



Penalty Clause

📅 28 September, 2000 | Fiqh of Financial Transactions, Penalty Clause

In the Name of Allāh,

the Entirely Merciful, the Especially Merciful

Praise is due to Allāh, Lord of the worlds, may the blessings and peace be upon our master Muḥammad, the last of prophets, on his family, and all his companions.

Resolution No. 109 (3/12) Penalty Clause

The Council of the International Islamic Fiqh Academy of the Organization of the Islamic Conference, holding its 12th session in Riyadh, Kingdom of Saudi Arabia, on 25 Jumādā al-Ākhirah - 1 Rajab 1421h (23-28 September 2000),

Having examined the research papers submitted to the Academy concerning the *Penalty Clause*,

Having listened to the discussion of the Academy's members and experts and other scholars,

Resolves

First: A penalty clause, in legal terminology, is an agreement between the two contracting parties on how to assess the compensation for the entitled party in case of default or delay of the other party.

Second: Confirming the Academy's previous resolutions concerning the penalty clause, namely:

- Resolution 85 (2/9) on *Salam*: "It is not permissible to include a penalty clause for delay of providing the commodity since a commodity sold through Salam is a debt and it is not permissible to impose an additional charge for delayed repayment of debt."
- Resolution no. 65 (3/7) on *Istiṣnā'*: "It is permissible to include a penalty clause if both contracting parties agree, unless subject to inevitable "
- Resolution no. 51 (2/6) on *Installment Sale*: "When the purchaser delays the payment of due installments, it is not permissible to impose any additional charge whether by virtue of a predetermined condition or Such a practice amounts to a commitment of the prohibited usury."

Third: It is permissible to include the penalty clause in the original contract or make it a separate agreement that succeeds the contract prior to the occurrence of the anticipated loss.

Fourth: It is permissible to include a penalty clause in all financial contracts

except when the original commitment is a debt. The imposition of a penalty clause in debt contracts is usurious in the strict sense.



Accordingly, it is permissible, for instance, to make a penalty clause on the contractor in the construction contract, the supplier in supply contracts and the manufacturer in Istina contracts if they fail to or delay in meeting their commitments.

It is not permissible, for instance, to make a penalty clause in Installment Sale on a debtor who delays the payment of unpaid installments, whether due to insolvency or payment evasion. It is also not permissible to impose such a clause in the Istisna contract on a purchaser who fails to meet his obligations. Fifth: The loss, which is permissible to compensate, includes the actual financial loss suffered by the partner, any other material loss and the certainly realisable gain that he misses due to his partner's default or delay. This does not

include moral prejudice.

Sixth: The penalty clause should become null and void when the concerned partner proves that his failure to meet obligations was due to reasons that fall out of his control, or when he proves that his partner has suffered no loss as a result of his breach of the contract.

Seventh: The Court is permitted, if so required by one of the two parties, to adjust the compensation amount, subject to a reasonable justification, or when the compensation proves to be exaggerated.

Recommendation

To organize a specialized symposium to research and study the terms and regulations that could be proposed to Islamic banks to guarantee the recovery of their owed debts.

Indeed, Allāh is All-Knowing.

