equate receivables to money, hence making it subject to *riba*.¹³⁷ They write that “receivables are deemed to be money, as are guarantees. As money, they are necessarily subject to the rules of *riba*.”¹³⁸ A regular, no-interest account receivable should not pose a problem, since there is no interest implicated.¹³⁹ While considered a “discount” by offering the customer a 2/10 net thirty option, the seller is really making a constructive interest loan, thereby violating the prohibition against *riba*.¹⁴⁰ The loan principle is the advance of inventory, which creates the receivable, and the interest rate is two percent due post ten days.

¹³⁶ See VIRGINIA B. MORRIS & BRIAN D. INGRAM, GUIDE TO UNDERSTANDING ISLAMIC INVESTING 10 (Lightbulb Press, Inc. 2001) (explaining the *riba* concept). In ABDULLAH SAEED, *Islamic Banking and Interest: A Study of the Prohibition of Riba and Its Contemporary Interpretation*, 2 STUDIES IN ISLAMIC LAW AND SOCIETY 79 (Brill 1996), the author cites six reasons why credit sales do not constitute *riba*. I use this as the framework, and my analysis addresses the first four of these factors, though not necessarily in the given order. Saeed writes:

In the context of Islamic banking, several arguments have been advanced to support the lawfulness of a higher price in a deferred payment sale: (i) that the *shari'a* texts do not prohibit it; (ii) that there is a difference between cash available now and cash available in the future as according to 'Ali al-Khafif, a contemporary jurist, “the custom (*'urf*) is that cash given immediately is higher in value than cash given in the future”; (iii) that this increase is not against time allowed for payment, and hence, does not resemble pre-Islamic *riba* prohibited in the Qur'an; (iv) that the increase is charged at the time of the sale, not after the sale occurred; (v) that the increase is due to factors influencing the market such as demand and supply, and the rise or fall in the purchasing power of money as a result of inflation or deflation; (vi) that the seller is engaged in a 'productive' and recognised [sic] commercial activity. *Id.* at 79.

¹³⁷ ABDULKADER S. THOMAS ET AL., STRUCTURING ISLAMIC FINANCE TRANSACTIONS 27–28 (Euromoney Books 2005).

¹³⁸ *Id.*

¹³⁹ There has been commentary that merely holding regular accounts receivable in and of itself does not *per se* implicate *riba*. See, e.g. FRANK E. VOGEL & SAMUEL L. HAYES, III, ISLAMIC LAW AND FINANCE: RELIGION, RISK, AND RETURN 3 (Kluwer Law International 1998) (“Many businesses find it necessary to supply credit to their customers through accounts receivables. An Islamic business can do this but is not [allowed to sell or pledge those receivables].”). Note, however, that the authors do not address the practice of offering discounts if accounts are paid within a fixed amount of time – such as the mentioned 2/10 net 30 discount. For a brief definition of 2/10 net 30, see Investopedia, 1%/10 net 30, <http://www.investopedia.com/terms/1/1-10net30.asp> (last visited Sept. 11, 2009).

¹⁴⁰ See SAEED, *supra* note 136, at 79.

While 2/10 net 30 also serves as an inducement for prompt payment rather than merely a profit scheme, two percent interest is just that, interest, and the increased profit is just that, increased profit.¹⁴¹

Deferred payment carrying higher cost has arguably been accepted as a valid upwards price revision to mitigate opportunity cost—the mitigation for opportunity cost of delayed payment receipt.¹⁴² While arguments to the contrary have been dismissed by noted scholar Professor Mahmoud Amin El-Gamal, one cannot ignore the mechanics of such an expensive interest rate—and progressively expensive if one assumes that post thirty, sixty, and ninety days also carries additional interest.¹⁴³ Specifically, while a company may need to mitigate opportunity costs for the delayed receipt of monies, the argument that the motivation to increase the price of the goods sold on credit is to mitigate opportunity cost, cannot justify an implicit twenty-nine percent interest rate.¹⁴⁴ The twenty-nine percent rate post ten days certainly

¹⁴¹ See RICHARD A. BREALEY & STEWARD C. MYERS, *PRINCIPLES OF CORPORATE FINANCE* 850 (McGraw-Hill 1996); see also, SCHAUM'S EASY OUTLINES: BOOKKEEPING AND ACCOUNTING 76 (DANIEL L. FULKS, JOEL J. LERNER & MICHAEL K. STATON eds., McGraw-Hill Professional 2003) ("Cash discounts are an inducement offered to the buyer to encourage payment of a bill within a specified period of time. They tend to narrow the gap between the time of sale and the time of collection, which can become a source of cash flow difficulties for the seller.")

¹⁴² Mahmoud A. El-Gamal, *An Economic Explication of the Prohibition of Ribâ in Calssical Islamic Jurisprudence*, 4 (2001) available at <http://www.ruf.rice.edu/~el-gamal/files/riba.pdf>. ISLAMIC IDENTITY AND THE STRUGGLE FOR JUSTICE 52 (Nimat Hafez Barazangi et al eds., University Press of Florida 1996) ("There are some questions about charging higher prices for items sold on credit. In general, Muslim jurists feel that such transactions should be avoided unless there is reason to believe that higher prices for deferred payment are justified on the ground of equity.")

¹⁴³ *Id.* ("[T]he fact that the same financial firm would sell one item for one price on a cash-and-carry basis, and for a higher price on a deferred basis, is not un-Islamic, provided that certain conditions are met. Whether or not we call that increase "interest" is a sophistry unworthy of serious academic discourse.")

¹⁴⁴ SCOTT GABEHART, *THE UPSTART GUIDE TO BUYING, VALUING, AND SELLING YOUR BUSINESS* 279 (Dearborn Trade Publishing 1997). Gabehart states that the implicit annual interest rate for 2/10 net 30 is 29% (which is 2% compounded monthly). This number is higher than an average dilution and uncollectible debt rate, which can sit at about 5 percent. Another benchmark may be the risk taken by lenders for loans based on accounts receivable. Banks generally loan an amount equivalent to roughly seventy or eighty percent of receivables, putting the 2/10 net 20 "interest rate" on the highest end. It is important to remember that both dilution and the amount of the receivable loan vary by industry, and in the case of accounts receivable loans, the age and structure of the receivables. Further, utilizing the common benchmark of stock markets, "surcharged receivables" provide a return far above an average that a developed stock market could offer. As a basis of comparison, specifically when weighing opportunity cost for the seller

implies the terrible inequity that *riba* was intended to correct.¹⁴⁵ A *Sharia* compliant seller would then likely be prohibited from dealing in interest, including offering the 2/10 net thirty option even if every customer up to that point had paid the entire balance within ten days (avoiding having to pay the post ten day interest).¹⁴⁶ Therefore, a structural change would be needed—either revising the two percent discount downwards to reflect the true opportunity cost and to act as insurance against cost fluctuations, or removing the 2/10 net thirty provisions altogether.

The second principal is the prohibition on contracts that are uncertain and will lead to dispute.¹⁴⁷ This generally applies to anything where the future occurrence or outcome is unknown, and so, the consideration is unsecured.¹⁴⁸ Since transactions must be based on some financial interchange to be subject to the prohibition of *Gharar*, it has limited applicability to the internal functioning of an organization.¹⁴⁹

Even if one identifies a significant internal financial exchange, it does not mean that *Gharar* is applicable. Take, for example, an employment contract that specifies an executive will be paid a bonus if his or her department achieves a certain dollar sales target that year. Such individual compensation structure is inherently uncertain be-

when payment receipt is delayed, then, one may consider average long-term U.S. stock market returns. See GILBERT J. SCHROEDER AND JOHN J. TOMAINE, *LOAN LOSS COVERAGE UNDER FINANCIAL INSTITUTION BONDS* 287–88 (American Bar Association 2007); see also GENE SICILIANO, *FINANCE FOR THE NON-FINANCIAL MANAGER* 177–79 (McGraw-Hill Professional 2003); Peter A. Diamond, *What Stock Market Returns to Expect for the Future?*, 63 *SOC. SEC. BULL.* 2, 38, 39 (2000) available at <http://www.ssa.gov/policy/docs/ssb/v63n2/v63n2p38.pdf> (“Over the past 200 years, stocks have produced a real return of 7.0 percent per year. Even though annual returns fluctuate enormously, and rates vary significantly over periods of a decade or two, the return on stocks over very long periods has been quite stable (Siegel 1999). Despite that long-run stability, great uncertainty surrounds both a projection for any particular period and the relevance of returns in any short period of time for projecting returns over the long run.”); SAEED, *supra* note 136, at 79.

¹⁴⁵ MAHMOUD A. EL-GAMAL, *ISLAMIC FINANCE: LAW, ECONOMICS, AND PRACTICE* 52 (Cambridge University Press 2006) (“It is thus apparent from the law that what is targeted by the prohibition of *riba* is the excessive inequity it entails.”); see also SAEED, *supra* note 136, at 79.

¹⁴⁶ Fatwa On Credit Cards, http://monzer.kahf.com/fatawa/FATAWA_CREDIT_CARD.pdf (last visited July 18, 2009).

¹⁴⁷ NYAZEE, *supra* note 3, at 203.

