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A special issue devoted to the
Academic Entrepreneurship and University Start-ups

Guest Editors
Zinatul A. Zainol and Rohaida Nordin



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1st Floor, IDEA Tower II

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43400 Serdang, Selangor Malaysia.

Gen Enq.: +603 8947 1622 | 1619 | 1616

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PUBLISHER

Kamariah Mohd Saidin

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Universiti Putra Malaysia

43400 UPM, Serdang, Selangor, Malaysia.

Tel: +603 8946 8855, 8946 8854

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Preface

Over the last few years, Malaysian universities have been actively promoting entrepreneurial activities within the campus. Academic entrepreneurship, which is the commercialization of the product of university research through licensing and the creation of spin-offs, have generated revenues for universities. Law and policies have been enacted and adapted to encourage academic entrepreneurship. However, the controversial issue here is whether universities should become 'commercial entities' and what implications this might have for the universities, academics, students and the general public.

This special issue of the *Pertanika Journal of Social Sciences and Humanities (JSSH)* addresses legal matters related to academic entrepreneurship and business activities. It comprises of 18 papers originally presented at the 2012 Tuanku Ja'afar Law Conference jointly organised by the UKM Faculty of Law, UKM Centre for Entrepreneurship and SMEs Development and Institute of West Asian Studies on 2-3 October 2012. The theme of the conference was '**Academic Entrepreneurship and University Start-ups.**' A total of 83 papers were presented in the 2-day conference, out of which 18 were selected for this special issue. The papers published in this special issue of *Pertanika JSSH* underwent strict editorial process as expected from its status as one of the leading research-based internationally recognised journals.

We are utmost grateful to the Faculty of Law, Universiti Kebangsaan Malaysia, and especially to our Dean, Prof. Dato' Dr. Aishah Bidin for her support in funding the printing cost of the special issue. The timely publication of this special issue would not be possible without the full commitment of UPM Press, as well as the strong support and guidance from the Journal Division, especially the Chief Executive Editor, Dr. Nayan Kanwal, and the Journal Officer, Ms. Erica Kwan Lee Yin.

Special thanks also to the Fundamental Research Grant Scheme (FRGS) project FRGS/1/20/2011/SSI/UKM/45 'Legal Analysis of Academic Entrepreneurship' which has inspired the 2012 Tuanku Ja'afar Law Conference and this special issue.

Zinatul A. Zainol
Rohaida Nordin

Guest Editors

January, 2014



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Intellectual Property Policy and Academic Patenting In Malaysia: Challenges and Prospects

Ida Madieha Azmi

Ahmad Ibrahim Kulliyah of Laws, International Islamic University Malaysia, PO Box 10, 50728 Kuala Lumpur, Malaysia

ABSTRACT

The Malaysian government has identified innovation as the main economic driver in the transition to a high income nation in 2020. In Malaysia, the public universities and public research institutes have been instrumental in the creation of intellectual property for the country. This paper begins with a foray into the rise of academic patenting in Malaysia by looking at patent statistics filed by academic institutions and government research institutes. It then examines two national policy instruments that have been formulated by the government to encourage technology transfer to the industry i.e. the Government Circular on the Management of Intellectual Property owned by the Government and the Distribution of Royalties 1999 and Intellectual Property Commercialisation Policy for Research and Development (R&D) Projects Funded by the Government of Malaysia. To examine the wisdom of these two policy instruments, their provisions are compared to the US Bayh-Dole Act 1980. The paper continues to examine some of the key US court decisions on the interpretation of the Bayh-Dole Act. Finally, the paper explores the position of institutional intellectual property policies in determining IP ownership disputes between the university employer and the academic employee. For this purpose, a comparable Australian case in which a university IP policy was scrutinized is discussed. This is done in order to have a better understanding of the legal challenges that might face any claims of IP ownership by academic institutions. The paper ends by suggesting that academic institutions in Malaysia will continue to play a big role in churning intellectual property for the country if the current policy stand is to be maintained.

