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Iraq, Secured Transactions, and the Promise of Islamic Law

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ABSTRACT

When Iraq regains political stability, major reconstruction projects will have to be funded and local businesses will need financing in order to gain a foothold in the new economy. In order to attract the necessary capital, the Iraqi law of secured transactions must be reformed to allow for lenders to take security in the assets of their borrowers. However, the challenge of reforming Iraqi commercial law is complicated by the requirement under the new Iraqi Constitution that any new statutes enacted by the Iraqi legislature comply with the principles of Islamic law. This Article sets forth proposals for reform that comply with Islamic law and explains how Islamic law, far from being inimical to the needs of international financial institutions, actually allows for each of the essential elements of a progressive law of secured transactions. This amenability of Islamic law to the requirements of the modern international economy holds great promise, not only for Iraq, but for all Islamic states that are seeking to invigorate their economies with the aid of foreign investment.

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> *"Islamic jurisprudence resembles an immense ocean on whose bottom one has to search, at the price of very great efforts, for the pearls which are hidden there."*
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> –The Drafting Committee of the *Majalla*[1]

I. INTRODUCTION

When security is restored in Iraq, reconstruction will proceed with renewed vigor.[2] A critical component of this reconstruction will

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1. DRAFTING COMM. FOR THE CIVIL CODE, REPORT TO HIS HIGHNESS THE GRAND VIZIER FROM THE DRAFTING COMMITTEE FOR THE CIVIL CODE (1877), *reprinted in* HERBERT J. LIEBESNY, THE LAW OF THE NEAR AND MIDDLE EAST: READINGS, CASES AND MATERIALS 66, 67 (1975) [hereinafter LIEBESNY].

2. *See generally* Special Inspector General for Iraq Reconstruction, SIGIR Homepage, http://www.sigir.mil (last visited Oct. 16, 2007) (providing information and initiatives relating to the reconstruction efforts in Iraq). The reconstruction of the Iraqi economy has been an ongoing project since Saddam Hussein was removed from power in 2003. *Id.* The reconstruction efforts were first conducted under the auspices of the Coalition Provisional Authority and are now overseen by the Special Inspector General for Iraq Reconstruction. *Id.* In light of the high level of sectarian violence in Iraq at the time of printing, many readers may doubt whether the stability that is the

be the modernization of Iraqi commercial law to ensure the efficient operation of the country's post-war economy. Of the many areas of Iraqi law that the U.S. Department of Commerce has identified as requiring reform, only one area falls within the scope of pure commercial law, namely, Iraq's law of secured transactions.[3] The adoption of a progressive, creditor-friendly law of secured transactions is essential for the success of Iraq's future economic stability since international lenders will be more likely to extend low-cost loans if they can be assured a first-priority security interest in the assets of their Iraqi debtors. The current Iraqi law contains several provisions that prevent the creation of an adequate security arrangement; therefore, absent significant legal reforms, international banks will be reluctant to provide funding for construction projects, new businesses, and other commercial enterprises that are essential to Iraq's economic recovery.

This Article takes a first step in assisting Iraq in reforming its law of secured transactions by proposing several amendments to existing Iraqi law. These amendments will enable Iraq to create a legal environment that will encourage the international banking system to fund the commercial projects that will propel Iraq into a new era of economic prosperity. The challenges faced in drafting such amendments were considerable due to the requirement under Article 2 of the new Iraqi Constitution that all new statutes must comply with Islamic law (*shari'ah*).[4] In light of this constitutional requirement, this project to reform Iraqi law began with a thorough examination of the Islamic law of secured transactions and then

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first condition of a healthy economy will return in the foreseeable future. In response to this concern, one need only look to the example of Rwanda, which suffered the horror of full-blown genocidal civil war in the mid-1990s, but now, just ten years later, enjoys one of the "most stable and least corrupt" African governments and is attracting foreign investment. G. Pascal Zachary, *Startup: Rwanda*, BUSINESS 2.0, Aug. 2007, at 66, 68.

3. U.S. DEP'T OF COMMERCE, OVERVIEW OF COMMERCIAL LAW IN PRE-WAR IRAQ (2003), *available at* http://www.export.gov/iraq/pdf/iraq_commercial_law_current.pdf. In its list of ten problematic areas in Iraqi law, the Department of Commerce emphasized that "Iraq has no public system for recording liens or other security interests in movable or personal property." *Id.* at 1. However, as discussed herein, the deficiencies of the Iraqi law of secured transactions go beyond the mere absence of a public registry. The other legal reforms recommended by the Department of Commerce include, among other things, the relaxation of restrictions on foreign investment, the reduction of business licensing requirements, the creation of an antitrust law, and the reform of intellectual property laws. *Id*; *see also* Theodore W. Kassinger & Dylan J. Williams, *Commercial Law Reform Issues in the Reconstruction of Iraq*, 33 GA. J. INT'L & COMP. L. 217, 221–28 (2004) (providing an overview of Iraq's commercial laws and proposals for reform).

4. IRAQI CONSTITUTION art. 2(1)(A), *available at* http://www.export.gov/IRAQ/pdf/iraqi_constitution.pdf. This Article assumes that Article 2 of the Iraqi Constitution will ultimately be interpreted in a strict manner that requires compliance with Islamic law even in commercial matters.

proceeded to an analysis of current Iraqi law. Against this background of study, the amendments proposed herein were carefully crafted to ensure compliance with Islamic law while still providing for the needs of a modern Iraq. Although this Article focuses on particular issues in Iraqi law, the concepts embodied in the proposals can also benefit other Islamic states around the world that are seeking to modernize their commercial laws.[5]

Part II of this Article explains in greater detail why Iraqi law must be reformed in the area of secured transactions. Part III identifies the five cardinal features of a progressive law of secured transactions, all of which should be adopted into Iraqi law. Part IV provides a detailed analysis of the Islamic law of secured transactions and examines the fundamental bases of these legal principles. This analysis will reveal that Islamic law, contrary to certain traditional views, allows for each of the five features of a progressive law of secured transactions. Part V provides an overview of Iraqi law and legal history. Finally, Part VI explains the current state of the law of secured transactions in Iraq, and sets forth a series of proposals for the amendment of Iraqi law that will serve to implement the legal reforms needed to attract the capital necessary for Iraq's successful reconstruction.

II. THE NEED FOR LEGAL REFORM IN IRAQ

In the coming years, hundreds of billions of dollars will be needed to rebuild the Iraqi infrastructure and economy. A considerable portion of these funds will be provided by donor countries in the form of grants and low-interest loans.[6] However, Iraq will also depend upon the private international banking system for the capital needed to finance oil and electricity projects, to fund construction projects, and to provide financing to a host of businesses that will need to gain stability in a post-war environment. However,

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5. The list of Islamic states will vary depending on the definition used. The membership of the Organization of the Islamic Conference, which consists of the following states, provides a helpful starting point: Afghanistan, Albania, Algeria, Azerbaijan, Bahrain, Bangladesh, Benin, Brunei-Darussalam, Burkina-Faso, Cameroon, Chad, The Comoros, Cote d'Ivoire, Djibouti, Egypt, Gabon, Gambia, Guinea, Guinea-Bissau, Guyana, Indonesia, Iran, Iraq, Jordan, Kazakhstan, Kuwait, Kyrgyzstan, Lebanon, Libya, Malaysia, The Maldives, Mali, Mauritania, Morocco, Mozambique, Niger, Nigeria, Oman, Pakistan, Qatar, Saudi Arabia, Senegal, Sierra Leone, Somalia, Sudan, Suriname, Syria, Tajikistan, Togo, Tunisia, Turkey, Turkmenistan, Uganda, United Arab Emirates, Uzbekistan, and Yemen. Org. of the Islamic Conference, http://www.oic-oci.org (follow "About OIC" hyperlink; then follow "Members" hyperlink) (last visted Oct. 16, 2007). Of course, the influence of the *shari'ah* on the laws of these states varies widely.

6. SPECIAL INSPECTOR GENERAL FOR IRAQ RECONSTRUCTION, QUARTERLY REPORT AND SEMIANNUAL REPORT TO THE UNITED STATES CONGRESS 121–35 (2007).

international banks will be reluctant to provide financing without an adequate security package that grants a first-priority security interest in the debtor's assets.[7] This need for reliable asset-backed financing is of particular importance in a post-war environment, where businesses and their lenders face a variety of risks. The ability of lenders to acquire an easily enforceable security interest in a debtor's assets depends on the legal regime in place in the country where those assets are located. Therefore, it is imperative that Iraq take the necessary steps to ensure that its commercial laws allow for the creation of security interests that meet the needs of the international banking community.

The need for a progressive law of secured transactions in Islamic countries, such as Iraq, has been highlighted in Michael McMillen's article describing a project-finance transaction for the construction of a Chevron petrochemical plant in Saudi Arabia.[8] An international syndicate of banks provided the financing for the project, and—as is typical of a project-finance transaction that limits the lender's recourse to the project revenues and assets—the banks required a first-priority security interest in the project assets.[9] Although the transaction was successful and the plant was built, the article describes in detail the many obstacles that Saudi Arabia's conservative interpretation of Islamic law presented to the creation of an enforceable security interest in the project assets.[10]

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7. Michael J.T. McMillen, *Islamic* Shari'ah-*Compliant Project Finance: Collateral Security and Financing Structure Case Studies*, 24 FORDHAM INT'L L.J. 1184, 1206 (2001); *see also* ABDULLAH SAEED, ISLAMIC BANKING AND INTEREST: A STUDY OF THE PROHIBITION OF RIBA AND ITS CONTEMPORARY INTERPRETATION 88 (1996) (discussing the role of security in traditional bank lending).

8. McMillen, *supra* note 7, at 1206.

9. *Id.* at 1205–06 (explaining that international banks are "accustomed to advanced statutory collateral security systems in which there are precise, but easily understood and implemented, systems for recordation of mortgages, pledges, and other security interests," and that these banks typically

> have precise requirements as to the nature of the security interest that is permissible in a lending transaction . . . [namely,] perfection of the security interest must be obtainable and the priority of the security interest must rank ahead of all competing creditors—i.e., a first prior perfected security interest; the security interest must cover all the assets comprising the project . . . .

A traditional project finance transaction requires a company to create a project company, or "special purpose vehicle" (SPV), which will hold the project assets during the construction of the project. *See* Michael P. Malloy, *International Project Finance: Risk Analysis and Regulatory Concerns*, 18 TRANSNAT'L LAW. 89, 89–90 (2004) (discussing the basic structure of international project financing). The construction of the project is funded by lenders who look solely to the revenue of the project (and not to the owner of the SPV) for repayment of the loans extended to the SPV. *Id.* at 90. Due to the limited recourse nature of the loans, the lenders demand that the loans be firmly secured by the project assets held by the SPV. *Id.*

10. Malloy, *supra* note 9, at 90.

A number of other articles have described project financings in Saudi Arabia, Kuwait, the United Arab Emirates, and other Islamic countries where there is a growing need for private financing of large-scale projects in order to reduce the spending of public monies and spread the risk among private investors.[11] All of these articles describe successful transactions in that all of the transactions managed to attract the funding needed for the project. However, these transactions highlight the central tensions in the intersection of western and Islamic finance: the reluctance of western investors to accept Islamic structures and the legal obstacles in Islamic countries to using structures familiar to western investors (although these obstacles vary from state to state). The initial need of any commercial project is always the same, namely, to raise capital. In the best of worlds, a project company—whether located in an Islamic or a western state—would have access to the capital of investors around the globe, including Islamic and western investors. However, this dream may be deferred due to the reluctance of western banks to invest in projects that use Islamic financial structures rather than structures familiar to the banks based on the Uniform Commercial Code (U.C.C.) and other western commercial laws. As a result, Islamic projects can be cut off from western funding. Likewise, western projects can be denied funding from Islamic investors if the financial structure of the project violates the strictures of Islamic law.

The solution to this problem is two-fold. First, western banks must be educated about Islamic finance in order to overcome their reluctance to invest in projects that make use of Islamic financial instruments. This must be accompanied by the ongoing efforts of the creative Islamic lawyers who are constructing financial mechanisms that both comply with Islam and satisfy the needs of western investors.[12] Second, Islamic scholars must continue to examine and

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11. *See, e.g.*, Mohammad S. Al Omar, *Islamic Project Finance: A Case Study of the Equate Petrochemical Company*, *in* THE PROCEEDINGS OF THE THIRD HARVARD UNIVERSITY FORUM ON ISLAMIC FINANCE: LOCAL CHALLENGES, GLOBAL OPPORTUNITIES 259, 262 (2000) (describing a project financing in Kuwait using an *ijara* structure); Nimali de Silva & John Dewar, *The Mirage Becomes Reality: Privatization and Project Finance Developments in the Middle East Power Market*, 24 FORDHAM INT'L L.J. 1029 (2001) (describing project finance transactions in Saudi Arabia, Oman, and Abu Dhabi); McMillen, *supra* note 7, at 1232–63 (describing alternatives to the typical project finance structure using the Islamic *sharikat mahassa-murabaha* approach and the *istisna'a-ijara* approach); Babback Sabahi, *Islamic Financial Structures as Alternatives to International Loan Agreements: Challenges for U.S. Financial Institutions*, 24 ANN. REV. BANKING & FIN. L. 487 (2004) (discussing various alternative approaches to western transactional structures).