¹⁴⁸ *Id.*

¹⁴⁹ EL-GAMAL, *supra* note 145, at 58 (“The potentially affected contract must be a commutative financial contract (e.g., sales). Thus, giving a gift that is randomly determined (e.g., the catch of a diver) is valid, whereas selling the same item would be deemed invalid based on [uncertainty].”)

cause the employee has limited control over whether the department will achieve the target numbers. Uncertainty, however, cannot be merely casual or potential; it must rise to the level of “overwhelming” uncertainty.¹⁵⁰ Further, the main principle of the contract must be uncertain, and one does not know if the principle aspect of this contract is the bonus pay; that is, whether the contract is centered on some determinable remuneration for employment and duties, of which the bonus may be only a small part.¹⁵¹ In light of these requirements, it would seem that most situations of uncertainty that pertain to the internal workings of a corporation will likely survive this prohibition.¹⁵²

The third principal is the liability for loss and the right to profit.¹⁵³ For example, an American company sells its printing machine to a Moroccan company, and the Moroccan company uses that printer as it sees fit. The Moroccan company has a right to the profit from that purchased property just as they bear the burden of loss if there had been damage from failure to upkeep the property.¹⁵⁴ However, if this was a lease and the American company was responsible for the standard maintenance, then the onus falls on the American company. In all situations of loss where one party had responsibilities, the injured party has a right to compensatory, punitive, and potentially consequential damages stemming from the breach.¹⁵⁵

Under Islamic law, liability for loss extends to any situation where one party does not meet his or her contractual obligations as promised in the contract.¹⁵⁶ Hence, liability might be applied in the

¹⁵⁰ *Id.* (“[Uncertainty] must be excessive to invalidate a contract. Thus, minor uncertainty about an object of sale (e.g., if its weight is known up to the nearest ounce) does not affect the contract.”)

¹⁵¹ *Id.* (“[F]or [uncertainty] to invalidate a contract, it must affect the principal components thereof (e.g., the price or object of sale). Thus, the sale of a pregnant cow was deemed valid, even though the status of the calf may not be known. Indeed, the price of a pregnant cow would be higher than the price of the same cow if it were not pregnant. However, the sale of its unborn calf by itself is not valid based on [uncertainty]. In the first case, the primary object of sale is the cow itself, whereas in the latter case the object of sale is the unborn calf, which may be still-born.”)

¹⁵² *Id.* at 59 (stating that it is worth noting that there is also a “safe-harbor” provision, in that if the subject matter has met all three aspects to qualify as uncertain, but the particular method used is the only way to achieve the particular goal of the contract, the contract will not be rendered invalid by *gharar*.).

¹⁵³ NYAZEE, *supra* note 3, at 193.

¹⁵⁴ Mohammad Hashim Kamali, *QAWA'ID AL-FIQH: The Legal Maxims of Islamic Law*, The Association of Muslim Lawyers (UK) at 3, available at http://www.sunnah.org/fiqh/usul/Kamali_Qawaid_al-Fiqh.pdf.

¹⁵⁵ NYAZEE, *supra* note 3, at 223; *cf.* U.C.C. §§ 2-715, 2-719, 2A-520 (2005).

¹⁵⁶ NYAZEE, *supra* note 3, at 194, 223.

internal scheme of the business with an employee who shirks his or her duty in contravention of the hiring contract, leading to injury of the company. This liability for loss theory should apply to parent-sub-sidiary relationships.¹⁵⁷

The fourth principal is prohibition of unjust enrichment. This prohibition seeks to prevent profit through unlawful, inappropriate practices, such as exploitative business relationships where receipt of income is not proper.¹⁵⁸ It extends to where one party obtains an advantage without reciprocally giving something valued equal in return.¹⁵⁹ This broad prohibition against unjust enrichment encompasses some of the principles enumerated above, including *riba* (interest) and *Gharar* (uncertainty or risk taking).¹⁶⁰ However, the prohibition also includes *Maysir*, which addresses gambling or “games of chance,” and may be applied to all such activities—like currency and stock speculation.¹⁶¹ Threat of an action under the oft-unsuccessful claim of “corporate waste” under Delaware law is perhaps the closest corollary to Sharia’s prohibition of unjustified enrichment.¹⁶²

The above principles and their examples demonstrate that the Islamic principles of contract govern aspects of the organization’s functioning, even without recognizing the organization as entity. The organization, and individuals executing the contracts, must keep these issues at the forefront of their minds.

In addition to these four contract principles, there are four conditions that apply to the principal subject matter (the *‘aql*, or central item or agreement on which the contract is made) of all contracts.¹⁶³

¹⁵⁷ *Id.* at 194. Under Nyazee’s broad definition of contract, “any statement or word that has the effect of legally binding a person to fulfill an obligation or to perform a duty.”

¹⁵⁸ *Id.* at 193; see also Husam Hourani, *The Three Principles of Islamic Finance Explained*, INT’L FIN. L. REV., available at <http://www.iflr.com/Article.aspx?ArticleID=1984844> (referencing the prohibition of unjustified enrichment meant to establish justice and to eliminate “exploitation in business”); see also AJIT KUMAR DASGUPTA, *A HISTORY OF INDIAN ECONOMIC THOUGHT* 51–52 (Routledge 1993) (giving a quasi-historical interpretation of unjustified enrichment).

¹⁵⁹ VOGEL & HAYES *supra* note 139, at 156–57 (stating that this is applied specifically to an option contract, which, except for the Hanabalis school, is considered void because of this violation).

¹⁶⁰ Sarker, *supra* note 95, at 1–3.

¹⁶¹ *Id.* at 2; see also ANGELO M. VERADOS, *ISLAMIC BANKING & FINANCE IN SOUTH-EAST ASIA: ITS DEVELOPMENTS & FUTURE* 45 (World Scientific, 2005); On Speculation and Gambling, http://islamic-world.net/economics/speculation_and_gambling.htm (last visited Mar. 12, 2008) (defining the basis of *Maysir*). See generally ISLAM IN WORLD POLITICS 151 (Nelly Lahoud & Anthony H. Johns eds., 2005).

¹⁶² See generally *White v. Panic*, 783 A.2d 543 (Del. 2001), for an outline of corporate waste.

¹⁶³ NYAZEE *supra* note 3, at 200, 235, 236.

First, the item or agreement must possess legal value, and as such, must be clean.¹⁶⁴ Second, the item or agreement must exist when the contract is formed.¹⁶⁵ Third, either party must be able to fulfill their end of the bargain at the time of the contract.¹⁶⁶ Fourth, there must be certainty, one or more party must not contract to give or get something that is uncertain or unknown.¹⁶⁷

Any of these four conditions can apply to a company's particular action. The condition that the object of the contract "must have legal value" firmly prohibits the company from becoming party to contracts which violate Islamic law.¹⁶⁸ For example, contracts whose subject matter relates to alcohol stand contrary to Islamic law and lack legal value.¹⁶⁹ Assume a food and beverage processing company (F&B, Inc.) contracts with South African Breweries to toll brew alcoholic beverages at F&B, Inc.'s facilities. While the conditions appear relatively straightforward, application of the conditions will likely be the central issue. The situation becomes murky when one attempts to identify how central or peripheral a topic may be to the subject matter of the contract, and who is responsible for the execution. If an F&B, Inc. Human Resource employee rents a lounge or bar for a company holiday party, does this contract center around unclean subject matter? If "open bar" was specifically mentioned in the contract between F&B, Inc. and the lounge or bar, this still does not necessarily guarantee that alcohol will be served. If it is understood that all invitees will bring their own alcohol, is it company sanctioned; if so, does that constitute the subject matter of the contract?¹⁷⁰

2. Questions of Agency

Apart from the issue of identifying the contract's subject matter, there is also the question of agency. Under Islamic law, agency is permitted only for lawful acts.¹⁷¹ The question of authority is interesting, because if the company has become *Sharia* compliant and all employees are aware of this, then the company should not be bound when

¹⁶⁴ *Id.* at 236.

¹⁶⁵ *Id.* One can imagine for this condition that the company may have to take care in structuring its R&D and exploratory contracts to make the R&D and exploration the particular object of the contract, not the speculative results.

¹⁶⁶ *Id.*

¹⁶⁷ *Id.*

¹⁶⁸ *Id.* at 200, 201.

¹⁶⁹ Nyazee *supra* note 3, at 202.

¹⁷⁰ *Id.* This example is intended to explore the validity of the contract and does not address the company's responsibility to avoid all things *haram*.

¹⁷¹ *Id.* at 229.

an employee contracts for “illegal” subject matter.¹⁷² However, since the company is most likely operating in a secular market, the boundaries of authority under the secular system, as per extra-corporate contracts, would apply, and the question of imputation of liability for *Sharia*-violative contracts and actions become the more relevant issue.

While a contract can be ascribed to one executor, the contract may be drafted, revised, or supported by others. The challenge becomes determining how far the imputation should be applied. Can it be traced up to the officers and directors of a corporation? In general, officers and directors would likely be the most vulnerable to imputation of contracts and company performance as they hold highest authority and are responsible for corporate undertakings and performance.¹⁷³ Since it does not recognize corporations, Islamic law weighs in on interactions that would lead to violations not through company-as-entity activities, but through *Sharia*-violative duties assigned to subordinates who execute those activities.¹⁷⁴

Rationally, one must have a point where imputation is “cut-off,” especially for corporate efficiency considerations. Otherwise, too much time would be spent ensuring that the corporation does not violate any prohibitions, translating into excessive micro-management. The company must look to the relevant Islamic agency rules to determine the reach of imputation.