Keywords: Intellectual property policy, academic patenting, commercialization, IP management

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E-mail address:

imadieha@iiium.edu.my (Ida Madieha Azmi)

INTRODUCTION

INTELLECTUAL PROPERTY AND WEALTH CREATION

Maskus (2000) describes intellectual property as information that has economic value when put into the market place. Economists have long described the strong link between intellectual property and the economic performance of a country, particularly in this k-economy and innovation era. There has been a significant shift in terms of the competitive edge of a country from production-based to knowledge based services (Kelli & Pisuke, 2008). The golden nuggets that fuel the modern economy are no longer physical assets but intangible assets (Lewelyn, 2010). There is a growing importance of knowledge-intensive business technology and the product life cycles are shorter. To maintain ones' competitiveness in this innovation age is to integrate innovation into development policies. Since the 1970s onwards, many countries have shifted their development policies into churning intellectual assets. The key players in the creation of intellectual assets are the academic institutions and public research officers who are the main recipients of public R & D funding (WIPO, 2011).

The rise of academic patenting has led to considerable concerns particularly on the objectives of research to determine whether it is purely for the gratification of knowledge or to generate money for the academic institutions. The next section underlines some of the policy concerns relating to academic patenting.

POLICY CONCERNS OVER ACADEMIC PATENTING

The rise of academic patenting incites concerns over the traditional role of an academic institution. A study by OECD (2004) highlights these issues:

- What has been the impact of IP and technology transfer activities on the direction of research?
- Should all patentable academic inventions be patented?
- What is the impact of patenting on the diffusion of public research?

The ethical conflicts arising from academic patenting form another major contention. Kumar (2010) reports that ethical conflicts within the universities include: the clash of academic and commercial cultures, the clash between the researcher and the university, the conflict between openness and secrecy, the ethics of patenting academic "upstream" inventions, and the potential conflicts of interest among academic researchers. In order to maintain the traditional role of the universities as vanguards of knowledge, Kumar advocates for the balancing of idealism and commercialization. Otherwise, in his estimation, universities will lose their identities and souls as the 'ivory tower'. Fabrizio (2007) meanwhile unearths new evidence to suggest that university patenting may indeed be hindering or at least slowing industrial innovation. The conclusion is drawn from 'results of an analysis of industrial innovation' that suggest 'increasing university patenting is

associated with a slowing pace of knowledge exploitation, especially in technology areas that rely more heavily on science as an input to innovation’.

Nevertheless, an empirical analysis on the effects of academic patenting and the quality and direction of scientific research points to the opposite direction. Franzoni and Scellato (2011) found that ‘virtually, there are no negative impacts discernible from research quality and research productivity. At the same time, the average financial returns from licensing activities are very limited.’ The authors argue that the ‘average’ academic patent has little if any negative impact on the dynamics of the subsequent scope and trajectories of scientific research, while it can still contribute to improving technology transfer from academia to industry and foster academic entrepreneurship.

The available empirical evidence suggests that there are not enough conclusive evidence substantiating both sides of the argument. WIPO (2011) alludes to this in the conclusion to the 2011 Report:

“Understanding how IP protection affects innovative behaviour has been a fertile field in economic research. Important insights gained long ago arguably still shape how economists view the IP system today. Above all, compared to other innovation policies, IP protection stands out in that it mobilized decentralised market forces to guide R & D investment. This works especially well where private

motivation to innovate aligns with society’s technological needs, where solution to technological problems are within sight, and where firms can finance upfront R & D investment”.

Despite such policy concerns many countries have passed Bayh Dole like legislation to bolster technology transfer from the laboratory to the marketplace. In the US, the Bayh Dole Act has been instrumental in reviving the US economy in the 1980s. Similar transformation can be seen in other parts of the world, ranging from Germany, Japan, Korea and the rest (WIPO, 2011). From the Malaysian experience, this paradigm shift comes in two forms; external government intervention and as well internal changes in corporate culture and academic research. The following section examines the development that has taken place in Malaysia in respect to academic patenting. It then proceeds to examine the policy instruments that have been formulated to move this change.