12. In order to introduce the additional flexibility into Islamic law that is needed in order to meet the requirements of the modern economy, Islamic scholars make use of alternative methods (*hiyal*) to achieve ends that cannot be achieved directly under Islamic law. JOSEPH SCHACHT, AN INTRODUCTION TO ISLAMIC LAW 78–79 (1964). The most well-known examples of *hiyal* are those alternative approaches used to carry out financial transactions without charging interest (*riba*), which is

interpret Islamic law in an effort to accommodate western financial structures to the extent possible. With this two-pronged approach, both Islamic and western project companies will find it easier to tap into the liquidity of capital—wherever that capital may be. Failing these efforts, commercial projects will not be able to reach the entire pool of global funding or may only receive funding at a higher cost. For example, if a syndicate of western banks believes that the structures employed in a certain Islamic project do not provide the same level of security that can be achieved under a western project-finance structure that relies on a progressive law of secured transactions, such as Article 9 of the U.C.C., the bank may refuse to finance the project, or will at least increase the cost to the borrower in the form of higher interest rates. In the specific case of Iraq, this threat of reduced (or high-cost) funding would threaten the successful reconstruction of the country. One way to reduce this threat is to revise the Iraqi laws in a manner that will provide for a progressive secured transactions regime that is amenable to project finance and will appeal to the international banking community while still complying with Islamic law.

A progressive law of secured transactions is not only necessary for project-finance transactions but is also a prerequisite for inventory and accounts-receivable financing, which are mainstays of modern commercial finance since they allow businesses to maintain low-cost lines of credit secured on their most valuable assets. Moreover, the securitization of revenue-producing assets—such as mortgages, accounts receivable, and intellectual property—which allows companies to tap into the vast financial resources of private equity and investment funds, is far more difficult without a progressive law of secured transactions.[13] On the most basic level,

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prohibited under Islamic law. Nicholas Dylan Ray, *The Medieval Islamic System of Credit and Banking: Legal and Historical Considerations*, 12 ARAB L.Q. 43, 58 (1997). Islamic bankers have developed a number of such methods, including *murabaha* (cost-plus financing), *ijara* (lease financing), *musharaka* (partnership finance), *mudaraba* (venture capital finance), and *istisna'a* (construction or manufacturing finance). *See* Kimberly J. Tacy, *Islamic Finance: A Growing Industry in the United States*, 10 N.C. BANKING INST. 355, 357–62 (2006) (providing a concise explanation of these types of Islamic transactions). *Hiyal* have also been devised to provide for something approximating a non-possessory security interest. Nicholas H.D. Foster, *The Islamic Law of Real Security*, 15 ARAB L.Q. 131, 145 (2000). These *hiyal* include providing the seller with a right of retention until payment is received *(habs)*, a sale/leaseback arrangement *(bay' bil-istighal)*, and a double sale *('ina)*, which entails the debtor selling an item to the bank and then immediately buying the item back from the bank on credit for a greater price. *Id.* at 146. In a double sale scenario, the bank receives payments that exceed the amount "borrowed" and retains title to the goods until payment in full is received. *Id.* at 146–48.

13. Securitization allows for the owners of payment-stream-producing assets (such as accounts receivable, mortgages, or other such assets that embody a right to receive payments) to tap into the vast pool of institutional investors by issuing bonds backed by the security of these assets. Steven L. Schwarcz, *Securitization Post-Enron*,

any credit transaction will be made more affordable for the debtor if the creditor can take a security interest in the debtor's assets. Even parties to an Islamic transaction (such as a *musharaka*, *murubaha*, or *mudaraba*) benefit from a liberalized law of secured transactions since it allows the creditor to secure whatever payment obligations are owed by the debtor. This reduces the risk of non-payment and, in turn, enables Islamic banks to reduce the fees charged in such transactions.[14]

A creditor-friendly, progressive law of secured transactions, such as Article 9 of the U.C.C., is not without its critics. The very nature of secured transactions makes the subject contentious. At its core, the law of secured transactions must establish priorities among claimants. Therefore, choices about priorities must be made, and groups that are subordinated will invariably challenge the fairness of the system. For example, tort claimants who have been personally injured by a corporation are subordinated to secured creditors under Article 9, and this is one of the reasons why many consider Article 9 to be a harsh law that favors financial institutions over innocent

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25 CARDOZO L. REV. 1539, 1541 (2004). Securitization enables a company to borrow money at a low cost in the form of a bond issuance that has a low yield because it is structured to reduce risk to the investors by securing the bonds on assets that are protected from the issuer's creditors in the event of bankruptcy. *Id.* The typical securitization transaction has the following structure: (i) the owner of the underlying assets sells the assets to a SPV, which sells them to a second SPV, (ii) this double-sale renders the second SPV "bankruptcy remote" so that the assets held by the SPV cannot be reached by the original owner's creditors upon bankruptcy, thus transforming the underlying assets into more secure collateral, (iii) the second SPV then issues limited recourse bonds (secured on the underlying assets) to investors at low interest rates that can only be paid by revenue streaming from the underlying assets. *Id.* at 1540. The Islamic *sukuk* has become the latest sensation in Islamic finance because it provides an Islamic-compliant securitization structure. *See generally* Tacy, *supra* note 12, at 360–61 (discussing the innovative nature of the *sukuk*). Rather than issue bonds, the SPV in a *sukuk* issues certificates that endow the holder with a beneficial interest in the SPV's assets. *Id.* The SPV holds these assets in trust for the certificate-holders and uses the revenue stream to pay off the obligations to the certificate holders (similar to trust-receipt financing). *Id.* However, the holder of a *sukuk* certificate may not actually enjoy the full security of the trust assets. For example, in the event of the issuer's default, the certificate holders' recourse may be limited to a put requiring the originator to repurchase the trust assets from the SPV (the proceeds of which will then be used to pay the certificate holders). *See, e.g.*, QATAR GLOBAL SUKUK QSC, OFFERING CIRCULAR 12, 18, 20 (2003), *available at* http://lfxsys.lfx.com.my/others/qatar/Offering%20Circular%208%20Oct%202003.pdf (providing the terms of a *sukuk*); *see also* FIRST GLOBAL SUKUK INC., OFFERING CIRCULAR 28, 35 (2001), available at http://cm2.zawya.com/researchreports/zawyapr/20060724_zawyaPR_081228.pdf. However, should the originator fail, or be unable, to purchase the assets, the certificate holders may not have a right to unilaterally sell the assets and collect the proceeds. *Id.*

14. *See* NICHOLAS DYLAN RAY, ARAB ISLAMIC BANKING AND THE RENEWAL OF ISLAMIC LAW 62–63, 74, 182–83 (Mark S. Hoyle ed., 1995) (providing examples of the use of security interests in conjunction with a *musharaka*, *murubaha*, and *mudaraba*).

victims of tortious actions.[15] The counter-argument is that a growing economy requires the low-cost credit made possible by Article 9, and that the benefits of a strong economy far outweigh any unfairness in the system. Another argument against a creditor-friendly law of secured transactions is that it fails to reduce the cost of credit in the long run since any gains realized by the debtor, in the form of lower interest rates offered by secured creditors, are offset by the higher rates charged by unsecured creditors (who are forced to increase their rates in response to the fact that secured creditors will have a first priority claim to the debtor's assets upon default). Other critics assert that secured lending introduces inefficiencies to the market by encouraging banks to lend to asset-rich companies rather than those companies that have the most potential for growth.[16] This Article will not explore these debates, except to assert that we should not argue with success. Article 9 of the U.C.C. has been an integral component of the great economic success of the United States since the 1950s, and Iraq should also have the opportunity to benefit from a law of such proven utility.[17]

Another example of the dramatic benefits that can result from a progressive law of secured transactions is provided by the Unidroit Convention for International Interests in Mobile Equipment (Cape Town Convention), which has been a resounding success since it entered into force in 2006.[18] The Cape Town Convention provides the framework for the creation of security interests in aircraft, trains, and space assets (such as satellites).[19] As evidence of the benefits that borrowers currently derive from the Cape Town Convention, the Export-Import Bank of the United States has reduced its exposure fee by one-third for foreign purchasers of American aircraft that hail from countries that have ratified the Aircraft Protocol to the Cape Town Convention.[20] This substantial rate reduction is a direct result

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15. *See, e.g.*, Charles W. Hendricks, *Offering Tort Victims Some Solace: Why States Should Incorporate a 20% Set-Aside into Their Versions of Article 9*, 104 COM. L.J. 265 (1999) (discussing a proposal to reform Article 9 of the Uniform Commercial Code).

16. *See* David Gray Carlson, *On the Efficiency of Secured Lending*, 80 VA. L. REV. 2179, 2200 (1994) (discussing this and other critiques of secured lending).

17. In 1954, Pennsylvania became the first state to adopt the U.C.C., and Massachusetts followed in 1958. The remainder of the fifty states adopted the U.C.C. during the 1960s. TABLE OF JURISDICTIONS WHEREIN CODE HAS BEEN ADOPTED, U.C.C. Refs. & Annots. (2004).

18. Convention on International Interests in Mobile Equipment art. 49(1), Nov. 16, 2001, S. Treaty Doc. No. 108-10, *available at* http://www.unidroit.org/english/conventions/mobile-equipment/mobile-equipment.pdf [hereinafter Cape Town Convention].

19. *Id.* arts. 2(2)–(3).

20. Press Release, Export-Import Bank of the United States, Ex-Im Bank Extends Offer of Reduced Exposure Fee Through March 2007 for Buyers in Countries Implementing the Cape Town Treaty (Sept. 7, 2006), *available at* http://www.exim.gov/pressrelease.cfm/89EB7EA7-D71B-1DBE-F247DEFE0FF93BF8/. The Cape Town

of the ability of the Export-Import Bank to acquire an enforceable security interest in the aircraft that are being financed. Economic analyses of the potential benefits of the Cape Town Convention have predicted that lower interest rates will save a hypothetical borrower $16 million over the life of a twelve-year bond-financed acquisition of a $100 million aircraft.[21] Iraq should certainly become a party to the Cape Town Convention and its Aircraft Protocol in order to reduce the cost of financing the planned expansion of its national airline, Air Iraq.[22] However, there is no reason for Iraq to limit the benefits of a progressive law of secured transactions to aircraft financings. Instead, Iraq should revise its commercial law in accordance with the proposals set forth herein and make these cost-saving benefits available for all sectors of its economy.

III. THE FIVE FEATURES OF A PROGRESSIVE LAW OF SECURED TRANSACTIONS

A progressive law of secured transactions contains the following five cardinal features that, taken together, allow for the creation of a security arrangement that will encourage lenders to provide financing to businesses:[23]

Convention only applies to that category of assets for which a separate protocol has entered into force. Cape Town Convention, *supra* note 18, art. 49(1). The Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment entered into force on March 1, 2006, three months following the deposit of the eighth instrument of ratification. Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment art. XXVIII(1), Nov. 16, 2001, S. Treaty Doc. No. 108-10, *available at* http://www.unidroit.org/english/conventions/mobile-equipment/aircraftprotocol.pdf [hereinafter Aircraft Protocol]. The eighth instrument of ratification for the Aircraft Protocol was deposited by Malaysia on November 2, 2005. Int'l Inst. for the Unification of Private Law, *Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment*, http://www.unidroit.org/english/implement/i-2001-aircraftprotocol.pdf (last visited Oct. 18, 2007).

21. Anthony Saunders et al., *The Economic Implications of International Secured Transactions Law Reform: A Case Study*, 20 U. PA. J. INT'L ECON. L. 309, 338–39 (1999).

22. *See* Air Iraq, http://www.airiraqco.com (last visited Oct. 16, 2007) (describing the planned expansion of Air Iraq).

23. Given the complexity of the law of secured transactions, there are a number of additional features which are desirable in a progressive law but which fall outside the scope of this article. Such features include the ability to create a security interest in all types of collateral, the continued validity of a security interest despite the sale of the collateral, the extension of a security interest to the proceeds realized by a debtor upon the sale of collateral, and the coordination of bankruptcy law with the law of secured transactions to ensure that a security interest can still be enforced after the bankruptcy of the debtor. Mark J. Sundahl, *The "Cape Town Approach": A New Method of Making International Law*, 44 COLUM. J. TRANSNAT'L L. 339, 345 (2006).

1. The creation of non-possessory security interests
2. The creation of security interests in future assets
3. The securing of future debts
4. Clear rules that give a secured party priority over competing claimants
5. The prompt enforcement of security interests without a court order

The ability of the debtor to grant a "non-possessory" security interest means that the security interest will be valid without the creditor having to take possession of the collateral.[24] This freedom to create non-possessory security interests is essential for a number of reasons. First, a strict possession requirement prevents companies from being able to offer as collateral any property that is required for the operation of their business (such as equipment or inventory) since they would have to surrender the property to the secured party. Second, many types of property are intangible and therefore cannot be possessed in a literal sense (such as a patent or a right to sue). Third, debtors can only pledge collateral to a single secured party if possession is required, since only one party can possess an item at a time. Fourth, a strict possession requirement could be applied in a way that would prohibit the creation of a security interest in future assets since it is impossible to possess assets not yet in existence. In order to avoid these pitfalls, many modern secured transactions statutes, most notably Article 9 of the U.C.C. and the Cape Town Convention, allow for non-possessory security interests.[25]

A progressive law of secured transactions also allows the parties to create a security interest that extends not only to property that exists at the time of contracting, but also to property that is acquired later by the debtor (referred to herein as future assets, or "after-acquired" collateral).[26] The assets of a modern business are constantly in flux as equipment is acquired, inventory is bought and sold, intellectual property is created, and accounts receivable arise. For a lender who agrees to fund the operations of a business, it is imperative that a security interest in future assets can be created at the outset in order to provide the creditor with the additional security that such collateral can bring. Indeed, a business that is seeking funding as a start-up will have little in the way of existing collateral, and lenders can only look ahead to future collateral for the security that will enable them to agree to finance the company.