While, in practice, a “pure” nexus of contracts theory is not a wholly tenable method to approach Western corporate issues, it is the most effective manner to measure conduct of the “corporation”—e.g.,

¹⁷² The Restatements address principal responsibility for an agent’s unauthorized actions. See generally RESTATEMENT (SECOND) OF AGENCY §§ 7, 8, 8A, 8B, 140, 230 (2004); RESTATEMENT (THIRD) OF AGENCY, §§ 2.01–2.07 (2008).

¹⁷³ AMERICAN BAR ASSOCIATION, CORPORATE DIRECTOR’S GUIDEBOOK, 1, 2, 11–13 (American Bar Association 2008); JOHN L. COLLEY, ET. AL., CORPORATE GOVERNANCE 11 (McGraw-Hill Professional 2003).

¹⁷⁴ NYAZEE, *supra* note 3, at 278 (noting that corporations are not discussed in Islamic law); see also 8 ENCYCLOPAEDIA OF ISLAM: RIGHTS AND LIBERTIES UNDER ISLAM 220 (M. Mukarram Ahmed ed., Anmol Publications 2005) (“If any government, or the administrator, or the head of a department orders an individual to do a wrong, then he has the right to refuse to comply with the order” and “giving orders to one’s subordinates to commit a sin or do a wrong is itself an offence [sic] and such a serious offence [sic] that the officer who gives this sinful order whatever his rank and position may be, is liable to be summarily dismissed. . . . In other words no one has the right to order his subordinates to do anything against the laws of God.” The punishment is also clear, “[i]f such a situation arises then the person who commits the offence and the person who orders that such an offence be committed, will both be liable to face criminal proceedings against them.”).

corporate actors—under Islamic rules.¹⁷⁵ It provides certainty, as responsibility can be traced to the individual who executed the contract. It also allows actions to be traced up a chain of command and thereby achieve an indirect, but equally effective, corporate compliance with *Sharia*.

IV. FINANCING THE CORPORATION

Methods of corporate financing will be shaped by Islamic legal prohibitions, with two major types of outside financing—issuance of stocks and floating bonds—involving the corporation and outside investor, and posing different challenges in squaring with Islamic law.¹⁷⁶ Outside financing raises concerns about conflicts with Islamic legal principles in two different ways. The first is the relationship of the parties. Is a partnership or contractual relationship created, and what are the rights and obligations of the parties?¹⁷⁷ The second is the financial consideration. Does the form of payout violate general Islamic prohibitions like prohibition of *riba* and *gharar*?

A. *Financing: Prohibition of Common Methods?*

As stated previously, Islamic law prohibits unjust enrichment. In sum, a company must ensure that it does not earn money in a way that implicates unlawful means. While the company must remain

¹⁷⁵ NYAZEE, *supra* note 3, at 278 (noting that corporations are not discussed in Islamic law); see also Melvin A. Eisenberg, *The Conception that the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. LAW 819 (1998). Eisenberg recognizes constraints on actions that are not just determined by freely contractual, persistently accessible agreements. While the voluntary contractual arrangements are important, there are other “established bureaucratic rules that are not open to continued re-examination, let alone negotiation.” *Id.* at 829. Eisenberg further states that “insofar as the nexus of contracts is a positive conception, it has no implications for the proper role of mandatory legal rules. To reason from the nexus-of-contracts conception to a rejection of mandatory rules is to mistakenly reason from *is* to *ought*.” *Id.* at 824. Yet these external constraints remain boundaries that constrain the right to carry on a business as an *unfettered, absolute* nexus of contracts.

¹⁷⁶ WILLIAM J. BAUMOL & ALAN S. BLINDER, *ECONOMICS: PRINCIPLES AND POLICY* 176–78 (Harcourt Brace Jovanovich 1979); see McCONNELL & BRUE, *supra* note 38, at 77 (briefly discussing the two common types of methods of raising funds, stock and bonds).

¹⁷⁷ NYAZEE, *supra* note 3, at 278 (defining Islamic partnership as the Islamic enterprise organization); see also VOGEL & HAYES, *supra* note 139, at 109 (describing different types of partnerships with different rules, according to the different Islamic schools); Sarker, *supra* note 95, at 6 (providing variants on the partnership types); Meezan Bank, <http://www.meezanbank.com/pages.aspx?iPageID=165> (last visited July 18, 2009) (describing various *Sharikat* types).

mindful of *all* Islamic prohibitions, perhaps the biggest challenge to company financing is the prohibition against *riba* (interest).

1. Shares

a. *Riba*

While *riba* has been heavily analyzed in its application to bonds, it also may be implicated in stock ownership.¹⁷⁸ *Riba* can be considered a fixed interest paid on top of any amount loaned, based on the amount of the loan, for a set period of time.¹⁷⁹ Succinctly stated, “[f]ixed income runs afoul of one of the unchangeable tenets of Islamic partnership (and company) law: that income is proportional to profits,” and that loss must be shared.¹⁸⁰ The prohibition is based partly on the goal of preserving fairness and justness, and avoiding commercial exploitation.¹⁸¹ By allowing one party to loan money to another party at a set rate of return, the lending party is allowed to ignore the borrowing party’s financial situation, which, aside from injury to the individual, also impacts social cohesion.¹⁸² Payment on traditional Western style bonds—a guaranteed, fixed percentage on the amount of money

¹⁷⁸ The *riba* violation of western bonds stems from their payment of a fixed payment on a single flat capital investment. See ALEXANDER VON POCK, STRATEGIC MANAGEMENT IN ISLAMIC FINANCE 36 (“[I]nvestment in currencies or bonds may raise issues of *riba*. . . although zero-coupon bonds are usually deemed acceptable.”)

¹⁷⁹ Sulaeiman, *supra* note 16; see also SAEED, *supra* note 136, at 46 (providing more information on the interest vs. usury debate; SAIKH MUHAMMAD BIN JAMIL ZENO, THE PILLARS OF ISLAM AND IMAN & WHAT EVERY MUSLIM MUST KNOW ABOUT HIS RELIGION 231 (Darussalam 2006) (providing translations and explanations of Qur’anic verses that utilize Usury and using Usury in translation but defining *riba* as money received on money); MUHAMMAD SAED ABDUL-RAHMAN, THE MEANING AND EXPLANATION OF THE GLORIOUS QUR’AN, vol. 1, 516–17 (MSA Publication Limited 2007).

¹⁸⁰ VOGEL & HAYES, *supra* note 139, at 170 (pointing out that a primary claim to income distribution also violates the tenets of Islamic law); see also WILLIAM A. RINI, FUNDAMENTALS OF THE SECURITIES INDUSTRY 35 (McGraw-Hill 2003) (stating that preferred shareholders have priority of income distribution over common shareholders).

¹⁸¹ See VOGEL & HAYES, *supra* note 139, at 78–79, 82 (citing Ibn Rushd as the first major proponent of the preservation of equality and fairness rationale behind *riba*); see also SALWA ISMAIL, RETHINKING ISLAMIST POLITICS: CULTURE, THE STATE AND ISLAMISM 48 (I.B. Tauris 2003) (stating that the prohibition is meant to ensure justice, because it will protect the poor from exploitation by the wealthy); ISLAMIC IDENTITY AND THE STRUGGLE FOR JUSTICE 51–52 (Nimat Hafez Barazangi et. al. eds., University Press of Florida 1996). *But see* EL-GAMAL, *supra* note 142, at 2–3.

¹⁸² HENNIE VAN GREUNING & ZAMIL IQBAL, RISK ANALYSIS FOR ISLAMIC BANKS 7 (World Bank Publications 2007) (“This [*riba*] prohibition is based on arguments of social justice, equality, and property rights.”).

paid into the company—fits the description of *riba*.¹⁸³ With this as the backdrop, the dividend aspect of stock ownership—both preferred and common—may also violate the prohibition of *riba*.

Riba is implicated in preferred stock ownership for the same reason it is implicated for bonds; preferred shares, unlike common shares, usually guarantee a fixed dividend payment per share which does not fluctuate based on earnings or business performance.¹⁸⁴ If the preferred stock is cumulative, then regardless of the company's loss and non-payment of dividends that year, the stock owner is entitled the fixed interest owed to him or her proportionate to the number of shares owned—flat principal invested.¹⁸⁵ Because of this, preferred stock violates the *riba* prohibition.

Common stocks may fare better in some cases, but not all. Common stock dividends are, theoretically, determined every quarter, as they are a distribution of the company's earnings.¹⁸⁶ The dividend

¹⁸³ MICHAEL V. BRANDES, *NAKED GUIDE TO BONDS: WHAT YOU NEED TO KNOW—STRIPPED DOWN TO THE BARE ESSENTIALS* 5–7 (John Wiley & Sons 2003); see also *Bond Categories*, http://www.russell.com/us/glossary/bonds/bond_categories.htm (last visited July 18, 2009).