The rise of academic patenting in Malaysia

In Malaysia the number of patents filed by the academic and research institutions have risen since mid 1990s (Table 1). The rise could have been prompted by government intervention in advancing suitable science & technology (S&T), fiscal and economic policies since the mid 1990s. (Rokiah *et.al.*, 2008; Ida Madieha *et. al.*, 2009; Lim Heng Gee *et. al.*, 2009). The policy shift towards patenting as a form of key

performance indicators pressured these academic institutions that are the main recipients of government R & D, to play an active role in the IP world. Prior to that, most of these institutions felt that as part of their accountability for using tax payer’s money, their obligation was to place the research findings in the ‘public domain’ or ‘open science.’ Since then, these institutions were forced to change their paradigm and corporate culture. In a study on the patent behavior of agricultural research institutes in 2011, Ismail (2011) recounts that many institutes prefer patents as opposed to ‘plant variety’ as the optimum protection over agricultural research findings.

From the 2005-2010 figures, public universities have managed to churn out hundreds of patents which amount to a

considerable success to the government’s intervention policies. It could also be surmised from the figures that even the new universities like University Malaysia Pahang, University Malaysia Perlis, University Malaysia Sabah, University Malaysia Sarawak and University Teknikal Malaysia Melaka have accelerated their uptake of patenting.

The increase is distinctly seen from 2006 onwards as the public educational institutions and government led research institutes have become the most dominant local patent players in Malaysia. Table 1 below illustrates this phenomenon.)

As for the government research institutes, MIMOS is leading the league in patenting activities. Table 2 illustrates that MIMOS, i.e. the National R & D Centre

TABLE 1
Statistics of Patent Application by IPTA and IPTS for year 2005-2010

IPTA	2005	2006	2007	2008	2009	2010	Grand total
International Islamic University Malaysia	3	9	9	2	0	0	23
UniversitiKebangsaan Malaysia	12	10	23	23	40	43	151
Universiti Malaya	30	13	17	18	41	44	163
Universiti Malaysia Pahang	0	0	0	4	49	41	94
Universiti Malaysia Perlis	0	0	0	0	7	4	11
Universiti Malaysia Sabah	1	0	0	2	1	9	13
Universiti Malaysia Sarawak	0	1	1	5	2	2	11
Universiti Malaysia Terengganu	0	0	0	3	0	1	4
Sultan Idris Education University	0	0	1	0	0	0	1
National Defence University	0	0	0	0	1	2	3
Universiti Putra Malaysia	19	22	25	55	71	90	282
UniversitiSains Malaysia	2	6	3	4	29	35	79
UniversitiTeknikal Malaysia Melaka	0	0	1	0	10	7	18
UniversitiTeknologiMalaysia	7	9	58	132	250	192	648
UniversitiTeknologi MARA	6	21	16	12	27	37	119
Total	80	91	154	260	528	507	1620

Source: MYIPO (unpublished)

for information technology has managed to accelerate its production of IP from a mere 1 application in 2006 to a total of 76 in 2007 and a further increase to 144 patents in 2010. Total patents applied for by MIMOS between 2005 and 2010 accounted for 67.5% of the total patents applied by all GRIs. Among the GRIs, MRB has the longest experience in patenting. Its earliest patent filing dated 1934 is concerned with the treatment of rubber latex. However, over the years, other GRIs have surpassed MRB by leaps and bounds although their patenting activities started only two decades ago.

The sudden change in magnitude is attributable to the shift of corporate culture with regards to the importance of patents. The introduction of internal IP policies in these institutes in relation to employee's inventions is another major factor behind this phenomenon. All these changes emanates from policy direction from the government.

The next section continues by examining the policy instruments that have been introduced to maneuver this change.