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24. *Id.*

25. U.C.C. § 9-203(b) (2001); Cape Town Convention, *supra* note 18, art. 7.

26. *See generally* Peter S. Menell, *Bankruptcy Treatment of Intellectual Property Assets: An Economic Analysis*, 22 BERKELEY TECH. L.J. 733, 814 (2007) (explaining how U.C.C. Article 9 allows lenders to attach future assets).

Similarly, a progressive law of secured transactions allows for future loans to be secured under a pre-existing security agreement without any amendments being made to the security documentation.[27] Under such a law, security agreements are imbued with an organic flexibility that allows the security arrangement to expand automatically to secure new loans without the need to supplement the existing documents. In addition to reducing transactional complexity and cost, a lender entering into a continuing relationship with a debtor—whether it is a long-term construction project that may require additional loans, or a line of credit from which a debtor draws down periodically—needs to know that it will have a first-priority security interest on the debtor's assets to secure future loans. Otherwise, the lender can only be certain that it enjoys seniority with respect to the initial loans, thus jeopardizing the long-term transaction. Article 9 of the U.C.C. permits both the use of future assets as collateral and the securing of future debts, which allows for the operation of the "floating lien," providing creditors in the United States with a simple and powerful method of maintaining adequate security as the debtor's assets change and the loan obligations expand and contract.[28] Likewise, the Cape Town Convention allows for future loans to be secured by the collateral identified in the original security agreement, provided that the agreement "enables the secured obligations to be determined."[29]

Perhaps the single most important feature of a progressive law of secured transactions is the existence of clear rules regarding the priority of a secured creditor over competing claimants.[30] Since even unsecured creditors are generally able to eventually attach the assets of a debtor to satisfy an unpaid claim, there is no benefit in taking a security interest unless the law grants a secured party priority over unsecured claimants.[31] Therefore, at a minimum, the law must provide that a secured party enjoys such priority over unsecured claimants. In addition, the law must set forth clear rules that establish the priority of competing secured creditors so that

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27. *See* William H. Widen, *Lord of the Liens: Towards Greater Efficiency in Secured Syndicated Lending*, 25 CARDOZO L. REV. 1577, 1588–89 (discussing progressive contracting techniques for reducing costs in future transactions).

28. U.C.C. § 9-204(a),(c). Technically, Article 9 of the U.C.C. does not allow for the creation, or "attachment," of a security interest until the asset has actually come into existence and "the debtor has rights in the collateral." *Id.* § 9-203(b)(2). However, parties can enter into a security agreement that extends to future assets and results in the automatic attachment of a security interest in the future assets when the debtor acquires rights in the assets.

29. Cape Town Convention, *supra* note 18, art. 7(d).

30. *See, e.g.*, Lois R. Lupica, *The Impact of Revised Article 9*, 93 KY. L.J. 867, 881–82 (2004) (discussing the system of priority established by the U.C.C.).

31. *See* Scott B. Ehrlich, *Avoidance of Foreclosure Sales As Fraudulent Conveyances: Accommodating State and Federal Objectives*, 71 VA. L. REV. 933, 947 n.40 (1985) (showing an unsecured creditor's ability to attach).

prospective creditors can determine in advance of making any loans whether they will have priority over other secured parties. If prospective lenders cannot determine in advance that they will enjoy priority over unsecured lenders and other secured parties, the risk of potential subordination may deter them from extending loans. Both the U.C.C. and the Cape Town Convention grant seniority to secured parties over unsecured creditors and resolve priority contests between competing secured creditors according to a transparent set of rules that rely on a searchable public registration system.[32] Between competing secured parties, the general rule under the U.C.C. grants priority to the "first to file or perfect," while the Cape Town Convention provides an even simpler rule granting priority to the first secured party that registers its security interest.[33] This public registration system provides a simple method of determining priority among competing claimants and allows prospective lenders to quickly determine whether there are existing security interests in a borrower's assets that would have priority over the prospective lender's security interest should the lender decide to advance funds.[34] Consequently, lenders can easily determine whether a prospective borrower has sufficient unencumbered collateral to secure a requested loan.

Even if a state's secured transactions laws contain all of the above-mentioned elements of a progressive legal regime, the value of the security interest is significantly reduced, and lenders will be reluctant to provide financing, if a security interest cannot easily be enforced.[35] Delay in enforcement not only deprives the secured party of the time-value of the proceeds that are realized upon the sale of the collateral, but also creates the risk that the collateral will be diminished in value through obsolescence or damage while in the custody of the debtor. The most serious impediment to the prompt enforcement of a security interest is a requirement for a court order

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32. U.C.C. § 9-317(a)(2) (granting priority to secured parties over "lien creditors," which include, among others, unsecured claimants who have reduced an unpaid judgment against the debtor to a right to levy against the debtor's property); Cape Town Convention, *supra* note 18, art. 29(1) (granting "[a] registered interest . . . priority over any other interest subsequently registered and over an unregistered interest").

33. U.C.C. § 9-324(a); Cape Town Convention, *supra* note 18, art. 29(1). Filing a financing statement is the most common method of perfecting a security interest under Article 9 of the U.C.C.; thus, the priority rule for the U.C.C. generally turns on the "first to file." However, perfection can also be achieved, although it is far less common, by taking possession of the collateral or by other means. U.C.C. § 9-314. In such cases, the first to perfect (whether by filing or other methods) gains priority. *Id.*

34. *See* Sundahl, *supra* note 23, at 345–46 (mentioning the significance of a public registration system in meeting the requirements of modern finance).

35. *Id.* (listing creditor enforcement measures as an essential perequisite of a modern economy).

prior to enforcement.[36] Such a requirement is likely to entail litigation, particularly when a secured party is faced with a recalcitrant debtor or other secured parties who wish to contest the enforcement. Therefore, secured parties must be permitted to enforce their security interests upon default (preferably by selling the collateral and applying the proceeds to the underlying obligation) without a court order. Both the U.C.C. and the Cape Town Convention provide examples of progressive statutes which permit secured parties to easily enforce security interests in this manner.[37]

IV. SECURED TRANSACTIONS UNDER ISLAMIC LAW

Islamic jurisprudence has developed an extensive system of rules governing secured transactions. As is true for Islamic law in general, these rules are derived from the following four fundamental sources (referred to collectively as the *usul al-fiqh*, or "roots of jurisprudence"): the Koran, the Traditions of the Prophet (*sunna*), the consensus of Islamic jurists (*ijma*), and the application of reasoning by analogy (*qiyas*).[38] The Traditions of the Prophet are based primarily on accounts (*ahadith*, sg. *hadith*) of events in the life of Mohammed and his Companions, who established standards for proper behavior by their example.[39] In addition to these primary sources, the following analysis of the Islamic law of secured transactions takes as its starting point the rules regarding *rahn* set forth in the *Majalat Al-Ahkam Al-Adliyah* (hereinafter the *Majalla*), an elegant codification of Islamic law that was adopted by the Ottoman Empire as its Civil Code in 1877.[40] As will be elucidated in

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36. *Id.* at 346.

37. U.C.C. § 9-610; Cape Town Convention, *supra* note 18, art. 29(1). Under the Cape Town Convention, the debtor must give its consent before the secured party may sell the collateral (although this consent can be given in the security agreement prior to default). *Id.* art. 8(1).

38. SCHACHT, *supra* note 12, at 114. An alternative view of the roles played by the four roots of Islamic jurisprudence is to treat the Koran and the *sunna* as the only true sources of Islamic law, while *qiyas* is a method of reasoning employed by scholars to arrive at a consensus (*ijma*) regarding the interpretation of the sources. Chibli Mallat, *From Islamic to Middle Eastern Law: A Restatement of the Field (Part II)*, 52 AM. J. COMP. L. 209, 262–63 (2004). *Qiyas* is a method of reasoning by analogy that allows scholars to extract general principles of law from specific cases described in the Koran or *ahadith*. FRANK E. VOGEL & SAMUEL L. HAYES III, ISLAMIC LAW AND FINANCE: RELIGION, RISK, AND RETURN 43 (1998).

39. VOGEL & HAYES III, *supra* note 38, at 23.

40. MAJALAT AL-AHKAM AL-ADLIYAH (1288), *reprinted in* 2 ARAB L.Q. 315 (1987) [hereinafter *Majalla*]. The *Majalla* is also sometimes referred to as the Ottoman Civil Code of 1877. *See, e.g.*, LIEBESNY, *supra* note 1, at 65; *see also* Foster, *supra* note 12, at 135 (regarding the date of the *Majalla*); LIEBESNY, *supra* note 1, at 66–69 (for further information regarding the drafting of the *Majalla*). The approach to Islamic law taken in this Article is derived primarily from the Sunni schools of

the following sections, despite the common opinion that the Islamic system of *rahn* is antithetical to the approach taken in the U.C.C. and other western codes, the *shari'ah* actually proves to be amenable to each of the five essential elements of a progressive law of secured transactions.

A. *Non-Possessory Security Interests*

Islamic law has been traditionally interpreted as requiring possession of the collateral (*marhoun*) by the secured party (*murtahin*) in order for the debtor/grantor (*rahin*) to create an effective security interest (*rahn*).[41] As explained above, the lack of non-possessory security interests is a serious hindrance to the efficient operation of a modern economy.[42] Article 706 of the *Majalla* sets forth this possession requirement in an unequivocal fashion:

> If the pledge is not transferred to the effective possession of the pledgee . . . such contract is incomplete and revocable. The pledgor may, therefore, denounce such contract before delivery of the pledge.[43]

This requirement has been echoed in the laws of Islamic countries as well as in the writings of legal scholars.[44] However, the fundamental

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jurisprudence due to the strong tradition of Sunni thought in the Iraqi legal system (which tradition stems largely from the strong role played by the *Majalla* in Iraq). *See infra* Part V (regarding the history of Iraqi law). However, given the recent shift of political power to the Shi'a population in Iraq, many legislators are also likely to approach questions of Islamic law from the perspective of Shi'a jurisprudence. *See* Haider Ala Hamoudi, *Money Laundering Amidst Mortars: Legislative Process and State Authority in Post-Invasion Iraq*, 16 TRANSNAT'L L. & CONTEMP. PROBS. 523, 539–40 (2007) (positing the importance of Shi'a jurisprudence in post-war Iraq).

41. The term "security interest" is used in this Article in preference to other similar terms (such as pledge, lien, hypothecation, mortgage, charge, or encumbrance) because "security interest" is the most abstract term. It embraces all types of secured transactions (in contrast to the words "pledge," which refers only to possessory security interests, or "hypothecation," which suggests a non-possessory security interest). BLACK'S LAW DICTIONARY 759, 1192–93, 1387 (8th ed. 2004).

42. Others commentators share this concern. *See, e.g.*, Foster, *supra* note 12, at 152 (noting that there are "doubts about the practical utility of such systems").

43. *Majalla*, *supra* note 40, art. 706. See also Article 729 of the *Majalla* which asserts that "[I]t is a fundamental rule that the pledgee has the right of retaining possession of the pledge . . . ." *Id.* art. 729.

44. For example, Article 15 of the Saudi Arabian Implementing Regulations of the Commercial Mortgage Regulation of 2004 requires that:

> [t]he mortgage shall be valid with respect to others if possession of the mortgaged object was transferred to the secured creditor (mortgagee) or to the impartial person *'adel'*, and the possession of the mortgaged object must remain in the hands of the person who received it until termination of the mortgage.

KINGDOM OF SAUDI ARABIA IMPLEMENTING REGULATIONS OF THE COMMERCIAL MORTGAGE REGULATION, art. 15 (2004) (on file with author) [hereinafter SAUDI ARABIAN IMPLEMENTING REGULATIONS]. For examples of commentators who assert the requirement of possession by the creditor, see NICOLAS DE TORNAUW, LE DROIT

sources of Islamic law do not expressly require the creditor to take possession of the collateral, nordo the sources strictly prohibit non-possessory security interests.

The primary source of Islamic law is, of course, the Koran, which lays the foundation for the Islamic law of secured transactions in verses 2:282 and 2:283:

> Believers, when you contract a debt for a fixed period, put it in writing. Let a scribe write it down for you with fairness; no scribe should refuse to write as God has taught him. Therefore, let him write; and let the debtor dictate, fearing God his Lord and not diminishing the sum be owes. If the debtor be an ignorant or feeble-minded person, or one who cannot dictate, let his guardian dictate for him in fairness. Call in two male witnesses from among you, but if two men cannot be found, then one man and two women whom you judge fit to act as witnesses; so that if either of them make an error, the other will remember. Witnesses must not refuse if called upon to give evidence. So do not fail to put your debts in writing, be they small or large, together with the date of payment. This is more just in the sight of God; it ensures accuracy in testifying and is the best way to remove all doubt. But if the transaction be a bargain concluded on the spot, it shall be no offense for you if you do not put it into writing.
>
> See that witnesses are present when you barter with one another, and let no harm be done to either scribe or witness. If you harm them you will commit a transgression. Have fear of God; God teaches you, and God has knowledge of all things.
>
> If you are travelling the road and a scribe cannot be found, *then let pledges be given.* If any one of you entrusts another with a pledge, let the trustee restore the pledge to its owner, and let him fear God, his Lord.
>
> You shall not withhold testimony; sinful is the heart of him who withholds it. God has knowledge of all your actions.[45]

The italicized phrase "then let pledges be given" (*fa rihanun maqbuda*) is viewed as the cornerstone of the possession requirement.[46] However, the fact that the Koran instructs the faithful to transfer possession of the collateral in the particular circumstances described in this Koranic verse does not necessarily amount to a strict requirement that all security interests must be possessory in order to be effective. The verse does not prohibit the

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MUSULMAN 170 (1860); ABDULLAH HASSAN, SALES AND CONTRACTS IN EARLY ISLAMIC COMMERCIAL LAW 147 (1997) (". . . [a] pledge becomes binding (*lazim*) when possession of it is taken."); Foster, *supra* note 12, at 136 (asserting that possession is the "fundamental basis" of *rahn* and that a security agreement "becomes binding only on transfer of possession"); McMillen, *supra* note 7, at 1221 (explaining that "[u]nder the *Shari'ah*, a *rahn* is, by definition, possessory" and that a *rahn* agreement is only enforceable against third parties if the creditor has possession.").