¹⁸⁴ JOHN E. MOYE, *THE LAW OF BUSINESS ORGANIZATIONS* 310–11 (Thomson Delmar Learning 2004) (discussing preference of shares, which usually includes dividends, set forth in the articles of incorporation); see also STEVEN M. BRAGG, *ACCOUNTING REFERENCE DESKTOP* 209 (John Wiley & Sons 2002) (describing preferred shares); RINI, *supra* note 180, at 31. In fact, many financial writings in the West compare the payment of fixed dividends for preferred stock with bonds and even interest banking accounts. See ESME FAERBER, *ALL ABOUT STOCKS: THE EASY WAY TO GET STARTED* 32 (McGraw-Hill Professional 1999) (expounding on the features of the “hybrid” debt-equity vehicle. “[T]he fixed dividends of preferred stocks appeal to investors who rely on regular returns for income. In this regard, preferred stock resembles the regular returns of interest on bonds.”); see also RINI, *supra* note 180, at 35 (“Preferred stocks are very similar to bonds. Both have fixed cash payments (fixed dividends for preferreds and fixed interest for bonds).”); RONALD J. EBERT & RICKY W. GRIFFIN, *BUSINESS ESSENTIALS* 51 (Prentice Hall 2001) (“[P]referred stock guarantees holders fixed dividends, much like the interest paid on savings accounts.”); Fatwa by Yusuf Talal DeLorenzo, Chief *Shariah* Officer at *Shariah Capital, Common and Preferred Stock* — Muslim-Investor.com, <http://muslim-investor.com/answers/preferred-stock.html> (noting that, normally, preferred shares are prohibited) (last visited July 18, 2009).

¹⁸⁵ JOHN E. MOYE, *THE LAW OF BUSINESS ORGANIZATIONS* 310–11 (Thomson Delmar Learning 2004) (describing cumulative vs. non-cumulative preferred shares).

¹⁸⁶ Joshua Kennon, *All About Dividends*, <http://beginnersinvest.about.com/od/dividendsdrips1/a/aa040904.htm> (last visited July 18, 2009) (noting that dividends are approved by the board to be paid usually every quarter); see also ESME FAERBER, *ALL ABOUT STOCKS: THE EASY WAY TO GET STARTED* 15–17 (McGraw-Hill Professional 1999) (noting that some companies pay cash dividends by quarter, semiannually, or annually, but are not required to pay them); FRANKLIN J. PLEWA, JR., & GEORGE T. FRIEDLOB, *FINANCIAL AND BUSINESS STATEMENTS* 86 (3d ed. 2006)

rate, however, may be guaranteed by the company.¹⁸⁷ If the company never guarantees a dividend payment—perhaps by actively deciding and revising dividend payments regularly (every, or almost every quarter)—then there is no fixed income stream from the capital invested and *riba* is inapplicable. The remaining question is whether a company can effectively guarantee through implication a dividend rate—either by in fact not re-determining dividends each quarter or purposely maintaining persistently unchanging dividends—and if so, whether that violates *riba* under the same theory as preferred shares.

A company may pay a continuing, unchanged quarterly dividend, perhaps even without publicizing their analysis of the appropriateness of dividends for that quarter.¹⁸⁸ There are several reasons for such a decision, one of which is the conception that a “regularly paid dividend” message attracts more capital.¹⁸⁹ The directors may be concerned that the company’s stock price will drop if its dividend is revised downwards, diminishing ability to raise capital through floating of new stock. Directors may feel forced to maintain a dividend for fear

(noting when a company may limit dividend payment of earnings); ROBERT L. DIXON, HAROLD E. ARNETT, *THE MCGRAW-HILL 36-HOUR ACCOUNTING COURSE* 157–58 (McGraw-Hill Professional 1993) (“The earnings of the sole proprietorship and of the partnership are legally earnings of the proprietors (sole proprietors or the partners), but the earnings of a corporation are legally earnings of the corporation; they do not become the earnings of the investor-owners until a true dividend is rendered.”); G. THOMAS FRIEDLOB, RALPH E. WELTON *KEYS TO READING AN ANNUAL REPORT* 95–96 (4th ed. rev. 2008) (“Retained earnings is the dollar amount of assets furnished by earnings of the company that were not distributed as dividends. In addition to being a source of assets, total retained earnings is also the maximum amount that can be distributed to stockholders as dividends.”); AHMED RIAHI-BELKAO, *ACCOUNTING—BY PRINCIPLE OR DESIGN?* 152 (Greenwood Publishing Group 2003).

¹⁸⁷ See Art Kamlet & Rich Carreiro, *Stocks – Dividends*, Sept. 29, 1997, <http://invest-faq.com/articles/stock-dividends.html> (last visited July 18, 2009) (“Many companies declare regular dividends every quarter, so if you look at the last dividend paid, you can guess the next dividend will be the same”); see also GEORGE M. CONSTANTINIDES ET AL., *HANDBOOK OF THE ECONOMICS OF FINANCE* (Elsevier, 2003) (“Firms do not set dividends de novo each quarter. Instead, they first consider whether they need to make any changes from the existing rate. Only when they have decided a change is necessary do they consider how large it should be. Managers appear to believe strongly that the market puts a premium on firms with a stable dividend policy.”); Press Release, Wachovia, First Union To Guarantee Current Wachovia Dividend Of \$2.40 To Wachovia Shareholders (May 22, 2001), available at https://www.wachovia.com/foundation/v/index.jsp?vnextoid=9eb82e3d3471f110VgnVCM200000627d6fa2RCRD&vnextfmt=default&key_guid=21b44e9f2b1eb110VgnVCM100000ca0d1872RCRD.

¹⁸⁸ CONSTANTINIDES, *supra* note 187, at 349

¹⁸⁹ *Id.*

of being voted out of lucrative or prestigious board seats. Corporate directors may hold shares and thus be hesitant to reduce their own incomes.¹⁹⁰ Regardless the cause, a reasonable investor could interpret such corporate action (or perhaps more accurate, inaction) as implying a dividend guarantee; the company and the investor are both aware of the message such dividend consistency (at least medium to long-term) sends to the marketplace.

Where return is not so obviously correlated to capital investment, the length of return and rate variability should be important in determining the type of return, e.g., whether it is fixed or based on shared profit and loss may implicate valid partnership.¹⁹¹ However, the dividend structure and management's reluctance to adjust dividend rates unless it is a necessity demonstrates some disconnect between the investment and any corresponding profit/loss generated by the investment.¹⁹²

b. *Solution*

One solution to the dividend-as-interest concern would be for the corporation to never define a set dividend, especially during periods of relatively constant revenues. Instead, the board could actively state that the company will not guarantee any previously declared dividend rate. To ensure this is not ignored by the investor after continuous and unchanging quarterly dividends, the company can reformulate their dividend every quarter. This quarterly dividend reformulation can be done within a band (i.e., between \$1.00 and \$1.20), or recalculated every quarter using a formula based on various metrics. Another solution is for the company to use a "dry spell" approach and not pay dividends one out of every six quarters, without announcing when that quarter will be. Or, a more moderate solution would be for the company to institute a policy whereby managers necessarily based dividends strictly on the year's profit, abandoning any commitment to assuring the market a stable dividend.

The first two approaches would disconnect set dividend returns from an investment. The last would mirror a valid partnership arrangement where profit and loss are shared.¹⁹³ It would also raise questions whether stocks purchased on the open market creates partnership or preserves partnership from a previous partner. In all, the

¹⁹⁰ DAVID KELLY ET. AL., BUSINESS LAW 338 (noting that directors can, and in some companies are required to, hold shares) (5th ed. 2005).

¹⁹¹ MUHAMMAD AL-BURAEY, ADMINISTRATIVE DEVELOPMENT: AN ISLAMIC PERSPECTIVE 184-85 (Routledge 1985) (concerning the valid Islamic *mudarabah* partnership).

¹⁹² CONSTANTINIDES, *supra* note 187, at 349.

¹⁹³ *Id.*

least radical, most market-friendly approach must be taken, as any reactive tactic may seriously injure the corporation.¹⁹⁴

2. Bonds

Bonds are contractual obligations that guarantee an ongoing agreement for return until maturity.¹⁹⁵ One purchases the bond with a face value, and the interest is a percentage of that bond's face value paid at set intervals for a specified period of time.¹⁹⁶ This structure—explicit agreement which guarantees payment on a fixed investment amount—violates the prohibition against *riba*.¹⁹⁷ If there was a question of *riba* and stocks, there is none with *riba* and bonds.

a. Solution

There has been tremendous growth in the number of Islamic Bonds, known as *sukuks*, in the past several years.¹⁹⁸ These bonds share risks with the bond purchasers, thereby avoiding the *riba* prohibition.¹⁹⁹ There are different types of *sukuks*—the Accounting and Auditing Organization of Islamic Finance Institutions recognizes four-

¹⁹⁴ See generally CONSTANTINIDES, *supra* note 187, at 349 (concerning market premium on stable dividends).

¹⁹⁵ InvestorGuide, *Basic Bonds Terminology*, <http://www.investorguide.com/igu-article-571-bonds-basic-bonds-terminology.html> (last visited July 18, 2009) (noting obligation to make interest payments until maturity); see also Shariq Nisar, *Islamic Bonds (Sukuk): Its Introduction and Application*, FINANCE IN ISLAM, <http://www.financeinislam.com/article/8/1/546> (last visited July 18, 2009) (concerning the contract of bonds).

¹⁹⁶ Nisar, *supra* note 195.

¹⁹⁷ VIRGINIA B. MORRIS, *GUIDE TO UNDERSTANDING ISLAMIC INVESTING* 10 (Lightbulb Press 2001) (giving a basic explanation of the *riba* concept).