TABLE 2
Patent Applications by R & D Institutes for year 2005-2010

R&D INSTITUTES	2005	2006	2007	2008	2009	2010	Total
MIMOS Berhad	2	1	76	110	131	144	464
Malaysian Palm Oil Board (MPOB)	19	10	21	10	19	19	98
Forest Research Institute Malaysia (FRIM)	1	1	0	2	3	16	23
Malaysia Agricultural Research and Development Institute (MARDI)	2	8	4	7	4	7	32
SIRIM Berhad	8	5	1	6	9	4	33
Institute for Medical Research (IMR)	0	2	1	2	2	1	8
Malaysian Nuclear Agency (MNA)	0	2	2	1	1	1	7
Malaysia Rubber Board (MRB)	1	0	1	0	2	2	6
Malaysian Cocoa Board (MCB)	1	1	2	0	1	1	6
Construction Research Institute of Malaysia (CREAM)	0	0	0	2	1	0	3
Institute Kemahiran MARA	0	0	0	1	0	0	1
Science and Technology Research Institute for Defence (STRIDE)	0	1	0	0	0	0	1
Construction Industry Development Board (CIDB)	1	1	0	0	0	0	2
Malaysia Institute for Nuclear technology Research	1	1	0	0	0	0	2
National Hydraulic Research Institute of Malaysia (NAHRIM)	0	0	1	0	0	0	1
Total	36	33	109	141	173	195	687

Source: MYIPO (unpublished)

THE POLICY FRAMEWORK FOR IP CREATION AND COMMERCIALIZATION IN MALAYSIA

Unlike countries that have adopted the Bayh Dole style legislation, Malaysia instead chose to adopt internal regulations. The two most important regulations are the 1999 Government Circular (Circular) and the 2009 Intellectual Property Policy (Policy). Both instruments are drafted by the government and bind universities and research institutions who are the major recipients of research and development grants from the government. As the Circular and Policy contain rules pertaining to ownership of intellectual property derived from government grants, a thorough understanding of the rules are deemed crucial. Some pertinent questions need to be asked as follows: Who owns the intellectual property derived from a government research grant? Does the government have a residual right or special right over the intellectual property? What is the position of the university employer over the academic employee? What if the intellectual property is not properly managed or commercialized by the university, would the government have the power to override the university's interest? These questions will be addressed in the following sections.

The Government Circular on the Management of Intellectual Property Owned by the Government and the Distribution of Royalties (1999).

One of the earliest policy instruments on IP creation is the Government Circular on the

Management of Intellectual Property Owned by the Government and the Distribution of Royalties (1999). The Circular governs IPs created and developed by public servants using government funds. The default position under the Circular is that the Government practically owns the intellectual property developed in by its employees. Specifically, under this 1999 Circular, a government department owns the IP property developed by its employees in these situations:

- i. When it is produced by the department;
- ii. When it is devised using the funds or facilities or equipment or materials from the department; and
- iii. When it is brought about without using the funds or facilities or equipment or materials from the department but within the official business of the department.

In addition to those basic situations, the government also asserts ownership of intellectual property in another two situations:

- i. When it is produced with the assistance of an external party, and the parties has already agreed to bestow the ownership of IP to the government department; and
- ii. When the parties have contractually agreed to assign the intellectual property to the department even though the intellectual property is created by the department's officer without using the funds, facilities, equipment or materials from the department and is connected to any official business of the department.

The Circular clearly provides for automatic 'vesting' of IP ownership to the government department. Once bestowed with the employee's IP, the department is allowed to retain ownership even after the end of the employee's service. This does not give enough incentive for the employees to employ their best efforts in research.

In contrast, any copyright created using the funds, facilities, equipment or materials from the department, even if falling within the official business duties or functions of the staff belongs to the individual employee.

The Circular sets a generous royalty scheme whereby half of the royalties generated goes to the officer who creates the intellectual property. The amount payable to the employee is capped to a maximum of RM30, 000 a month or RM360, 000 a year. If there is any lump sum payment, it should not be more than RM500, 000. The remaining half is to be distributed to the Kumpulan Wang Amanah Majlis Pendidikan dan Kemajuan Sains Negara (MPKSN) administered by the then Ministry of Science, Technology and Environment.