45. THE KORAN 2:282–:283 (N. J. Dawood trans., Penguin Classics 5th ed. 1990) (emphasis added).

46. *See, e.g.*, BURHAN-AD-DIN ALI, THE HEDAYA 632 (1870); McMillen, *supra* note 7, at 1221 (describing *fa rihanun maqbuda* as a "mortgage with possession") (citation omitted).

creation of non-possessory security interests in circumstances that differ from those described in the passage above. When the Koran strictly prohibits certain behavior, it does so in language that clearly bans the behavior outright. For example, the Koranic prohibition on interest/usury (*riba*) is expressed in unequivocal terms in several Koranic verses, such as in 2:275, which declares: "God has permitted trading and made usury unlawful."[47]

A more complete understanding of the phrase *fa rihanun maqbuda* can be obtained by reading the phrase in the broader context of verses 2:282 and 2:283. This section of the Koran is primarily concerned with the importance of providing evidence of a loan transaction. The section begins with the command that parties to a loan put the transaction in writing, and urges that a scribe be used for this purpose. The underlying purpose of this command is also made explicit, namely, that writing "ensures accuracy in testifying and is the best way to remove all doubt" regarding the terms of the loan.[48] It is within this context that the line regarding the giving of pledges appears. The Koran urges that possessory pledges should be given in the event that no scribes are available to record the terms of the transaction. The purpose of the pledge is clearly to serve as a rough substitute for a written record (that is, as an alternative method of providing evidence that the loan was given).[49] Of course, in this set of circumstances, transfer of the

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47. THE KORAN, *supra* note 45, at 2:275. Other examples of the Koran's unequivocal prohibition on *riba* can also be found at 2:275 ("God has laid His curse on usury . . . ."), 2:276 ("Believers, have fear of God and waive what is still due to you from usury, if your faith be true; or war shall be declared against you by God . . . ."), and 3:130 ("Believers, do not live on usury, doubling your wealth many times over."). *Id.* at 46, 65 (2:275, 2:276, 3:130). The prohibition on *riba* affects the law of secured transactions in that a security interest will not be enforceable to the extent that it secures the payment of interest. McMillen, *supra* note 7, at 1225. Despite the firm prohibition against the charging of interest under Islamic law, Iraq permits interest. *Legal Interest on Commercial Debts as Governed by Iraqi Law*, 18 ARAB L.Q. 205, 205 (2003). However, certain limits are placed on the use of interest, such as the imposition of a 7% rate cap in transactions not involving banks and a prohibition of interest on interest. *Id.*

48. THE KORAN, *supra* note 45, at 41 (2:282).

49. Other commentators have recognized the evidentiary purpose of the pledge. *See, e.g.*, TORNAUW, *supra* note 44, at 171 ("Le gage n'est, comme on l'a déjà fait observer, qu'une preuve de l'existence de la créance."); DAVID SANTILLANA, 2 ISTITUZIONI DI DIRITTO MUSULMANO MALICHITA 465 (1938) ("Il 'rahn' islamico, come il pegno del diritto germanico, era in origine piuttosto un mezzo di *provare* la esistenza del credito che non un modo di assicurarne il pagamento."). The transaction described in verse 2:283 of the Koran closely resembles the pre-Islamic concept of *rahn* which was current in seventh-century Arabia when Islam took root. *See* HASSAN, supra note 44, at 142. The nature of this pre-Islamic incarnation of *rahn* is understood to have been a type of "earnest money," which entailed the transfer of possession of property from one party to another after the conclusion of a contract as proof that the contract had been concluded (and, perhaps, as security for the performance of the contract as well). *Id.* at 147. The transfer of possession was essential for the operation of pre-

pledged property to the creditor is necessary since there would be no evidence of the loan if the debtor retained possession of the property. Therefore, the Koranic requirement that possession of pledged property be transferred to the creditor should be read narrowly to apply only to the situation described in 2:282 and 2:283 (i.e., when a *rahn* transaction is carried out for evidentiary reasons) and should not apply when the sole purpose of the *rahn* transaction is to provide security in the event that the debtor refuses to repay a loan that he admits to having received.

This narrow reading of verses 2:282 and 2:283 is supported by the maxim of interpretation set forth in Article 64 of the *Majalla*, which states that "[t]he absolute is construed in its absolute sense, provided there is no proof of a restricted meaning."[50] Pursuant to this principle, possession should not be viewed as an absolute requirement since the text of the Koran provides "proof of a restricted meaning"—the restricted meaning being that a possessory *rahn* is only necessary for the purpose of providing evidence of a transaction.[51] Moreover, Islamic jurists rely on an understanding of the "effective cause" (*'illah*) of a legal rule in order to properly determine the scope and application of the rule.[52] Therefore, since the *'illah* of the possession requirement is the need to provide proof of the debt, possession should *only* be required in those situations where proof of a transaction is necessary. The rule requiring possession should not be extended by analogy to the scenario where proof of the transaction is not needed, since the *'illah* motivating the possession requirement is not present in those situations. It would follow that Islamic law should be understood as allowing non-possessory security interests when their purpose is solely to provide security rather than to serve as proof of a loan (as is invariably the case in modern commercial transactions).

Islamic *rahn* as a method of proving the existence of a contract. *See id.* at 147. Although Islamic law brought changes to *rahn*, such as the abolition of forfeiture as a method of enforcement, the requirement that possession be transferred to the creditor was retained and has now become an historical relic. *Id.* at 146–47; SCHACHT, *supra* note 12, at 39; Foster, *supra* note 12, at 145; *see also* Foster, *supra* note 12, at 134 (discussing alternative theories about the nature of pre-Islamic *rahn*).

50. *Majalla*, *supra* note 40, art. 64.

51. *Id.*

52. *'Illah* has also been translated as the *ratio dicidendi* or the underlying reason or purpose of a rule, but the preferred translation of "effective cause" captures the true meaning of *'illah,'* which is the nature of an activity or situation that triggers the application of a rule. *See, e.g.*, Umar F. Moghul, *Approximating Certainty in Ratiocination: How to Ascertain the 'Illah (Effective Cause) in the Islamic Legal System*, 4 J. ISLAMIC L. 125, 131, 142–43 (1999) ("The *'illah* may be explained as the reason for which a particular law is believed to have been established by the Lawgiver. It is thus essential to know the *'illah* in order to understand the law itself and to determine the scope and applicability of the law.") (citation omitted).

In addition to the passage in the Koran, there are two *ahadith* that are commonly discussed in relation to secured transactions.[53] One *hadith* simply states that "the Prophet mortgaged his armor for barley grams."[54] This gives no indication as to whether possession was transferred. However, another *hadith*, reproduced here, does indicate the transfer of possession of the collateral to the creditor:

> The Prophet said, 'One can ride the mortgaged animal because of what one spends on it, and one can drink the milk of a milch animal as long as it is mortgaged.'[55]

This *hadith* clearly contemplates a possessory security interest (since the secured party is given permission to ride the pledged animal that is, one assumes, already in his possession). However, as with the Koranic verse discussed above, this *hadith* does not prohibit the creation of non-possessory security interests, but instead only addresses the ability of a creditor to use collateral (and the fruits of the collateral) in his possession.

The problems created by the requirement that the secured party take possession of the collateral would seem to be alleviated by a rule that allows the secured party to lend the collateral back to the debtor after having taken possession initially.[56] However, the secured party is not required to let the debtor use the property. Moreover, if such permission is granted, the secured party would still retain the right to repossess the collateral at will, which would create untenable uncertainty for the debtor.[57] In addition, allowing the debtor to use the collateral without giving public notice of the security interest by means of registration would result in a "hidden lien" in the collateral that could prejudice subsequent secured parties or purchasers of the property.[58]

The possession requirement has been given a certain degree of flexibility under Islamic law. For example, a family member, partner, or agent can take possession of the collateral on behalf of the

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53. *See* HASSAN, *supra* note 44, at 148–50 (regarding other *ahadith* which concern aspects of secured transactions not addressed here).

54. SAHIH BUKHARI, 3 AHADITH OF SAHIH BUKHARI § 45.685 (M. Muhsin Khan trans.), *available at* http://www.usc.edu/dept/MSA/fundamentals/hadithsunnah/bukhari/; *see also id.* § 45.686 ("The Prophet bought some foodstuff on credit for a limited period and mortgaged his armor for it."). Two other *ahadith* describe the granting of a security interest in arms, although it is again not clear whether possession would have been transferred. *Id.* §§ 45.687, 45.690.

55. *Id.* § 45.688.

56. *Majalla*, *supra* note 40, art. 722 ("The pledgee may lend the pledge to the pledgor."); *see also* ALI, *supra* note 46, at 650.

57. ALI, *supra* note 46, at 650.

58. *See infra* Part VI.A (regarding the problem of hidden liens).

creditor.[59] Furthermore, the creditor can appoint a trustee (*adl*), with the consent of the debtor, to take possession of the collateral in his stead.[60] However, neither of these modifications of the possession requirement resolves the basic problem presented by possession, which is that the debtor is not able to retain possession of (nor use) the collateral.[61] Nor is relief from this problem provided by the principle espoused by some Islamic jurists that "possession is in accordance with the nature of the property to be possessed."[62] Although this concept does promise some relief in that it may allow for constructive possession of intangible property that cannot be physically possessed, it leaves in place the strict requirement of physical possession for tangible property.

There are other ways of relaxing the possession requirement. For example, creditors could achieve constructive possession by giving notice (by registration or other means) to prospective creditors of a secured party's existing security interest. This idea of substituting registration for possession has a precedent in the Saudi Arabian laws that allow, at least theoretically, for the creation of a security interest in real property by the mere execution of a *rahn* agreement followed by the registration of the agreement on the title deed of the mortgaged property.[63] This example is helpful because, unlike modern western legal systems, Islamic law generally does not distinguish between real and personal property with respect to secured transactions.[64] Therefore, if Saudi jurists hold that registration is an adequate substitution for physical possession in the case of real property, this same rule should apply to personal property as well. In fact, the new Saudi Arabian regulations regarding commercial mortgages do relax the possession requirement for personal property by (1) allowing for the constructive possession of personal property by the possession of a "deed that represents the mortgaged object" (in other words, a document of title); and (2) providing for the creation of a security interest in commercial paper

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59. *Majalla*, *supra* note 40, art. 722 ("The pledgee may keep the pledge himself or may have it kept by some person in whom he has confidence, such as members of his family, or a partner, or a servant.").

60. *Id.* art. 752 ("Possession by a bailee is equivalent to possession by the pledgee."). The debtor cannot be appointed as trustee for the creditor. *See also* ALI, *supra* note 46, at 644; Foster, *supra* note 12, at 137 (discussing the role of a bailee).

61. *See* Foster, *supra* note 12, at 137 (noting that a bailee cannot "surrender possession to either party" without consent, and thereforethe debtor is unable to use the asset).

62. McMillen, *supra* note 7, at 1222.

63. *Id.* However, McMillen points out that recordation of such mortgages has generally not been permitted due to concerns that the mortgage transactions involve prohibited interest-bearing loans. *Id.*

64. Foster, *supra* note 12, at 139; McMillen, *supra* note 7, at 1219.

and securities by endorsement and, in the case of securities, registration with the issuer.[65]

It may be argued that the possession requirement under Islamic law is rooted in custom or the consensus of jurists. However, despite the majority rule requiring possession by the creditor, not all Islamic jurists and schools of jurisprudence have adopted this view.[66] For example, the Maliki school holds that possession is not required for the creation of a valid *rahn* since the mere agreement of the parties to create a security interest is sufficient.[67] Moreover, consensus and custom can change with respect to a legal principle for which there is no strict prohibition in the Koran or *ahadith*.[68] Clear prohibitions contained in the Koran must be respected under the maxim that "[w]here the text is clear, there is no room for interpretation."[69] However, where no clear rule exists, interpretive tools should be applied to reveal the full scope of what is permissible.[70] Multiple interpretations of Islamic law are permitted pursuant to the fundamental maxim that "[o]ne legal interpretation does not destroy another."[71] This acceptance of different interpretations underlies the flexibility that is a hallmark of Islamic law.[72] As evidence of this flexibility, one need only look at the different schools of Islamic legal thought that have grown up and coexisted in harmony over the centuries.[73]

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65. SAUDI ARABIAN IMPLEMENTING REGULATIONS, *supra* note 44, arts. 12–14, 16.