¹⁹⁸ Shakir Husain, *Growth in Sukuks Indicates Popularity*, GULF NEWS, <http://archive.gulfnews.com/articles/07/07/02/10136125.html> (last visited July 18, 2009) (stating that the *sukuk* market is said to have grown from \$600 million in 2002 to an anticipated size of \$50 billion in 2007); see also Mohammed Abbas, *Mideast Islamic Bond Market*, REUTERS, July 9, 2007, <http://www.reuters.com/article/banking-financial-SP-A/idUSL0323967420070709?pageNumber=2&virtualBrandChannel=0> (last visited July 18, 2009) (stating that according to Moody's, the upper size of the market was reported to range from \$27 to \$50 billion in 2007); The Bank of New York, *Improving Corporate Governance in Islamic Finance*, GLOBAL CORPORATE TRUST 2, http://www.bankofny.com/CpTrust/data/tl_islamic_finance.pdf (last visited July 18, 2009) (citing the Islamic Finance Information Service as reporting \$24.5 billion worldwide *sukuk* market in the first half of 2007 alone).

¹⁹⁹ Nisar, *supra* note 195; see also Abbas, *supra* note 198; Berni Moestafa, *Indonesia planning to sell Islamic bonds*, INTERNATIONAL HERALD TRIBUNE, July 18, 2006, <http://www.iht.com/articles/2006/07/17/bloomberg/bxinvest.php> (last visited Apr. 12, 2008).

teen—that the borrower can use to structure its financing.²⁰⁰ The bond setups may be similar to “lease-to-own arrangements, layaway plans, joint purchase and sale agreements, or partnerships.”²⁰¹ *Sukuk* payments have also been established to function as a sort of rent.²⁰²

The *Sharia*-friendly investment alternative also brings risks for the *sukuk* owners, especially those that invest in *sukuks* as an alternate to stocks with fixed dividend interests.²⁰³ One major source of the risk is that the *sukuks* straddle a dichotomy of rights in a state’s corporate statute. A *sukuk* issued by a Delaware corporation would not come with the *automatic statutory* rights that accompany stock ownership, namely, the right to have a say in company direction.²⁰⁴ It is important to distinguish between rights conferred by the Certificate of Incorporation and automatically guaranteed statutory rights. Under the Delaware code, the corporation may specifically adopt protections for lenders, like bondholders, though there is no requirement by the state to do so.²⁰⁵ Without this adoption, issuers of the *Musharaka sukuk* may bind themselves to consult with the *sukuk* investors, but the consultation remains individually contractual and optional as a part of the financing agreement.²⁰⁶ In either case, the corporation need not offer *sukuk* holders any rights of a shareholder.

²⁰⁰ Husain, *supra* note 198; see also Andreas A. Jobst, *The Economics of Islamic Finance and Securitization*, 19 (Int’l Monetary Fund, Working Paper WP/07/117), available at <http://www.imf.org/external/pubs/ft/wp/2007/wp07117.pdf>.

²⁰¹ Wayne Arnold, *Adapting Finance to Islam*, N.Y. TIMES, Nov. 22, 2007, at C1.

²⁰² Mahmoud A. El-Gamal, *Islamic Bank Corporate Governance and Regulation: A Call for Mutualization*, Sept. 2005, <http://www.ruf.rice.edu/~elgamal/files/IBCGR.pdf> (last visited July 18, 2009)

²⁰³ The Bank of New York in October 2007 published a paper raising several concerns over corporate governance and *sukuks*. Hani Kablawi, *Improving Corporate Governance in Islamic Finance*, THE BANK OF NEW YORK MELLON, http://www.bankofny.com/CpTrust/data/tl_islamic_finance.pdf (last visited July 18, 2009) (calling for cross-border rules, standards, and oversights to be instituted).

²⁰⁴ DEL. CODE ANN. tit. 8, § 221 (stating that bond, debenture or other obligation holders may have voting rights, but only if conferred in the certificate of incorporation).

²⁰⁵ DEL. CODE ANN. tit. 8, § 221, acknowledges that bonds, debentures, or other obligations may be granted rights under §221, stating “[e]very corporation may in its certificate of incorporation confer upon the holders of any bonds, debentures, or other obligations issued or to be issued by the corporation the power to vote.” *Id.* A *sukuk* should fall under “other obligations.” Quantifying the disadvantage would pose serious challenges, as it would include numerically determining the premium on shareholder rights, something which may vary considerably from company to company, liquidity, market, and so on.

²⁰⁶ Nisar, *supra* note 195 (describing some of the features of the *mudarba sukuk* such as: “[T]he MS contract is based on the official notice of the issue of the prospectus which must provide all information required by *shariah* for the *Qirad* con-

Hence, one is left with a difficult problem: if one is not a stock owner, then one is guaranteed absolutely no democratic rights. If the company explicitly or implicitly guarantees its dividends, a religious Muslim cannot own stock. Thus, a religious Muslim might never have corporate democratic rights. One cannot help but think that, irrespective of whether the corporation's organizational structure developed logically given the history and theoretics of the corporation, it does not accommodate a changing investment landscape.²⁰⁷

Granting shareholder equivalent rights to "alternate investors" is indeed a radical step. However, there is a middle ground. State legislatures may consider creating basic uniform rules addressing alternative financing agreements which involve multiple individual investors. Such uniform rules would allow investors to adhere to their religious restrictions without shutting those investors out of the corporate democracy. It is likely that this accommodation may first happen in an economically competitive economy with an existing Muslims population, like Thailand, before it is adopted by Western countries with Muslim minorities.²⁰⁸

3. *Inter-Corporate Financing and Self-Financing*

One potentially troubling type of investment, as it pertains to *riba*, is an interest bearing loan between a parent corporation and a wholly owned subsidiary. This subject should be of special concern to corporations that exist in or will expand to an Islamic market.²⁰⁹ As-

tract such as the nature of capital, the ratio for profit distribution and other conditions related to the issue, which must be compatible with *shariah*.”)

²⁰⁷ To see the changing landscape, one must also look at the impact this has had on the industry. See POCK, *supra* note 178, at 36 (Deutscher Universitäts-Verlag 2007) (discussing Islamic Mutual funds and several newly launched Islamic indexes, such as those of the FTSE and Dow Jones); see also Dow Jones Islamic Market Index, available at <http://www.djindexes.com/mdsidx/?event=showIslamic>; IBRAHIM WARDE, *ISLAMIC FINANCE IN THE GLOBAL ECONOMY* 142 (Columbia Univ. Press 2000) (discussing the Dow Jones Islamic Market index). See generally MICHAEL R. YOUNG & JACK H. NUSBAUM, *ACCOUNTING IRREGULARITIES AND FINANCIAL FRAUD: A CORPORATE GOVERNANCE GUIDE* 17–18 (2006) (discussing the growth of *sukuks* in recent years).

²⁰⁸ Arada Therdtammakun, *Thailand Considers First Sovereign Sukuk in 2008*, HINDUSTAN TIMES, Sept. 13, 2007, available at <http://www.hindustantimes.com/StoryPage/StoryPage.aspx?id=8181d6fc-1346-4f03-ada9-a336d6458b50&&Headline=Thailand+considers+first+sovereign+sukuk+in+2008>.

²⁰⁹ See generally Bhagwan Chowdhry & Vikram Nanda, *Financing of Multinational Subsidiaries: Parent Debt vs. External Debt*, J. CORP. FIN. 1, 259–81 (1994), available at <http://www.anderson.ucla.edu/faculty/bhagwan.chowdhry/jcf1.pdf> (“Subsidiaries of multinational corporations rely heavily on intra-firm loans from parent corporations for their financing needs. The advantage of an intra-firm par-

suming that the prohibition of *riba* will apply to loans between the two companies by reason of the investor and the contract executor, the question refocuses on whether, in the eyes of Islam, this inter-company loan is a loan or a legal and accounting fiction.²¹⁰ After all, Islam does not explicitly recognize corporations and should not place primacy on the secular legal division between them.²¹¹

On the one hand, it makes sense to treat this as a true loan, violating *riba*. Each organization is separately established under the law, organized under its own filing; following proper formalities, each company has an independent board of directors, operations, control, accounting, and no agency authority.²¹² However, one faces a conundrum: since Islamic Law does not recognize corporations, how can Islamic law recognize the legal boundaries between corporations, acknowledging them as two distinct entities?²¹³ While Islamic law can recognize other legal dictates and rules so long as they do not clash

ent loan over external subsidiary debt is that there are no bankruptcy costs associated with internal loans.”) (citation omitted).

²¹⁰ Western companies have faced a “piercing” or “lifting of the corporate veil” when a plaintiff tries to attack the parent company’s assets, claiming insufficient separation between the parent and subsidiary. See THE REALITY OF INTERNATIONAL LAW: ESSAYS IN HONOUR OF IAN BROWNLIE 226 (Guy S. Goodwin-Gill & Stefan Talmon eds., Oxford Univ. Press 1999); see also W. G. Egelhoff, *Patterns of Control in US, U.K., and European Multinational Corporations*, in ORGANIZATION OF TRANSNATIONAL CORPORATIONS 82–96 (John H. Dunning & Gunnar Hedlund eds., 6th ed. 1993) (focusing specifically on two types of management control by multinational corporations of foreign subsidiaries: “performance reporting systems” and “the assignment of parent company managers to foreign subsidiaries”; and demonstrating that the relationship between the two companies certainly is not that of completely independent parties whose only relationship stems from cooperation or partnership, much less is a loan).

²¹¹ NYAZEE, *supra* note 3, at 278.