One major loophole with the Circular is that it does not deal directly with research funds channeled by the government and administered by the universities or research institutes. At that particular point of time, some public universities such as UM, UPM, UKM, UTM and the then ITM had institutionalised their own internal IP policies. The major objective was to assert rights over IPs developed within their premises. The position taken in these policies stand in contrast to the Circular

which suggest that IPs created using government funds are bestowed to the government. The argument is that as these universities are government universities, their employee-researchers fall within the definition of public servants under the 1999 Circular.

Obviously, this position is not acceptable to both the academic institutions and the government. The universities are the major recipients of the government's R & D funds and their role in the development of new technologies in Malaysia is critical to the economy. With the beginning of the new millennium, the pressure heightened and the time was felt ripe for Malaysia to emulate the US in introducing policy measures, similar to the Bayh-Dole Act. The Act has been instrumental in facilitating commercialization and technology transfer from university laboratories to the private sector and re-positioned the US as a global technology producer and leader (2006, Bayhdole 25, Inc; Bloom (2011).

This gap is filled with the formulation of the Intellectual Property Commercialisation Policy for Research and Development (R&D) Projects Funded by the Government of Malaysia (The Policy) by the Ministry of Science, Technology and Innovation Malaysia (MOSTI) in June 2009.

Intellectual Property Commercialisation Policy for Research and Development (R&D) Projects Funded by the Government of Malaysia (2009)

The aim of the Policy is to establish a common framework to regulate the ownership and management of Intellectual

Property from the creation, protection, innovation, exploitation and technology transfer activities carried out by ministries, government agencies and research institutions which use research funds provided by the Government of Malaysia. Under the Policy, generally, the recipient of a government R & D fund is the owner of any intellectual property resulting from the research. This paves the way for more robust commercialization of academic research output as the academic institution has full disposition over its intellectual capital. Under the Policy, the term “commercialisation” is defined to mean the taking of an idea to an outcome – whether a product, service, process or organizational system in order to market by way of licensing, assignment, spin-off, or joint ventures.

The Policy sets out 7 different scenarios. As a first rule, the intellectual property is endowed to the Recipient that receives funding to run the research project. Secondly, where the research project is commissioned onto an institution either through consultancy or commission agreement, the IP belongs to the commissioner. Such a rule is consistent with the standard policy that an IP accrues to the one who commissions the work. Thirdly, where a government agency that is awarded with an R & D grant from the government in turn disburses the fund to a Recipient, in such a case the Recipient may pursue ownership over the IP. In all these three circumstances, the IP is owned by the Recipient as they involve a straight forward case of disbursement of research funds.

The remaining four scenarios spell out situations where there is collaboration between the recipient and a third party. In these instances, it may result in the joint ownership of the IP. This is where,

- i. the IP is developed jointly by the Recipient of the fund and another research institution;
- ii. the research involves a joint research with more than one institution i.e. where there are several Recipients to a project;
- iii. a research institution and a third party partakes in a joint research;
- iv. the funding comes from both the government as well as a third party.

Consistent with the nature of R & D that requires close collaboration with the industry, the Policy provides the default position that the IP belongs solely to the institution which has been granted the R & D fund (Clause 6.2). However, it appreciates the situation where the third party may have made substantial contribution to the collaborative effort that resulted in the IP. In such a situation, the natural consequence is that the IP will be jointly owned. Furthermore, Clause 6.2.3 allows the vesting of IP ownership solely to the third party where:

- i. The project is focused mainly on product development or improvements to the third party’s existing products or services and where only the third party’s existing Intellectual Property is involved;

- ii. The Relevant Body must benefit from the project by acquiring relevant industry experience through the exposure provided by working with the third party; and
- iii. The third party must bear the full project costs, including costs of manpower, equipment and facilities.

In all the three situations above, the funding comes from the industry. The role of the academic institutions is to assist the industry in either product development or involvement in industry training. In that instance, the resulting implication is that the industry must own any IP that comes about from the collaboration.