66. *See* A. QUERRY, DROIT MUSULMAN 443 (1871) (explaining that, with respect to whether possession of the collateral by the secured party was absolutely necessary, "[l]es légistes ne sont pas d'accord sur cette nécessité.").

67. ALI, *supra* note 46, at 632; SANTILLANA, *supra* note 49, at 471. In his Hedaya, Ali explains how some scholars believe that the mere offer to relinquish the collateral to the secured party is sufficient, even if the secured party does not actually take possession. ALI, *supra* note 46, at 632.

68. *See Majalla*, *supra* note 40, art. 14 ("Where the text is clear, there is no room for interpretation.").

69. *Id.*

70. There exists a minority point of view that Islamic law is not subject to new interpretation (*ijtihad*) and that Muslims must follow the interpretations current in the Middle Ages when "the gate of *ijtihad*" was closed. Mallat, *supra* note 38, at 264–65. This Article adopts the majority position that the gate of interpretation was never closed and that our understanding of Islamic law continues to evolve. Professor Mallat provides a more detailed discussion of the purported "closing of the gate of *ijtihad*" with references. *Id.*; *see also* Ali Khan, *The Reopening of the Islamic Code: The Second Era of Ijtihad*, 1 U. ST. THOMAS L.J. 341 (2003).

71. *Majalla*, *supra* note 40, art. 16; *see also* Mahdi Zahraa, *Characteristic Features of Islamic Law: Perceptions and Misconceptions*, 15 ARAB L.Q. 168, 175 (2000) (explaining that multiple interpretations are acceptable "so long as the jurist has provided sufficient evidence for his view") (citation omitted) .

72. *See* Zahraa, *supra* note 71, at 175.

73. *See, e.g.*, REPORT OF THE COMMISSION APPOINTED TO DRAFT THE MEJELLE (1285), *reprinted in* 1 ARAB L.Q. 367, 370–371 (1985) (discussing the great divergence of opinions among the four classical schools of Islamic law).

Those scholars who cling steadfastly to the traditional belief in the strict prohibition of non-possessory security interests should take into consideration the principle under Islamic law that the law should change over time as evolving circumstances demand. The *Majalla* expresses this principle in Article 39, which states that "[i]t is an accepted fact that the terms of law vary with the change in the times."[74] In response to the tremendous changes in business and finance since the seventh century, most notably the rise of the capital-intensive industrial economy and its reliance on the global capital markets, Islamic law has the ability to shape its rules to suit the demands of the modern economy.[75] The emergence and rising importance of intangible property—such as intellectual property, payment rights, and things in action—has made physical possession impossible for many assets.[76] Possessory security interests are also utterly impractical since businesses in the modern economy frequently need to retain possession of their tangible assets in order to continue operating.[77] Moreover, in light of the need for non-possessory security interests for the operation of securitizations, project finance, and other types of asset-backed finance transactions, the possession requirement traditionally required by Islamic jurists should be abolished.[78] The modern computer revolution has also created new tools that render the possession requirement unnecessary. While possession served an important purpose in medieval times by serving as a means of giving public notice that the secured party had an interest in the collateral (notice being given by the fact that the secured party held the property), computer registries now provide a far more efficient method of providing this notice. This

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74. *Majalla*, *supra* note 40, art. 39. The Iraqi Civil Code also expresses this concept in Article 5, which asserts that "[t]he change of provisions (rules) to conform to changing times is not denied." Iraqi Civil Code, art. 5 [hereinafter Civil Code]. The texts of the Iraqi Civil Code, the Law of Commerce No. 149 of 1970 [hereinafter 1970 Law of Commerce] and the Law of Commerce No. 30 of 1984 [hereinafter 1984 Law of Commerce] are reprinted in NICOLA H. KARAM, BUSINESS LAWS OF IRAQ (1990); *see also* Zahraa, *supra* note 71, at 193. One example of how Islamic law evolves to accommodate changes in business practices is found in its recognition of the modern corporation as a legal person. *See* 2 YUSUF TALAL DELORENZO, A COMPENDIUM OF LEGAL OPINIONS ON THE OPERATIONS OF ISLAMIC BANKS 3–4 (2000).

75. *See* Mahdi Zahraa & Shafaai M. Mahmor, *The Validity of Contracts When the Goods are Not Yet in Existence in the Islamic Law of Sale of Goods*, 17 ARAB. L.Q. 379, 379 (2002) (explaining that "[t]he legal language, rules, principles, and norms in a Muslim society are the product of continuous dialogue between Islamic *Shari'a* rules and principles, on the one hand, and the social norms and contemporary technological means, facilities and knowledge available in the society, on the other").

76. *Id.* at 379.

77. *See, e.g.*, Robert Charles Clark, *Abstract Rights Versus Paper Rights Under Article 9 of the Uniform Commercial Code*, 84 YALE L.J. 445, 475 (1975) ("[I]t is commercially desirable in many situations to allow debtors to retain possession of collateral needed in their businesses . . .").

78. *See, e.g.*, Zahraa & Mahmor, *supra* note 75, at 379.

significant technological change, particularly when taken together with the changes in the economy and financial structures, should prompt a relaxation of the possession requirement.

Finally, Islamic law recognizes that necessity can prompt relaxation of established rules (and even permits the suspension of such rules).[79] In the case of Iraq, it is necessary that the commercial laws be revised in order to provide an environment that will attract the foreign investment needed to fund post-war reconstruction. Those who question whether economic necessity is sufficient to trigger this provision of Islamic law need only look to the historical example of the town of Bokhara.[80] When the inhabitants of Bokhara had fallen into severe debt, Islamic jurists permitted the merchants in town to make use of the sale with right of redemption, apparently with the understanding that this previously prohibited secured credit mechanism would allow for the revitalization of the economy.[81] The citizens of Iraq are in a similar position of tremendous economic need and can be equally benefited by the adoption of a progressive law of secured transactions that permits non-possessory security interests.[82]

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79. Article 21 of the *Majalla* states that "[n]ecessity renders prohibited things permissible." *Majalla*, *supra* note 40, art. 21. While necessity typically can only allow for the adoption of a controversial rule when adherence to traditional rules will result in severe harm or death, a lower standard of need (*haja*) rather than stark necessity (*darura*) is sufficient when a large number of people share this need. VOGEL & HAYES, *supra* note 38, at 38.

80. *Majalla*, *supra* note 40, art. 32.

81. *Id.*

82. In the event that Iraqi jurists cannot agree to abolish the possession requirement in its entirety, possession should not be required at least for intangible property, such as intellectual property or accounts receivable. Actual physical possession is simply an impossibility in the case of intangible property and therefore should not be required pursuant to the Islamic maxim of interpretation "[w]hen the literal meaning cannot be applied, the metaphorical sense may be used." *Id.* art. 61. Therefore, "possession" could be understood in a metaphorical sense with respect to intangible property and could be satisfied by a symbolic act of possession by documentation or, optimally, by public registration. The Iraqi Civil Code has adopted this principle that the metaphorical interpretation should prevail when the literal meaning is impossible. Civil Code, *supra* note 74, art. 155(1). The *shari'ah* review boards (SRBs) of some Islamic financial institutions have issued *fatawa* permitting non-possessory security interests in certain intangibles. For example, the SRB of the Faisal Islamic Bank of Bahrain allowed for a security interest in the debtor's bank account (provided that the debtor was deprived of its power to dispose of the funds held in the account). DELORENZO, *supra* note 74, at 122. Similarly, the SRB of the Kuwait Finance House issued a *fatwa* approving the creation of a non-possessory security interest in accounts receivable. *Id.* at 131; *see* VOGEL & HAYES, *supra* note 38, at 48–50 (providing a general discussion of the operation of SRBs in Islamic banks).

B. *Security Interests in Future Assets*

Islamic law has traditionally prohibited the creation of a security interest in future assets. This prohibition is set forth in Article 709 of the *Majalla*:

> The subject matter of the pledge must be something which may be validly sold. Consequently, *it must be in existence at the time of the contract*, must have some specific value, and also be capable of delivery.[83]

This requirement that collateral be in existence at the time of contract (which is, in essence, a prohibition on the creation of security interests in future assets) was described by McMillen as one of the major impediments to structuring a project finance deal in Saudi Arabia.[84] In McMillen's case, this obstacle was overcome by updating the security documentation as property was acquired, a practice which is sanctioned in Article 713 of the *Majalla*:[85]

> The subject matter of the pledge may be increased by the pledgor after the conclusion of the contract. That is to say, a second piece of property may be added to the first after the contract relating thereto has been concluded, the first pledge remaining intact. The additional pledge is added to the pledge of the original contract, as though the original contract had been concluded with reference to the two pledges, both becoming one pledge for the debt as it stood at the time the pledge was increased.[86]

Although this ability to add new collateral to the original collateral when the new collateral is acquired by the debtor provides some relief from the strict "existence" requirement, it still presents certain problems. First, it increases the transactional cost by requiring additional work in updating the security documentation.[87] Second, it presents a risk that future assets will not be subject to the security interest if the debtor defaults before the security documents are updated. Third, it could harm subsequent creditors who take a security interest in the future collateral before the security documents are updated. If a subsequent creditor takes a security

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83. *Majalla*, *supra* note 40, art. 709 (emphasis added).

84. McMillen, *supra* note 7, at 1220, 1225 (explaining that a *rahn* arrangement is invalid "to the extent that it covers property that does not exist at the time of the execution of the *rahn* agreement"). However, McMillen also points out that security interests in future collateral have been permitted in projects financed by the Saudi Industrial Development Fund. *Id.*

85. *Majalla*, *supra* note 40, art. 713; McMillen, *supra* note 7, at 1230. Foster also explains that future assets can be subject to *rahn* contract but that they have to be added to the contract after they come into existence. Foster, *supra* note 12, at 140.

86. *Majalla*, *supra* note 40, art. 713.

87. *See generally* Ronald J. Mann, *Explaining the Pattern of Secured Credit*, 110 HARV. L. REV. 625, 661–664 (1997) (discussing the nature and significance of documentation costs within secured transactions).

interest in the new collateral and extends credit in reliance on having a first-priority security interest in the collateral, the subsequent creditor would be prejudiced if the original creditor later added this after-acquired collateral to his security agreement and gained priority over the subsequent creditor.

Despite the long-standing tradition that a security interest cannot be created in future assets since such assets are not in existence at the time of contracting, a reexamination of the fundamental legal concept that underpins the "existence" requirement (the concept of *gharar*) reveals that the existence of the collateral at the time of contracting is not, in fact, required by Islamic law. The path leading to this conclusion begins with a closer look at Article 709 of the *Majalla*. The first sentence of this article states that collateral is restricted to those things "which may be validly sold."[88] This core requirement is then elaborated upon in the remainder of Article 709, and it is in those following sentences that the *Majalla* goes astray by asserting that it is only possible to sell (and therefore only possible to create a security interest in) those things that are "in existence at the time of the contract."[89] This error in the interpretation of Islamic law can be traced back first to the *Majalla*'s provisions regarding sales, where it is stated in Articles 197 and 205, respectively, that "[t]he thing sold must be in existence" and "[t]he sale of a thing not in existence is void."[90] In a fairly recent article by Mahdi Zahraa and Shafaai Mahmor, the validity of this "existence" requirement in the context of sales was shown to be an unjustifiably narrow application of the Islamic prohibition of transactions that create *gharar*, an Arabic term which can be translated as danger, risk, uncertainty, doubt, or lack of knowledge.[91] In the context of sales, the purpose of this prohibition is generally to protect an unwitting buyer who is placed at risk due to an uncertainty or lack of knowledge regarding the quality, quantity, or existence of purchased goods.[92]

Zahraa and Mahmor begin their deconstruction of the "existence" requirement by explaining that the requirement can rest on only two

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88. *Majalla*, *supra* note 40, art. 709.

89. *Id.*

90. *Id.* arts. 197, 205.

91. Zahraa & Mahmor, *supra* note 75, at 384–86; *see also* MOHAMMAD HASHIM KAMALI, ISLAMIC COMMERCIAL LAW: AN ANALYSIS OF FUTURES AND OPTIONS 91 (2000) (discussing "sale of the non-existent").

92. Zahraa & Mahmor, *supra* note 75, at 391; *see also* KAMALI, *supra* note 91, at 84–98 (providing a more detailed discussion of *gharar*). Types of sales that have traditionally been prohibited due to *gharar* include the sale of items of uncertain quality (e.g., an unborn animal, unripened fruit, or items selected by the chance throw of a pebble) and the sale of an item for which delivery was unlikely (e.g., a runaway camel). *Id.* at 87–88. A sale can also be invalidated on the basis of *gharar* when the seller is subject to intolerable risk concerning the price, as may arise if the agreement is for the buyer to pay the market price at a future date. *Id.* at 88.

possible foundations: a consensus (*ijma*) of Islamic jurists, or a *hadith* that forbids any transaction involving *gharar*.[93] The following version of this *hadith* is transmitted by Abu Dawud, a ninth-century collector of *ahadith*:

> A time is certainly coming to mankind when people will bite each other and a rich man will hold fast what he has in his possession (i.e. his property), though he was not commanded for that. Allah, Most High, said: "And do not forget liberality between yourselves." The men who are forced will contract sale while the Prophet (peace be upon him) forbade forced contract, *one which involves some uncertainty* [i.e., *gharar*], and the sale of fruit before it is ripe.[94]

In their article, Zahraa and Mahmor reject *ijma* as a basis for the "existence" requirement due to the fact that consensus does not exist on the issue, which has been subject to debate and differing views throughout the centuries.[95] They then explain that the *hadith* prohibiting transactions that create *gharar* has been improperly interpreted by a majority of jurists as prohibiting the sale of things that are not in existence at the time of contracting.[96] Contrary to this traditional view, Zahraa and Mahmor posit that the *hadith* should be interpreted in a wider sense in accordance with the true meaning of *gharar*, which does not necessarily prohibit the sale of things that are not in existence but instead only prohibits the sale of non-existent things *when the circumstances of such a sale create great uncertainty and risk for the buyer*.[97] According to Zahraa and Mahmor, the tendency of many jurists to prohibit the sale of non-existent things stems from the misinterpretation of another *hadith* in which Mohammed says "do not sell what you do not have."[98] This injunction has been misinterpreted as prohibiting the sale of non-existent goods when, in fact, it only means that a man cannot sell what he does not own (an Islamic expression of the Roman principle *nemo dat quod non habet*).[99]

Since the requirement that collateral must be in existence at time of contracting is based on the traditional prohibition on the sale of non-existent things (per Article 709 of the *Majalla*), this

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93. Zahraa & Mahmor, *supra* note 75, at 382–84.