²¹² See GARY BORN, INTERNATIONAL CIVIL LITIGATION IN UNITED STATES COURTS: COMMENTARY & MATERIALS 160–61 (Kluwer Law Int’l 1996); see also *Sims v. Sims*, 994 F.2d 210, 218 (5th Cir. 1993) (enumerating factors that may be used in federal courts); CYNTHIA DAY WALLACE, THE MULTINATIONAL ENTERPRISE AND LEGAL CONTROL: HOST STATE SOVEREIGNTY IN AN ERA OF ECONOMIC GLOBALIZATION 639–41 (Martinus Nijhoff Publishers 2d ed. 2002) (explaining that the ECJ has used a “single-entity” doctrine “to ignore legal separation in groups of companies. . . customarily pre-requisite to corporate veil lifting” and that “for EU courts, it suffices that a parent and its subsidiary be under common control and management. Legal separation is disregarded in favour of ‘economic reality.’” Where there is not complete parental control, the courts have used two different approaches to determine if it is proper to disregard the entities’ separation.); JAN PIETER KRAHNEN & REINHARD H. SCHMIDT THE GERMAN FINANCIAL SYSTEM 373–74 (Oxford Univ. Press 2004) (noting that in principle German law does not recognize the American theory of piercing the corporate veil).

²¹³ NYAZEE, *supra* note 3, at 278.

with the laws of Allah, this contemplates another issue entirely—that applicability of a fundamental tenet of Islamic law, prohibition of *riba*, would be entirely dependent on a Western legal determination.²¹⁴

By relying on Western corporate law to recognize two different entities, and applying the *riba* prohibition to their interaction, one is using secular law to determine whether *Sharia* applies, thereby making secular law the source for interpreting Islamic law. Rather, interpretation should rest with the Islamic sources alone as to whether, and how, Islamic law applies.²¹⁵ Otherwise, by accepting another law to interpret applicability of Islam, one is denying the completeness and supremacy of Islamic rules.²¹⁶ Perhaps the best advice is for the

²¹⁴ NYAZEE, *supra* note 3, at 160 (“Each prevalent law must be treated as a new case and be analysed in the light of the principles of Islamic law. . . . Each [secular] law must be shown to be valid according to the principle of Islamic law.”).

²¹⁵ See ENCYCLOPAEDIA OF ISLAM *supra* note 174, at 120–22 (“The Holy Quran is the fundamental source of the Sharia. It is the last and final revelation therefore its teachings shall always remain the source of Sharia for all times.” He elaborates that, “[t]he main purpose of Itjihad [consensus] is to find ways and means to preserve and safeguard the principles of Islam in an ever changing and developing human society and to find solutions to new problems which have not been directly or clearly discussed or decided by the Quran and the Sunnah.”); see also TAMARA SONN & MARY WILLIAMSBURG, A BRIEF HISTORY OF ISLAM 134–35 (Blackwell Publishing 2004) (about the closing of the gates of Ijtihad, or scholarly consensus on interpretation of Islamic law, in the 10th century. The authors comment on the inflexibility of the development and interpretation of Islamic law today because of the closing of that gate).

²¹⁶ See MOHAMED TAHER, ENCYCLOPAEDIC SURVEY OF ISLAMIC CULTURE 204 (Anmol Publications PVT. LTD., 1997) (“The Will of Allah is embodied in the *Shari’ah*, which is the universal, eternal and all-comprehensive legal and moral code.”); see also L. ALI KHAN, A THEORY OF UNIVERSAL DEMOCRACY 132–33 (Martinus Nijhoff Publishers 2003) (“Islam prohibits its followers from making or proposing any innovations in the fundamental structure, design, and ingredients of protected knowledge.”). Khan gives examples based on Islamic contract law, writing that a society can circumvent some of the witness requirements (gender hierarchies) of Islamic law by choosing to employ secularism, rather than enforcing “*Sharia*, including its norms that conflict with modern values.” *Id.* at 133. Values, such as those that preserve the gender hierarchies, “cannot be altered under the supremacy of *Sharia* doctrine.” *Id.* at 132. In the case of inter-company financing, allowing secular law to determine whether the financing is subject to the *riba* prohibition can be seen as the equivalent of substituting secular law for Islamic law. Unlike Khan’s example where an entire aspect of secular law is chosen over Islamic law, the situation I describe uses a portion of secular law to make Islamic law inapplicable. However, the point is the same, rather than complying with strict Islamic prohibitions, or at least determining their applicability on the merits, one is applying secular law.

company to get an Islamic legal opinion, or *fatwa*.²¹⁷

V. INTERNAL AUDITING

United States federal regulations and listing rules mandate various audit requirements for U.S. registered or U.S. traded corporations.²¹⁸ For example, the New York Stock Exchange requires that a company have an auditing committee.²¹⁹ Similarly, Sarbanes-Oxley and the Securities and Exchange Act of 1934 require that an outside auditor review the company's financial reports.²²⁰ Both an in-house and outside auditing review creates greater oversight, hopefully reducing accounting irregularities.²²¹

Europe also has audit standards that are set both on the national and pan-European level.²²² Like the New York Stock Exchange rules, EU directive 2006/43 EC requires companies to have auditing committees. However, the same directive establishes pan-European "minimum" auditing standards, such as auditor independence, while leaving enforcement to the states.²²³ Under the "Publicity Law," Ger-

²¹⁷ See Looklex/Encyclopaedia, *Fatwa*, <http://i-cias.com/e.o/fatwa.htm> (last visited July 24, 2009); About.com, *Islamic Glossary: Fatwa*, <http://islam.about.com/od/law/g/fatwa.htm> (last visited July 24, 2009).

²¹⁸ While Delaware General Corporation Law does not require reporting or oversight, such as by committees, it does require that the corporation allow the shareholder to inspect its "books and records." See DEL. CODE ANN. tit. 8, § 220(b)(1); see e.g., 15 U.S.C. § 7213(a) (2002); 15 U.S.C. § 78j-1 (2006).

²¹⁹ NYSE, Inc., Listed Company Manual § 303(a)A (2002) and 303A.00 NYSE Euronext rules.

²²⁰ See 15 U.S.C. § 7213(a) (2002); 15 U.S.C. § 78j-1 (2006).

²²¹ YOUNG & NUSBAUM, *supra* note 207, at 16 (noting that modern scholars believe that auditing mechanisms should provide corporate transparency and accurate reporting).

²²² See Council Directive 2006/43, art. 22, ¶5, 2006 O.J. (L 157/87) (EC); *id.* at art. 53 (mandating that various EU nations implement the directive by June 29, 2008); see also GEORGE J. BENSTON ET AL., *WORLDWIDE FINANCIAL REPORTING: THE DEVELOPMENT AND FUTURE OF ACCOUNTING STANDARDS* 140 (Oxford Univ. Press 2006) ("The auditing directives do not include rules for the statutory audit and the auditor but rely on national laws.").

²²³ Council Directive 2006/43, *supra* note 222; see also CHRISTIANE STROHM, *UNITED STATES AND EUROPEAN UNION AUDITOR INDEPENDENCE REGULATION: IMPLICATIONS FOR REGULATORS AND AUDITING PRACTICE* 63 (DUV 2006) (discussing French audit standards that are more stringent than the directive); BENSTON ET AL., *supra* note 222 at 140-41, 157 ("[T]he Eighth Directive . . . sets minimum requirements for the qualification, independence, and professional integrity of auditors . . . [and] does not change the fact that the member states remain the major regulatory force."). To achieve greater company transparency, the European Union has also passed Council Directive 2004/109, art. 5, §§ 1-2, 2004 O.J. (L 390/38) (EC) (mandating reporting and assigning liability to a specific actor within the

many mandates that these audited reports are to be filed with the appropriate officials, as well as published in an official gazette if the company is of a certain size.²²⁴ The United Kingdom has auditing requirements insofar as all companies must be statutorily audited, unless the company meets certain exceptions such as size, dormancy, or purpose.²²⁵ In France, all companies must be audited, irrespective of the company's size.²²⁶ It is important to note that directive 2006/43 EC does not require members of the auditing board to have the same level of independence that is required of U.S. auditors, and the European country may not necessarily have implemented stricter rules than the directive.²²⁷

Since the creation of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) in 1991, there has been a more unified move to standardize Islamic auditing principles as they pertain to accounting, governance, and auditing.²²⁸ However, these principles are oriented toward financial institutions and Islamic

corporation), and Council Directive 2007/14, 2007 O.J. (L 69/27) (EC). See generally United Kingdom Department for Business Enterprise & Regulatory Reform, Audit Directive, <http://www.berr.gov.uk/bbf/financial-reporting/directive/page25922.html> (last visited July 24, 2009).

²²⁴ See BENSTON ET AL., *supra* note 222, at 110–16 (presenting an interesting discussion of the UK system).

²²⁵ GEOFFREY MORSE, PALMER'S COMPANY LAW: ANNOTATED GUIDE TO THE COMPANIES ACT 2006 388–92 (Sweet & Maxwell 2007). See Companies Act – Overview, <http://www.companieshouse.gov.uk/companiesAct/companiesAct.shtml> (last visited Apr. 10, 2008) (noting that the Companies Act of 2006 will come into force in its entirety by October 2009).

²²⁶ ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, CORPORATE GOVERNANCE OF NON-LISTED COMPANIES IN EMERGING MARKETS 34 (OECD 2006) (explaining that French companies, regardless of size, must be audited).