94. SUNAN ABU-DAWUD, COMMERCIAL TRANSACTIONS (*Kitab Al-Buyu*), Book 22, no. 3376 (Ahmad Hasan trans.), *available at* http://www.usc.edu/dept/MSA/fundamentals/hadithsunnah/abudawud/022.sat.html (emphasis added); *see also* VOGEL & HAYES, *supra* note 38, at 64 (discussing other *ahadith* concerning *gharar*).

95. Zahraa & Mahmor, *supra* note 75, at 382–83.

96. *Id.* at 386.

97. *Id.* at 384–86. Zahraa and Mahmor are supported in their conclusion by other Islamic jurists, such as Ibn Taymiyyah who held that "only the state of non-existence that leads to uncertainty is prohibited from sale on the ground of uncertainty, but not on the ground of non-existence." *Id.* at 388.

98. *Id.* at 386. This *hadith* is reported by Abu Dawud, *sunan Abu Dawud,* Kitab al-Buyu', fi Bay' al-Rajul ma Laysa 'Indah.

99. *Id.*

requirement is susceptible to the same challenges voiced by Zahraa and Mahmor, and should be replaced by a more limited prohibition against the creation of security interests that give rise to *gharar*.[100] This would allow for the creation of security interests in future assets as long as certain precautions are taken to avoid unacceptable uncertainty regarding the nature of the future collateral. However, what level of uncertainty is tolerable under the concept of *gharar* remains unclear.[101] One view is that uncertainty in a sales transaction only becomes unacceptable when it is likely to give rise to a dispute that threatens to frustrate the basic purpose of the sale, which is likely to occur if the buyer or seller does not receive what was reasonably expected.[102] Such uncertainty can be avoided in a security agreement by including provisions that describe the future collateral in a manner that provides some assurance regarding the range of type, quality, and quantity of the collateral so that the expectations of the parties are clear and no subsequent surprises leading to disputes arise.[103]

C. *Securing Future Debts*

Islamic law takes a rather progressive approach to future debt and provides only minor obstacles with respect to this issue. Article 714 of the *Majalla* sets forth the rule regarding future debt and provides an example:

> The debt secured by the pledge may be validly increased in respect to the same pledge. Example: A person pledges a watch worth two thousand piastres to secure a debt of one thousand piastres. If such person contracts a further loan from the creditor of five hundred piastres, the watch becomes a pledge for one thousand five hundred piastres.[104]

This provision of the *Majalla* suggests that Islamic law allows for a security agreement to provide that the collateral will secure not only

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100. *Majalla*, *supra* note 40, art. 709.

101. VOGEL & HAYES, *supra* note 38, at 64 (explaining that "scholars have been unable to define the exact scope of *gharar* or reach full agreement among themselves concerning it."); *see also* Sabahi, *supra* note 11, at 491 n.18 ("[T]he 'acceptable' level of uncertainty in each transaction is a fact-specific issue and must be determined on a case-by-case basis.").

102. KAMALI, *supra* note 91, at 88–89.

103. The Chevron transaction described by McMillen involved much more detailed documentation than is typical in project finance transactions, in part due to requirements under Saudi Arabian law that security documentation contain "an accurate designation and description" of the collateral. McMillen, *supra* note 7, at 1216–17, 1225. Zahraa and Mahmor also recommend the use of detailed contractual provisions in order to reduce uncertainty when selling future assets. Zahraa & Mahmor, *supra* note 75, at 384 n.33, 386, 397. The description of the future assets need not be specific but simply sufficient to dispel grave uncertainty.

104. *Majalla*, *supra* note 40, art. 714.

all debts existing at the time of contracting, but also all future debts that arise between the debtor and creditor.[105] When such future debts arise, as described in the example provided in Article 714, they can be automatically added to the original secured debt. Not all Islamic jurists support such a liberal reading of Article 714, however, likely due to the fact that such an open-ended contractual provision introduces an uncertainty that may rise to the level of *gharar*.[106] This uncertainty would stem from assets being subject to a security interest that secures a potentially limitless string of obligations that goes far beyond the level of encumbrance originally foreseen by the debtor.[107] Some jurists even take an extreme view that a security interest cannot secure future debts; instead, any future debts must be added explicitly to the security documents when the debt arises and the exact amount of the debt must be stated.[108] This hostility toward the securing of future debts is a minority position and is difficult to maintain in light of Article 714 of the *Majalla*. However, in order to avoid the possibility of violating the principle of *gharar*, it is advisable to take certain steps to limit the potential magnitude of the debt that a debtor's collateral will secure. This can be achieved by simply including in the security agreement a maximum debt limit and describing, with somewhat greater detail than is customary in typical international loan documents, the permissible scope of future debts. Neither of these contractual provisions would impose a burden of any consequence on lenders.

D. *Priority over Competing Claimants*

Islamic law allows a secured party to defeat all unsecured claimants.[109] This rule is evident in the enforcement provisions of the *Majalla* that, as described in greater detail below, allow for the sale of the collateral upon default with the proceeds going to the secured creditor (without any provision being made for any rights of unsecured claimants).[110] The *Majalla* does not provide a priority rule with respect to competing secured parties since it prohibits more than

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105. Foster agrees that Islamic law allows for the securing of future debts, even if conditional. Foster, *supra* note 12, at 142.

106. McMillen, *supra* note 7, at 1220–21.

107. *Id.*

108. *See, e.g.*, ALI, *supra* note 46, at 637, 658; McMillen, *supra* note 7, at 1220–21, 1225, 1230. However, in his Hedaya, Ali softens his position regarding the securing of future debts by recognizing the permissibility of accepting collateral for a future debt provided that a commitment has been made to make the loan. ALI, *supra* note 46, at 637.

109. *Majalla*, *supra* note 40, art. 729.

110. *Id.* arts. 757, 760-761; see also *id.* art. 729 (providing that upon "the death of the pledgor, the pledgee has a prior right over other creditors and may obtain payment of the debt from the pledge").

one secured party from holding a security interest at the same time.[111] If one creditor has a security interest in a debtor's assets, the debtor may, with the secured party's consent, grant another security interest, but it would have the effect of voiding the first security interest.[112] This rule is established by Articles 743 and 744 of the *Majalla*:

> *Article 743*
>
> A pledge by either pledgor or pledgee of the original pledge to some third person is null and void, unless the permission of either the pledgor or pledgee has been obtained.[113]
>
> *Article 744*
>
> In the event of a pledge of the original pledge being made by the pledgor to some third person with the permission of the pledgee, the second pledge stands in the place of the first pledge, which becomes null and void.[114]

This rule unduly benefits creditors to the detriment of the debtor. The effect of the rule is to prevent the debtor from seeking secured financing from a source other than the original lender since the debtor cannot grant a security interest to a subsequent lender without the consent of the original lender.[115] This stranglehold on the debtor is not even permitted under the pro-creditor regime of the U.C.C.[116]

The strict approach taken in the *Majalla* with regard to multiple secured parties is not the only interpretation of this aspect of Islamic law. For example, the Maliki school allows for a second creditor to take a security interest in a debtor's property.[117] Once multiple secured parties are allowed, the need arises for a rule to determine priority between these competing secured creditors.[118] In this situation, the Maliki school ranks secured parties according to the date of the creation of the security interest, which results in priority being granted to the original lender.[119]

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111. *Id.* arts. 743–44.
112. *Id.*
113. *Id.* art. 743.
114. *Id.* art. 744.
115. *Id.*
116. Under Article 9 of the U.C.C., an agreement between a secured party and the debtor which prohibits the debtor from granting subsequent security interests cannot prevent the debtor from doing so (although doing so may constitute a breach of contract). U.C.C. § 9-401(b) (1977).
117. Foster, *supra* note 12, at 142. Even if possession is deemed to be required for the creation of a valid security interest, the creation of multiple secured parties might be achieved by having the original secured party take possession of the collateral on behalf of the second secured party, as well as on its own behalf. *Id.*
118. *Id.*
119. *Id.*

The *Majalla*'s antagonism toward multiple security interests is likely tied to the requirement that a secured party take possession of the collateral. For if only one party can have possession, only one security interest should be possible. However, if the possession requirement is abolished, any restrictions on the existence of multiple secured parties should fall away. In that case, we are left with the sole issue of how to determine priority, which, according to the Maliki school, should be decided according to the date of creation. This rule is not intolerable, although a preferable rule, from the perspective of western financial institutions, would be to determine priority according to the date that the security interest was registered with a public registrar.[120] This would be a rather minor evolution of the traditional rule, which is permitted under the general principle that Islamic law can evolve to suit technological developments, such as the development of searchable, computer-based registries.[121]

E. *Enforcement Without a Court Order*

Provided that certain formalities are observed, Islamic law allows for the prompt enforcement of a security interest without a court order.[122] A security interest can be enforced under Islamic law by selling the collateral and remitting the proceeds to the creditor.[123] Strict foreclosure (or forfeiture) is generally not permitted.[124] Sale of the collateral is also the preferred method of enforcement in western legal systems and is another example of the progressive nature of Islamic law.[125] Generally speaking, the creditor has the right to enforce a security interest under Islamic law by sale, which, unless the debtor voluntarily sells the collateral, requires a court order, as set forth in Articles 756 and 757 of the *Majalla*:

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120. *See, e.g.*, David W. Banowsky & Carlos A. Gabuardi, *Secured Credit Transactions in Mexico*, 28 INT'L LAW 263, 279–80 (1994) (discussing requirement of registration to perfect pledgee's interest in collateral).

121. *See* discussion *supra* Part IV.A (describing the ability of Islamic law to change as circumstances change).

122. *Majalla*, *supra* note 40, arts. 760–61.

123. *Id.* arts. 756–57, 760–61.

124. Foster, *supra* note 12, at 145; McMillen, *supra* note 7, at 1224. However, some Maliki jurists allow for strict foreclosure. Foster, *supra* note 12, at 145 n.111.

125. *See, e.g.*, U.C.C. § 9-610 (1977) (providing for sale of the collateral after default).

Article 756

> Neither the pledgor nor the pledgee may sell the pledge without the consent of the other.[126]

Article 757

> Should the pledgor refuse to make payment when the debt falls due, he shall be directed by the Court to sell the pledge and pay the debt. Should he still persist in his refusal, the pledge shall be sold by the Court and the debt repaid.[127]

However, this general rule is modified by additional principles enunciated by Articles 760 and 761 of the *Majalla*, which allow (1) the debtor to appoint the secured party as its agent for purposes of selling the collateral, and (2) the secured party, as the debtor's agent, to sell the collateral upon default without a court order:

Article 760

> The pledgor may validly appoint the pledgee or the bailee, or some third person his agent for the sale of the pledge when the debt falls due for payment. The pledgor may not thereafter revoke the power of such agent, nor can he be removed in the event of the death of either the pledgor or the pledgee.[128]

Article 761

> An agent for a sale of a pledge shall, when the debt falls due for payment, sell such pledge and hand the proceeds to the pledgee.[129]

Taken together, these articles allow the secured party to sell the collateral without needing to obtain the debtor's consent after default and without a court order.[130] This conclusion can be reached by way of the following analysis: first, a court order is only needed under Article 757 if the debtor does not agree to sell the collateral himself; therefore, if this consent can be obtained, the court order requirement can be circumvented. The risk that the debtor's consent may be withheld can be avoided by simply having the debtor appoint the secured party as the debtor's agent. Under Article 760, the debtor may make an irrevocable appointment of the secured party as his agent with respect to the sale of the collateral.[131] In order to ensure that the secured party will have these powers of agency upon default, the appointment should be made prior to default by including an

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126. *Majalla*, *supra* note 40, art. 756. Foster writes that the secured party can sell the collateral upon default without the debtor's consent only if the proceeds would extinguish the debt. Otherwise, the debtor's consent is required. Foster, *supra* note 12, at 143–44.

127. *Majalla*, *supra* note 40, art. 757 (emphasis added).

128. *Id.* art. 760.

129. *Id.* art. 761.

130. *Id.* arts. 760–61.