²²⁷ GEORGE S. DALLAS, GOVERNANCE AND RISK 169 (McGraw-Hill 2004) (explaining that German employers require employees to sit on the supervisory board and audit committee, but this does not pass muster under the Sarbanes-Oxley independence requirement; however, the SEC has been lenient for such non-US companies); see also LARS OXELHEIM, CORPORATE AND INSTITUTIONAL TRANSPARENCY FOR ECONOMIC GROWTH IN EUROPE 318 (Emerald Group Publishing 2006) (noting that while Sarbanes-Oxley prohibits the auditing board from receiving compensation from or being affiliated with the corporation, the SEC deemed employees on the supervisory board—a German practice—as independent); JOHN ARMOUR & JOSEPH A. McCAHERY, AFTER ENRON: IMPROVING CORPORATE LAW AND MODERNISING SECURITIES REGULATION IN EUROPE AND THE US 456 (Hart Publishing 2006) (noting that independence of German auditors is not necessary); Council Directive 2006/43, *supra* note 222 at art. 2, ¶ 5.

²²⁸ THOMAS ET AL., *supra* note 137, at 206–08; see also AAOIFI.com, AAOIFI – Accounting and Auditing Organization for Islamic Financial Institutions, <http://www.aoifi.com/> (last visited July 24, 2009).

insurance companies.²²⁹ To ensure a company's *Sharia* compliance where *Sharia* is not the official rule of law, a company can implement oversight mechanisms through internal and external auditing, based on both the secular framework used by Western companies and *Sharia* auditing methods used by some Islamic financial institutions.²³⁰ Specifically, companies can implement "*Sharia* Supervisory Boards," or SSBs.²³¹ Such boards have already been adopted in governance of Islamic banks, for indices like the Dow Jones Islamic Market Index, and even by governments for their financial institutions like central banks and security agencies.²³² In fact, some countries require that certain entities have an SSB.²³³

There is no reason the SSB auditing concept cannot be applied to a corporation. To extend to corporate actions outside the financial realm—such as monitoring whether the corporation is engaging in *haram* or Islamic prohibited activities—the "auditing structure" would essentially need to be implemented as part of a management control mechanism.²³⁴ In this way, the company could ensure *Sharia* compliance with all aspects of its activities.

The SSBs would ensure the company remains transparent and would help protect the Islamic investor, and those who work in the organization, from practices that violate Islamic law. Otherwise, the actors who violate the Lawgiver's principles would not only impact themselves, but also all stakeholders.²³⁵ For secular auditing, some

²²⁹ THOMAS ET AL. *supra* note 137, at 206–08.

²³⁰ See YOUNG & NUSBAUM, *supra* note 207, at 16–20 (discussing internal and external auditing models).

²³¹ Sulaeiman, *supra* note 16 (discussing the *Sharia* Supervisory Board, or SSB); see also THOMAS ET AL. *supra* note 137, at 32–33.

²³² See BILL MAURER, *MUTUAL LIFE, LIMITED: ISLAMIC BANKING, ALTERNATIVE CURRENCIES, LATERAL REASON* 105 (Princeton Univ. Press 2005); MARAT TERTEROV, *DOING BUSINESS WITH BAHRAIN: A GUIDE TO INVESTMENT OPPORTUNITIES AND BUSINESS PRACTICE* 87 (Anthony Shoult ed., 2d ed. 2005) (explaining that Islamic banks in Bahrain must "appoint a *Sharia* Advisory Board, which operates in an identical manner to the Religious Advisory Board prescribed by the Full Commercial Bank (Islamic) license."); see also POCK, *supra* note 178, at 44.

²³³ See POCK, *supra* note 178, at 44; TERTEROV, *supra* note 232, at 87.

²³⁴ CLIVE R. EMMANUEL, ET AL., *ACCOUNTING FOR MANAGEMENT CONTROL* 97 (Cengage Learning EMEA 1990) ("Management Control is thus seen as the mediating activity between strategic planning (the setting of objectives) and task control (the carrying out of specific tasks). . . . Unlike strategic planning and operational control, management control is an essentially routine affair, reporting on the performance of all aspects of an organization's activity on a regular basis, so that all areas are systematically reviewed."); see also *id.* at 96 T. 4.1 (giving a chart discussing dimensions of management control).

²³⁵ TONY MORDEN, *PRINCIPLES OF STRATEGIC MANAGEMENT* 257 (Ashgate 2007) (explaining who constitutes corporate stakeholders and how the corporation af-

companies utilize a three angle control approach—an internal audit committee, an internal audit department, and external auditors—as each of those approaches faces particular shortcomings.²³⁶ The audit committee may lack access to information and its members may not be auditing professionals.²³⁷ The internal auditing department may be mired in bureaucracy and inefficiency.²³⁸ The external auditing company lacks the same on-premises access to documents and records as an in-house committee or department, and the review period is far more infrequent than in-house review.²³⁹ *Sharia* auditing committees and departments will encounter the same challenges facing the various Western auditing mechanisms, and likely more so, as *Sharia* auditing encompasses greater qualitative review and investigation. The auditor independence goals of the United States and European Union regulations should also be observed by the SSB, but this may prove difficult in application.²⁴⁰

Based on the qualitative nature of this particular type of auditing, Western *Sharia* oversight mechanisms will face additional obstacles, primarily, unavailability of resources. In-house personnel should be sufficiently knowledgeable about *Sharia* to gauge compliance, as *Sharia* compliance is often performed by trained Islamic legal scholars, referred to as “*Sharia* Advisors.”²⁴¹ Availability of outside firms that offer “*Sharia* Auditing” may also be an issue, especially for non-financial services industry compliance.²⁴² The seemingly small num-

fects their interests); see also NYAZEE, *supra* note 3 at § V.B. (discussing the stakeholder vs. shareholder conflict under Western law).

²³⁶ YOUNG & NUSBAUM, *supra* note 207, at 16.

²³⁷ *Id.* at 16–17.

²³⁸ *Id.* at 17–18.

²³⁹ *Id.* at 18–19.

²⁴⁰ HOLGER TIMM, CULTURAL AND DEMOGRAPHIC ASPECTS OF THE ISLAMIC FINANCIAL SYSTEM AND THE POTENTIAL FOR ISLAMIC FINANCIAL PRODUCTS IN THE GERMAN MARKET 42 (GRIN Verlag 2007). While Timm states that the *Sharia* supervisory board “must work independently of the management,” the most effective insulation from the influence of management would be auditor independence as specified under Sarbanes-Oxley, to the extent possible. *Id.*

²⁴¹ SECURITIES COMMISSION OF MALAYSIA, GUIDELINES ON ISLAMIC FUND MANAGEMENT 2–3, <http://www.sc.com.my/eng/html/resources/guidelines/guidelines/FundManagers/IslamicFundManagement.pdf> (establishing guidelines that must be followed by all Islamic fund managers; and requiring that a *Sharia* Adviser must be someone who “possesses the necessary qualifications and expertise, particularly in *fiqh muamalah* and Islamic jurisprudence, and has experience and/or exposure in Islamic finance.”); see also POCK, *supra* note 178, at 222 (stating that *Sharia* advisors on the SSB are usually “specially trained Islamic scholars”).

²⁴² The launch of Qatar’s first Islamic consultancy company, Bait Al Mashura Finance Consultations, specializing in Islamic finance services industry, auditing and training was in February 2008. This suggests a lack of such firms in countries

ber of *Sharia* auditing firms in the Gulf region suggests that geographic issues may also present a challenge when seeking to retain a *Sharia* Auditing firm. With scant availability of external resources, one can conclude that a domestic internal review mechanism will be largely unavailable or ill-equipped. Therefore, the corporation's only viable options are high-cost external auditing, or foregoing *Sharia* auditing altogether.

VI. CONCLUSION

This article seeks to illustrate, by use of some of the larger, more contentious examples, that Islamic law reaches outside the banking and finance sector, and that it carries significant implications for corporate operations as well. Consideration of *Sharia's* reach is fundamental for any corporation that currently exists in, or plans to establish a presence in a Muslim market; or for the corporation that wishes to ensure all financing avenues remain open.²⁴³

Some of the topics addressed will become of even greater importance within the coming years, even for companies that have not

with a dispersed Muslim population, let alone for general corporate, non-finance companies. See *The Peninsula: Qatar's Leading English Daily, First Islamic Finance Consultancy Company Launched*, http://www.thepeninsulaqatar.com/Display_news.asp?section=Local_news&month=February2008&file=local_news2008021032241.xml (last visited July 24, 2009). In addition, until mid-December, 2007, Ernst & Young had been the only firm in the Gulf States to offer *Sharia* auditing. See Press Release, Ernst & Young Wins Global Islamic Finance Award Again (Dec. 17, 2007), available at <http://www.ameinfo.com/142181.html> ("Noor Ur Rahman Abid, Managing Partner, Audit and Assurance Business Services, Ernst & Young, Middle East, added, 'Our pioneering approach is reflected in the fact that we are the only professional services firm in the GCC to offer *Shari'a* auditing.'").