131. *Id.* art. 760.

appointment provision in the security documents.[132] As the debtor's agent, the secured party will be empowered to give the necessary consent for the sale of the collateral upon default. Article 761 reiterates that the secured party, as the debtor's agent, may sell the collateral upon default without a court order (and then apply the proceeds to the underlying obligation).[133] Adding this appointment language in the security documents would be a small inconvenience and a great benefit for international lenders who want to avoid judicial involvement in the enforcement of security interests.[134]

V. AN OVERVIEW OF IRAQI COMMERCIAL LAW

Iraqi legal history begins with the Mesopotamian Code of Hammurabi and winds its way through the era of pre-Islamic Arab law, the rise of Islamic law, and finally, the modern era of Iraq's Franco-Islamic Civil Code, which incorporates elements of Islamic law and the Napoleonic Code.[135] During their occupation of Iraq from 1917 to 1932, the British provided for the continued application of Islamic law in Iraq by having the civil courts apply the *Majalla*.[136] This strong tradition of Islamic law in Iraq was reflected in the Iraqi Civil Code, which was drafted in stages beginning in 1936 under the auspices of the great Egyptian law professor 'Abd Al-Razzaq Al-Sanhuri, and was enacted in 1951.[137] Sanhuri, who also drafted the Egyptian Civil Code of 1949, was aware of the prominent role played by the *Majalla* in Iraqi legal history, and allowed the principles of the *Majalla* to exert greater influence in the Iraqi Civil Code than was the case for the Egyptian Civil Code.[138]

In addition to the Civil Code, Iraq has enacted a series of commercial laws which govern various issues that arise in the course

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132. *See* ALI, *supra* note 46, at 645.

133. *Majalla*, *supra* note 40, art. 761.

134. There is some support among Hanafi, Maliki, and Hanbali scholars for the permissibility of a sale without a court order. *See, e.g.*, Foster, *supra* note 12, at 137.

135. For a concise discussion of the history of Iraqi law, see S. H. AMIN, THE LEGAL SYSTEM OF IRAQ 59–76 (1989). For a collection of articles regarding the ancient security arrangements in the Near East, see SECURITY FOR DEBT IN ANCIENT NEAR EASTERN LAW (Raymond Westbrook & Richard Jasnow, eds. 2001).

136. AMIN, *supra* note 135, at 73.

137. Zuhair E. Jwaideh, *The New Civil Code of Iraq*, 22 GEO. WASH. L. REV. 176, 178–80 (1953). Born in 1895, Al-Sanhuri masterminded the re-emergence of the *shari'ah* in the legal systems of the Middle East. Nabil Saleh, *Civil Codes of Arab Countries: The Sanhuri Codes*, 8 ARAB L.Q. 161, 162 (1993). Sanhuri remade the legal landscape of much of the Middle East by first drafting the Egyptian Civil Code, which later became the model for the civil codes of Iraq, Kuwait, Libya, and Syria. *Id.* at 163.

138. Saleh, *supra* note 137, at 163; *see also* KARAM, *supra* note 74, at 3.4.i (explaining that "[t]he first source of this code has been taken from *Majallat Al Ahkam Al 'Adliyya*, which was the Civil Code that was compiled for the Ottoman Empire").

of commerce. The first such law was adopted in 1943, but was replaced in 1970 with the Law of Commerce Number 149 (1970 Law of Commerce).[139] Fourteen years later, the 1970 law was repealed and replaced by the Law of Commerce No. 30 of 1984 (1984 Law of Commerce).[140] The 1984 Law of Commerce addresses various commercial matters, such as trade names, company registration, company books and accounts, negotiable instruments, commercial mortgages, letters of credit, and delivery terms for international sales transactions.[141] The 1984 Law of Commerce overrides not only the 1970 Law of Commerce (with the exception of the provisions regarding bankruptcy), but also trumps any other law—other than the Iraqi Constitution—that contradicts its provisions.[142] However, the 1984 Law of Commerce also makes clear that the Civil Law controls with respect to all matters that are not addressed in the 1984 Law of Commerce.[143] Therefore, in order to gain a complete picture of Iraqi law with respect to secured transactions, it is necessary to read the 1984 Law of Commerce together with the Civil Code, giving preference to the 1984 Law of Commerce where inconsistencies arise.

On October 15, 2005, the Iraqi people approved by referendum the new Iraqi Constitution.[144] The document establishes Iraq as an Islamic state by recognizing Islamic law as "a fundamental source of legislation" and prohibiting the passage of any law that "contradicts the established provisions of Islam."[145] This constitutional provision is relevant to the law of secured transactions because it requires that any legal reforms that take place in this area comply with the requirements of Islamic law. Accordingly, each of the reforms proposed in Part VI of this Article have been designed to comply with the dictates of Islam, while still preserving the essential elements of a progressive law of secured transactions.

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139. 1970 Law of Commerce, *supra* note 74, art. 793.

140. *See* 1984 Law of Commerce, *supra* note 74, art. 331(1).

141. *Id.* art. 12–37, 40–201, 273–82, 294–330.

142. Art. 331(4) states that "every provision in the valid laws which is inconsistent with the provisions hereof is hereby repealed." *Id.* art. 331(4).

143. Specifically, the 1984 Law of Commerce states that "[t]he Civil Law shall apply to all matters not specifically provided for herein or in any other specific law." *Id.* art. 4(2).

144. Edward Wong, *Iraqi Officials Declare Charter Has Been Passed*, N.Y. TIMES, Oct. 26, 2005, at A1.

145. IRAQI CONSTITUTION art. 2(1), *available at* http://www.export.gov/IRAQ/pdf/iraqi_constitution.pdf.

VI. SECURED TRANSACTIONS UNDER IRAQI LAW AND PROPOSED REFORMS

Both the Iraqi Civil Code and the 1984 Law of Commerce provide for the creation of security interests. The Civil Code includes separate provisions for the creation of a mortgage over real (immovable) property and the creation of security interests in personal (movable) property.[146] The 1984 Law of Commerce sets forth special rules for the creation of a security interest in personal property that secures commercial debts (referred to in the statute as a "commercial mortgage").[147] Since the focus of this Article is the creation of security interests in a company's personal property, the following analysis and proposals for reform will be limited to the rules governing "commercial mortgages" set forth in the 1984 Law of Commerce as supplemented by provisions of the Civil Code.

As described in greater detail below, Iraq's current law of secured transactions contains progressive elements with respect to the permissibility of security interests in future property and the ability of security interests to secure future debts. However, Iraqi law contains other features which fail to meet the needs of international lenders. This section proposes certain amendments to the Iraqi Civil Code and the 1984 Law of Commerce that are designed to ensure that Iraqi law contains the five essential elements of a progressive law of secured transactions. These amendments will create a legal environment that will both attract foreign investment to Iraq and facilitate the secured financing of local businesses by Iraqi banks. Each of the following proposals has been carefully crafted to comply with Islamic law as required by Article 2 of the Iraqi Constitution.

A. *Non-Possessory Security Interests*

Under Iraqi law, a security interest can be created by entering into a written contract between the secured party and debtor.[148] The agreement must be dated, must "describ[e] adequately the sum secured by the mortgage," and must "describ[e] adequately" the

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146. Civil Code, *supra* note 74, arts. 1285–1320, 1321–60 (addressing real property and personal property, respectively).

147. 1984 Law of Commerce, *supra* note 74, arts. 186–201. The 1984 Law of Commerce established a legal regime which governs security interests in personal property in the context of commercial transactions. *Id.* art. In the statutory language, the rules governing the creation of "commercial mortgages" are limited to "the mortgage of movable property to secure commercial debts." *Id.* art. 186.

148. Civil Code, *supra* note 74, art. 1344(2).

collateral.[149] A written agreement containing these elements is, however, not the only requirement for creating an enforceable security interest in personal property. The debtor must also own the collateral.[150] Moreover, the secured party must take possession of the collateral. Both the Civil Code and the 1984 Law of Commerce set forth this possession requirement. The 1984 Law of Commerce states that a security interest is only enforceable against the debtor or third parties "if possession of the collateral passes to the mortgagee or a trustee appointed by both parties."[151] Similarly, Article 1322 of the Civil Code states that "[i]n order for a possessory mortgage to be completed and become binding on the mortgager the mortgagee must receive (take possession of) the thing mortgaged."[152] This possession requirement is relaxed to some degree by the recognition that a secured party or trustee can obtain constructive possession if (1) the collateral "is placed at his disposal in such manner as will lead third parties to believe that the property has entered his custody," or (2) "if he receives an instrument representing the mortgaged property which vests a right unto the possessor to take delivery thereof."[153] Substituting the possession of a document of title (or "instrument representing the mortgaged property") for actual possession of the underlying warehoused property is a liberalizing modification of an otherwise very restrictive rule requiring possession. Although actual possession of the document of title is still required, the secured creditor will not have to take possession of the warehoused goods. However, this provision only applies to property represented by a document of title. For all other collateral, actual possession is required, unless constructive possession can be achieved by placing the collateral at the creditor's "disposal in such manner as will lead third parties to believe that the property has entered his custody."[154] This provision suffers from a vagueness that is likely to deter international lenders since it is not clear what steps must be taken to "lead third parties to believe that the property has entered his custody."[155] Must the secured party engage in field warehousing by

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149 *Id.* art. 1344(2). A reiteration of this standard appears in Article 1352 of the Civil Code. *Id.* art. 1352. Article 514(1) of the Civil Code sets forth a similar standard with respect to the sale of a thing, namely, that "[t]he object of the sale must be designated in a manner which negates excessive ignorance (indefiniteness)." *Id.* art. 514(1).

150. *Id.* art. 1325.

151. 1984 Law of Commerce, *supra* note 74, art. 187.

152. The Civil Code also defines a "possessory mortgage" as "a contract by which the mortgager gives property to be held in possession of a mortgagee or an ('adl') against a debt. . . ." Civil Code, *supra* note 51, art. 1321. Regarding possession by an *adl*, see also Article 1323 of the Civil Code. *Id.* art. 1323.

153. *Id.*

154. *Id.*

155. The new Saudi Arabian regulation regarding commercial mortgages contains a similar provision with regard to possession which deems possession to exist

erecting fences around the collateral and locking the enclosure? Can "possession" be achieved if the secured party simply posts signs on or near collateral retained by the debtor which state that a security interest exists in favor of the secured party? Can the possession requirement be satisfied if notification is given to third parties by publication in a local gazette, trade journal, or newspaper?[156] This uncertainty may prevent some lending institutions from operating in Iraq.

Iraqi law should be revised to abolish the requirement that the secured party take possession of the collateral. As explained above, possession is not strictly required under Islamic law; consequently, this amendment would comply with Article 2 of the Constitution.[157] In order to effect this reform, Article 187 of the 1984 Law of

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if the collateral is at the creditor's "disposal in the manner that makes others believe that such object has become in (*sic*) his possession." Saudi Arabian Implementing Regulations, *supra* note 44, art. 16(a).

156. Special rules for the creation of a security interest are provided with respect to nominal instruments, promissory notes, accounts receivable, and sales with a right of redemption. 1984 Law of Commerce, *supra* note 74, art.. A security interest in nominal instruments by assignment, and promissory notes by endorsement with a statement that the note has been mortgaged, can be mortgaged to the creditor. *Id.* art. 189. See also Article 1355 of the Civil Code, which provides that a security interest in "bills to order" and "nominal bills" requires notation on bills that a mortgage is being created. Civil Code, *supra* note 74, art. 1355. A creditor can also take a security interest in the debtor's accounts receivable (described in the Civil Code as "mortgage of a debt"). *Id.* art. 1354. In order to do so, the creditor must take possession of the document establishing the debt, e.g., a credit sale agreement, and must notify the account debtor. *Id.* Finally, a sale with a right of redemption is deemed to be a "possessory mortgage." *Id.* art. 1333.

157. The reader should keep in mind that Islam is not the only legal culture that lies behind Iraqi law. French law also had a great influence on the Iraqi Civil Code and is perhaps equally responsible for the requirement under Iraqi law that the secured party must take possession of the collateral. See *supra* note 152. The original French expression of the "possession requirement" is found in Articles 2076, 2114, and 2119 of the 1804 Napoleonic Code, which were drawn not from the more liberal Roman law but from the restrictive Germanic approach to secured transactions which came from a deeply-rooted fear of losing one's farming implements or other tools to a creditor. George Lee Flint, Jr., *Secured Transactions History: The Fraudulent Myth*, 29 N.M. L. REV. 363, 365, 370 (1999); George Lee Flint, Jr. & Marie Juliet Alfaro, *Secured Transactions History: The Impact of English Smuggling on the Chattel Mortgage Acts in the Spanish Borderlands*, 37 VAL. U. L. REV. 703, 724–25 (2003); CODE NAPOLEON, OR, THE FRENCH CIVIL CODE: LITERALLY TRANSLATED FROM THE ORIGINAL AND OFFICIAL EDITION, PUBLISHED AT PARIS, IN 1804 arts. 2076, 2114 & 2119 (George Spence trans., 1827), *available at* http://www.napoleon-series.org/research/government/c_code.html. Unlike the Germans, the Romans had liberalized their secured transactions law considerably and allowed for non-possessory security interests in the form of a *hypotheca* (as opposed to a possessory pledge, known as a *pignus*). Flint, *supra* note 121, at 368–69; *see also* Roger J. Goebel, *Reconstructing the Roman Law of Real Security*, 36 TUL. L. REV. 29, 29 (1961). The Napoleonic hostility to non-possessory security interests continues in many civil law countries today—as well as in Iraq. Flint, *supra* note 157, at 365.