²⁴³ For the Islamic Finance market, see Middle East Review 2003/2004, World of Information Reviews Series, at xi (Walden Publishing 27th ed. 2004). See also Phillip Moore, *Islamic Capital Markets: Still Breaking Records*, The 2008 Guide to Opportunities and Trends in Islamic Finance, Jan. 2008, at 8 ("The slowdown in the global capital market has yet to dent the Islamic sector, with the value of *sukuk* deals doubling in 2007. Indications are that the vast infrastructure investments planned for the Middle East and South Asia will help keep the trend on an upward path."). Note, however, that the opportunities for sourcing of capital are not relegated to the Middle East. *London acts as a global gateway for Islamic finance*, *id.* at 6, discussing London's role as one that "could be expected to play a part in the development of Islamic investment products. The London Stock Exchange's markets are increasingly attractive to those wishing to invest or raise funds in a Shariah-compliant way."). In 2008, for example, London markets saw "the UK's first Shari'ah-compliant exchange-traded funds (ETFs)." *Id.* In sum, "[t]he exchange's capital markets are also playing an important role in financing the development of companies from around the world[.]" *Id.*

yet considered *Sharia* practices, from increasing international popularity abroad of Islamic bonds to continued international corporate expansion.²⁴⁴ Consequently, for the corporation to serve or operate in an Islamic market, domestic or foreign, the corporation will have to formulate products and solutions that balance appealing to religious systems and not alienating its mainstream customer or investor base.

A. *Secular Implementation*

I prefer to end this article with a more complete solution, rather than open-ended analysis. Thus, I end this article with a proposal, albeit fanciful.

An international working group should be established to encourage and facilitate entities to comply with Islamic principles. A primary function of the group would be to create a model Islamic corporate code which is congruent with the local incorporation laws.²⁴⁵ To do this, the group should create a supplement to the particular state or county's relevant business act, keying that supplement to the relevant articles on which they are based. The company can adopt this supplement in their Certificate of Incorporation or Bylaws, if the local statute(s) so permit.²⁴⁶ The group has the option to later create a supplement for other organization forms.²⁴⁷

The greatest divergence from the current codes would be in terms of restrictions; for example, prohibiting issuance of preferred shares and ensuring that common shares have a variable dividend,

²⁴⁴ See Moore, *supra* note 243, at 8 (noting that “[b]y mid-December, total issuance in the *sukuk* market had reached a record \$43 billion in 177 deals,” compared to \$27 billion in deals in 2006, \$12 billion and \$7 billion in 2005 and 2004, respectively.); see also TAYLOR GROUP ET AL., *THE MIDDLE EAST AND NORTH AFRICA 2004* 144 (Routledge 2003) (noting that tremendous growth of Islamic funds is due partly to making investments acceptable under *Sharia*, using criteria that has “now been established for Islamically-acceptable equity investment.”); Josh Martin, *Islamic Investors Eye Us: Despite Political Differences, Islamic Investors Are Being Drawn to the US, Attracted By More Islam-Friendly Investment Vehicles*, BNET, Dec. 2002, http://findarticles.com/p/articles/mi_m2742/is_2002_Dec/ai_n25058646.

²⁴⁵ See, e.g., DEL. CODE ANN. tit. 8, §§ 101–398 (2006), available at <http://delcode.delaware.gov/title8/c001/index.shtml>; America Bar Association, Revised Model Business Corporation Act (2002), available at <http://www.abanet.org/bus-law/library/onlinepublications/mbca2002.pdf>; Aktiengesetz [AktG, Stock Corporation Act], Sept. 6, 1965 (F.R.G.), available at <http://bundesrecht.juris.de/aktg/>; Danish Company Law, Feb. 20, 1995, (Den.) available at <http://www.mondaq.com/article.asp?articleid=6049&searchresults=1>.

²⁴⁶ DEL. CODE ANN. tit. 8, §§ 102(b)(1), 109 (2006).

²⁴⁷ RICHARD A. MANN, BARRY S. ROBERTS, & LEN Y. SMITH, *SMITH AND ROBERSON'S BUSINESS LAW* 579 (West 11th ed. 2000).

prohibiting issuance of standard bonds and granting rights to *sukuks*, restricting certain corporate powers and engagement in certain businesses activities (i.e., investing in other corporations engaged in prohibited behavior), and prohibiting loans with interest to officers or employees who are directors.²⁴⁸

There are three main advantages to creating a model Islamic act as a supplement, keyed to each chapter of the relevant state or country corporation acts. The first advantage is that an Islamic supplement allows partial compliance as the company elects. A company may not wish to comply with all of the rules of *Sharia*, but only those that it feels are tenable and appropriate in the current or target market. If nothing else, partial compliance may create the first inroads of “corporate *Sharia* compliance” in the Western business landscape.

The second advantage of a supplement is that it allows for greater breadth and depth of content. The keyed supplement can expand with more flexibility on a specific subject matter and guide the company on other, related aspects of corporate activities. For example, the Delaware General Corporation Law broadly grants the corporation the right to conduct its business in a manner it chooses under the powers granted by the relevant Delaware code.²⁴⁹ The Islamic tracking can specify those prohibited aspects not found in the incorporation code but relevant to the corporation’s conduction of business, such as sales on credit.

The third advantage of a supplement is that it enables low-cost compliance by the companies. Without a supplement containing a well-organized compilation of relevant Islamic law, the company may have to verify Islamic compliance for every action. A comprehensive and organized supplement would diminish corporate compliance costs as the company could avoid paying expensive consultants to verify the properness of each activity. A company could instead implement the Islamic supplement on its own, in a timely manner.²⁵⁰

Denoting the company as *Sharia* compliant could be accomplished by easy, cost-effective certification. The company could submit their certificate of incorporation, which would adopt or state compliance with the tracked code, to a compliance organization designated by the working group that drafted the code-tracking supplement.²⁵¹ The

²⁴⁸ DEL. CODE ANN. tit. 8, § 121(a); § 122(4), (9), (11), (13), (19); § 221; § 143 ; § 151(c), (e) (2006).

²⁴⁹ DEL. CODE ANN. tit. 8, §§ 121(a), 122(4), (8), (10), (11), (13) (2006).

²⁵⁰ See Nisar, *supra* note 195 (noting that even *Sharia* financial auditing is relatively new). Sparse local resources could increase cost to the point of prohibition. Ability to demonstrate evidence of compliance would ease costs for firms and improve the likelihood of compliance.

²⁵¹ DEL. CODE ANN. tit. 8, § 103(c)(1) (2006).

obligations the company had committed to would then be enforceable by the shareholders who could bring suit over any divergence in corporate action from the certificate of incorporation.²⁵²

1. *Social and Economic Benefits Coincide*

There are coinciding social and financial benefits to creating and implementing such a supplement. Socially, companies which adopt this supplement will be responsible for helping to better incorporate Muslim communities into the fabric of society and the business world by inviting them to become active shareholders and giving secularists the chance to become acquainted with Muslims in a cooperative environment. Financially, the company's ability to operate a *Sharia* compliant corporation while having access to Western markets and financial resources may drive foreign "Sharia sensitive" corporations to re-incorporate in the West, bringing with it large amounts of revenue.²⁵³ Thus, the corporation, shareholder, and state will benefit.

2. *Composition, Group Structure, and Funding*

The working group should be comprised of a combination of Islamic and Western legal scholars and practitioners, as well as seasoned corporate actors.²⁵⁴ The company could be required to pay a registration fee if it adopts such a supplement, as well as an annual "renewal fee."²⁵⁵ Income from the initial registration and renewal fees

²⁵² DEL. CODE ANN. tit. 8, § 111 (2006).

²⁵³ See, e.g. DEL. CODE ANN. tit. 8, § 103(c)(2) (2006) ("All taxes and fees authorized by law to be collected by the Secretary of State in connection with the filing of the instrument[. . .].") Fees include filing fees and annual franchise taxes. See Delaware.gov, Division of Corporations – Annual Report and Franchise Tax Information, <http://www.corp.delaware.gov/frtax.shtml> (last visited July 24, 2009) ("All corporations incorporated in the State of Delaware are required to file an Annual Report and to pay a franchise tax."); see also 1 LEGAL ASPECTS OF DOING BUSINESS IN NORTH AMERICA 196 (Dennis Campbell ed., 2007) ("Delaware offers a very competitive tax climate. The corporate income tax rate is 8.7 percent on net income."); Uriel Procaccia, *The Case Against Lex Mercatoria*, in NEW DEVELOPMENTS IN INTERNATIONAL COMMERCIAL AND CONSUMER LAW: PROCEEDINGS OF THE 8TH BIENNIAL CONFERENCE OF THE INTERNATIONAL ACADEMY OF COMMERCIAL AND CONSUMER LAW 87, 9 (Jacob S. Ziegel ed., Hart Publishing 1998) ("[A] third of the revenues of the State of Delaware is derived from incorporation and annual corporate fees."); see also THE EVOLUTIONARY ANALYSIS OF ECONOMIC POLICY, *supra* note 101 ("In 1970 nearly 25% of Delaware's budget was due to the Franchise tax."); Romano, *supra* note 101, at 242.

²⁵⁴ This would be in line with the common SSB model, and it would ensure that the group understands and is tracking the statutes properly.

²⁵⁵ This would be comparable to the initial state registration fee, franchise tax, and incorporation tax levied by some, but not all, U.S. states, though not every

would fund further research, supplement updates, and creation of new supplements for different organization types. The working group may also be able to provide further support to their supplement, such as arbitration services, or offering external *Sharia* consulting, discounted for corporations which have adopted the supplement in its entirety and are paying the associated renewal fee.

B. In Sum

This article has sought to do more than analyze the application of *Sharia* to the Western corporate structure. It has sought to demonstrate that the Western corporation can offer an extraordinary opportunity to bring together seemingly contradictory cultures. The greatest calamity would be the blind march into battle of the cultures, overlooking the incredible opportunity for rich, complimentary benefits, culturally, economically, and socially.