Commerce should be amended as follows (proposed additions are underlined while strikethrough indicates proposed deletions):

Article 187

In order for a mortgage to be contracted and enforceable against the debtor and third parties, the possession of the mortgaged property need not ~~must~~ pass to the mortgagee ~~or to a trustee appointed by both contracting parties~~.[158]

~~(2) The creditor mortgagee or the trustee shall be deemed to have possession of the mortgaged property:~~

~~a. if it is placed at his disposal in such manner as will lead third parties to believe that the property has entered his custody;~~

~~b. if he receives an instrument representing the mortgaged property which vests a right unto the possessor to take delivery thereof.~~

The abolition of the possession requirement could also be achieved by simply deleting Article 187 in its entirety. However, an explicit statement that possession is not required, as proposed in the amendment, would provide the certainty that will encourage lenders to operate in Iraq.

The abolition of the possession requirement presents certain potential problems, but these problems can be resolved by further innovations. Specifically, non-possessory security interests create the problem of the "hidden lien," which can prejudice secondary secured parties and subsequent purchasers of the collateral both of whose claims to the collateral would be subordinated to the claim of the original secured party.[159] Possession of the collateral protects these parties since they would be put on notice of the original security interest by the fact the secured party has possession of the collateral. When possession is no longer required, another mechanism must be put in place to provide such notice to third parties. Under both Article 9 of the U.C.C. and the Cape Town Convention, this notice is provided by means of a public registration system that prospective lenders and purchasers can search in order to determine whether the collateral in question is subject to an existing security interest.[160] Under the U.C.C., this registration system is typically maintained by the Secretary of State, and its records are indexed according to the name of the debtor.[161] If a prospective lender wishes to determine if a prospective borrower's collateral is subject to a security interest, the

158. 1984 Law of Commerce, *supra* note 74, art. 187.
159. *See supra* Part VI.A.
160. U.C.C. §§ 9-519(c), 9-523(c) (1977).
161. U.C.C. § 9-519(c).

lender can search for security interests under the debtor's name.[162] Under the Aircraft Protocol to the Cape Town Convention, the registry can be searched under the serial number of the asset.[163] In order to gain priority under either the U.C.C. or the Cape Town Convention, a secured party mut be the first to register its security interest.[164] Therefore, prospective lenders and purchasers can quickly determine by searching the registry whether another party will have a better claim with respect to the asset in question.

Iraq should likewise promote the registration of security interests in order to avoid the threat of hidden liens by revising Article 1344(2) of the Civil Code so that priority is granted to registered security interests over unregistered security interests. Priority among competing registered security interests could be determined according to the date of registration, while priority among unregistered security interests could continue to be determined by the date of creation). A Register of Commerce has already been established in Iraq for the purpose of registering companies and is indexed according the name of debtor.[165] The role of this registry could easily be expanded to accept registrations of security interests. These changes could be carried out by amending Article 1344(2) as follows:

Article 1344(2)

(2) In order to be effectual against a third party a ~~possessory~~ mortgage which is constituted over a movable thing must have been recorded in a paper with an established date describing adequately the sum secured by the mortgage and thing mortgaged and may be registered with the Register of Commerce. ~~this established date~~ A registered mortgage will have priority over an unregistered mortgage. Among competing registered mortgages, the date of registration will fix the rank of the mortgage. Among competing unregistered mortgages, the date of creation will fix the rank of the mortgage. The application for registration must comprise the following information:

a. the name of the mortgagor;

b. the name of the mortgagee; and

c. an adequate description of the mortgaged property.[166]

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162. U.C.C. §§ 9-519(c), 9-523(c) (requiring the filing office to index financing statements by debtor's name and respond to requests for information regarding a particular debtor).

163. *See* Susan Jaffe Roberts et al., *International Secured Transactions and Insolvency*, 40 INT'L LAW. 381, 390 (2006) (discussing the searchable registry created under the Cape Town Convention).

164. U.C.C. § 9-322(c); Cape Town Convention, *supra* note 18, art. 29(1); *see* discussion *supra* Part III.

165. 1984 Law of Commerce, *supra* note 74, arts. 26–37.

166. Civil Code, *supra* note 74, art. 1344(2).

As an alternative to the Registry of Commerce, an Internet-based registry could be established that would accept online registrations of security interests and could easily be searched online by prospective lenders around the world. The Internet-based registry established for the registration of security interests in aircraft under the Cape Town Convention could be used as a model for the Iraqi system.[167]

B. *Security Interests in Future Assets*

Pursuant to Iraqi law, a security interest can be created in "everything which . . . may be sold."[168] This is a progressive aspect of Iraqi secured transactions law that allows debtors to leverage the value of all of their current assets as collateral. However, in keeping with the *shari'ah*, Iraqi law places limits on the sale of future assets which, in turn, limits the use of such future assets as collateral.[169] Namely, the Civil Code states that it is only possible "to sell future things and rights if they have been described adequately in such manner which negates ignorance (indefiniteness) and fraud."[170] This is not the blanket prohibition on the sale of future assets found in the *Majalla*, but embodies instead the more reasonable rule regarding future assets, which only limits the sale of future assets to the extent that the sale creates *gharar*.[171] Since Iraqi law already contains this more moderate rule, amendment is not necessary. However, depending on the level of specificity required by the courts in the description of collateral (which is unclear under the law), this rule could still impinge on the ability of secured parties to create a security interest in future assets. Lenders need to be aware that the description of collateral contained in their security agreements will likely need to be more detailed than is typical in security agreements governed by Article 9 of the U.C.C. (which allows for fairly abstract descriptions such as "all equipment" or "all inventory").[172] In order to ensure the enforceability of security interests in future assets, lenders should describe the future collateral with the greatest degree of specificity possible, although absolute specificity (such as description

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167. The registry for aircraft is administered by Dublin-based Aviareto, a joint-venture between SITA SC and the Irish Government. Aviareto, http://www.aviareto.aero/ (last visited Oct. 18, 2007).

168. Civil Code, *supra* note 74, art. 1328.

169. *Id.* art. 514(2).

170. *Id.* A similar standard is set forth in Article 129 of the Civil Code, which states that "[t]he object of the obligation *may be non-existent* at the time of contracting if it is obtainable in the future and has been designated (described) in such a manner negating excessive ignorance and fraud." *Id.* art. 129 (emphasis added). Article 593(1) states that a "litigious right," i.e. a judicial claim, can be sold, therefore subjecting judicial claims to security interests. *Id.* art. 593(1).

171. *Majalla*, *supra* note 40, art. 709.

172. U.C.C. § 9-108(b).

by serial number) is certainly not demanded under Islamic, or Iraqi, law.[173]

C. *Securing Future Debts*

Iraqi law also takes a progressive approach to the ability of lenders to create a security interest that secures future debts.[174] Under Iraqi law, a security agreement can provide that the security interest will secure all future, as well as existing, even if there is no commitment to extend future loans and the size of the future loans is undetermined. This progressive rule is found in Article 1331 of the Iraqi Civil Code which provides that a security interest in personal property can secure the same debts as an "authentic mortgage" (i.e., a mortgage of real property).[175] An authentic mortgage, in turn, can secure "a conditional future or contingent debt," including a credit line, provided that the exact amount (or the maximum amount) of the debt to be secured is stated in the agreement.[176] Thus, future debts can be secured on personal property, as well as on real property, provided that a maximum debt limit is set forth in the security agreement. Requiring the statement of a maximum debt limit has the effect of preventing the gross uncertainty regarding the amount of secured debt, which might otherwise rise to the level of forbidden *gharar* under Islamic law. Since the existing law embodies the minimum requirements of Islamic law as described above, no further liberalization is permitted under the Constitution and, therefore, no amendments are recommended.[177]

D. *Priority over Competing Claimants*

The 1984 Law of Commerce provides that a secured party has priority over unsecured or "ordinary" creditors with respect to the proceeds realized upon the sale of the collateral.[178] As is true for the Maliki school, Iraqi law determines priority among competing secured creditors according to the dates of the competing creditors' security

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173. The ability of parties to create a security interest in future assets is supported by Article 129 of the Civil Code, which explains that fungible property subject to a security interest can be replaced and that even non-fungible property can be replaced with another item provided that the agreement provides for such replacement. Civil Code, *supra* note 74, art. 192.

174. *Id.* arts. 1293, 1331.

175. *Id.* art. 1331.

176. *Id.* art. 1293.

177. The only further possible liberalization of the rule regarding future debts would be to abolish the requirement to state a minimum, but this is not permitted under the *shari'ah*. *Majalla*, *supra* note 40, art. 709.

178. 1984 Law of Commerce, *supra* note 74, art. 193(2) (stating that "[t]he mortgagee shall have a priority right over ordinary creditors to collect his debt—principal, interest and expenses—from the resultant price of the sale").

agreements.[179] As discussed above, this approach to determining priority may be acceptable to some lenders; however, greater transparency and certainty can be achieved by modifying the rule so that priority would be determined according to the dates of registration in a searchable public registry. This modified approach would give a prospective lender greater certainty because the lender would easily be able to determine whether it would have a first-priority security interest in the debtor's collateral simply by searching for existing security interests in the public registry. This modification can be implemented by adoption of the amendment of Article 1344(2) of the Civil Code that is recommended above in Part VI.A.

E. *Enforcement Without a Court Order*

Under the 1984 Law of Commerce, a security interest can be enforced by the sale of the collateral and the application of the proceeds to the underlying debt.[180] However, Article 193(1) requires that a court order be sought before the secured party can sell the collateral.[181] Moreover, before seeking the court order, the secured party must demand payment from the debtor and then wait seven days before taking further action.[182] This requirement for a court order authorizing the sale cannot be waived.[183] This enforcement procedure is far more onerous than the procedure permitted under the Civil Code, which allows the secured party to sell the collateral upon default without a court order.[184] This rule allowing enforcement without a court order was superseded by Article 193(1) of the 1984 Law of Commerce, but only with respect to commercial transactions.

The requirement under the 1984 Law of Commerce that a court order be sought before a secured party can enforce its security agreement should be abolished for three reasons. First, it harms both debtor and creditor by creating uncertainty regarding the prompt

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179. Civil Code, *supra* note 74, art. 1344(2). Article 1321 of the Civil Code also states that creditors have priority over other secured creditors "who come after him in the order of precedence regardless of whoever has possession of said property." *Id.* art. 1321.

180. 1984 Law of Commerce, *supra* note 74, art. 193(1).

181. *Id.* art. 193(1).

182. *Id.*

183. *Id.* art. 196.

184. The Civil Code states that a secured party's enforcement rights with respect to a security interest in personal property are the same as exist with respect to a mortgage over real property. Civil Code, *supra* note 74, art. 1341. A mortgagee of real property faced with a default is granted the power under the Civil Code to demand the immediate sale of the mortgaged property "without having to obtain a judgment" and such enforcement cannot be delayed "even where the mortgager or a third party had filed an objection in the court." *Id.* art. 1316.

enforcement of the security interest and thus threatens to diminish the value of the security interest.[185] Second, a court order is not mandatory under Islamic law, which allows for the secured party to sell collateral without a court order provided that the secured party has been appointed by the debtor as its agent. Finally, the Civil Code provides for the enforcement of non-commercial security interests without a court order, which results in the peculiar situation that commercial lenders face greater obstacles in enforcing a security interest than other lenders. In order to ameliorate these shortcomings, Article 193(1) of the 1984 Law of Commerce should be amended as follows to mirror the enforcement provisions found in Article 1341 of the Civil Code:

Article 193(1)

(1) ~~Where the debtor fails to pay the mortgage money (debt) the creditor may, after the lapse of seven days from the date of a notice served on the debtor requiring payment of the debt, apply to the court for leave to sell the mortgaged item as of urgency, in accordance with the Law of Civil Procedure and in the manner designated by the court.~~ The mortgagee has the same right as that of the authentic mortgagee in regard to levying execution on the thing mortgaged and then on the properties of the debtor where the provisions of Article 1299 (hereof) shall be applied.[186]

In order to ensure compliance with Islamic law, the Iraqi legislature may wish to include additional language requiring as a prerequisite to enforcement without a court order that the debtor appoint the secured party as its agent with respect to the sale of the collateral. If such language is added, the law should not prevent such appointment from taking place prior to default in the security agreement.

VII. CONCLUSION: THE PROMISE OF ISLAMIC LAW

When Iraq regains political stability, major reconstruction projects will have to be funded and local businesses will need financing in order to gain a foothold in the new economy. In order to encourage lenders to inject the necessary capital into Iraq, the Iraqi law of secured transactions must be reformed to allow lenders to create an easily enforceable security interest in the assets of their borrowers. The challenge of reforming Iraqi commercial law is complicated by the requirement under the new Iraqi Constitution

185. See discussion *supra* Part III.

186. 1984 Law of Commerce, *supra* note 74, art. 193(1). Article 1299 of the Civil Code, which is cited in the final clause of the added text, provides that a secured party will have a right to recover any deficiency that remains following the enforcement of the security interest but may only recover such deficiency on equal footing with other unsecured creditors. Civil Code, *supra* note 74, art. 1299.

that any new statutes enacted by the Iraqi legislature comply with the principles of Islamic law. In light of this requirement, the proposals for reform set forth in this Article were drafted to ensure compliance with Islamic law. In the process, this Article has shown that Islamic law, far from being inimical to the needs of international financial institutions, actually allows for each of the five essential elements of a progressive law of secured transactions: non-possessory security interests, the use of future assets as collateral, the securing of future debts, the existence of clear rules giving a secured party priority over competing claimants, and the enforcement of a security interest without a court order. As a result, Iraq will be able to amend its law of secured transactions to meet the needs of the international investment community while still adhering to its constitutional requirements. This amenability of Islamic law to the requirements of the modern international economy holds great promise, not only for Iraq, but for all Islamic states that are seeking to invigorate their economies with the aid of foreign investment.

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