National Interest First

Deep in the heart of the Policy is national interest. One is with regard to the prioritization of local manufacture in the licensing of the IP. Clause 10.9 of the Policy imposes the requirement that the invention must be 'manufactured substantially in Malaysia'. The rationale of the Policy is to ensure that all government funded inventions are worked in Malaysia. The Policy sets out two exceptions where the local manufacture requirement is exempted. This is when:

- i. reasonable but unsuccessful efforts have been made to grant licence on similar terms to potential licensee(s) who would be likely to manufacture substantially in Malaysia; or
- ii. under the circumstances, domestic manufacture is not commercially feasible.

The allowance of foreign manufacturing of local technologies is attributable to the low uptake of such technologies by local companies. Some of the academic research are on high end technologies whose application in Malaysia could be limited. It could also be that the demand for the technologies, products and processes in Malaysia is comparatively smaller due to its limited market reach.

Secondly, it is with respect to the government's 'march in' rights. Under the Policy, such 'march in' rights is stipulated in Clause 14.0 of the Policy. It enables the government to request the IP owner to grant a royalty free, non exclusive, sole or exclusive license to a third party. However, the government's 'march in' right is only exercisable in certain exceptional situations i.e.

- i. when the action is necessary as the Recipient has not taken, or is not expected to take effective steps to achieve Commercialisation of the subject invention in any field of use within a reasonable time;
- ii. where such action is necessary to alleviate public health or safety needs.

Accordingly, under the MOSTI Policy, the government reserves its 'march in' right when the Recipient has neglected to commercialise its IP or when there is countervailing public health or safety needs. Such assurance is comforting as the R & D funds come from tax-payers' money. It is of paramount importance that the fund is being used for the development of products

and processes that can advance the quality of life for the citizens and is not left to waste.

This is comparable to the Bayh-Dole Act, where the US Government has several rights in federally funded subject inventions. The agency that granted the federal funds receives from the contractor “a nonexclusive, nontransferrable, irrevocable, paid-up license to practice . . . [the] subject invention.”¹ The agency also possesses “[m]arch-in rights,” which permit the agency to grant a license to a responsible third party under certain circumstances, such as when the contractor fails to take “effective steps to achieve practical application” of the invention.² The Act further provides that when the contractor does not elect to retain title to a subject invention, the Government “may consider and after consultation with the contractor grant requests for retention of rights by the inventor.”³

The Policy, however, goes beyond the Bayh-Dole Act with respect to the Government’s reserve rights. Under the Policy, the government holds the right to exploit the IP royalty free in certain exceptional situations itemized under Clause 5.6 of the Policy; i.e.:

- i. when there is a national emergency or where there is a public interest, in particular, national security, nutrition, health or the development of other vital sectors of the national economy as determined by the Government of Malaysia so requires; and

- ii. or where a judicial or relevant authority has determined that the manner of the exploitation by the owner of the Intellectual Property or his licensee is anti-competitive.

The additional power to override the ownership of the academic institutions in the circumstances above reflects the government’s interest to keep ‘public interest’ as a major factor in the disposition of IP rights.

Vesting of Ownership Rights

The Policy categorically endows the IP ownership to the Recipient of the R & D fund. The Bayh-Dole Act instead provides election for the ‘federal contractors’ (any person, small business firm, or nonprofit organization that is a party to a funding agreement) to retain title to any subject invention. The Act defines “subject invention” as “any invention of the contractor conceived or first actually reduced to practice in the performance of work under a funding agreement.”⁴ To be able to retain title, a contractor must fulfill a number of obligations imposed by the statute. The contractor must “disclose each subject invention to the [relevant] Federal election within two years after disclosure” stating that the contractor opts to retain title to the invention; and the contractor must “file a patent application prior to any statutory bar date.”⁵ The “Federal Government may receive title” to a subject invention if a contractor fails to comply with any of these

¹§ 202(c)(4)

²§ 203

³§ 202(d).

⁴§ 201(e)

⁵§§ 202(c)(1)-(3).

obligations". On this score, the MOSTI Policy provides a better policy option than the US Bayh-Dole Act.

The phrase 'elect to retain title' under the Bayh-Dole Act brings about interesting legal arguments on whether it amounts to an automatic divestiture of ownership rights to the 'federal contractors.' In *Board of Trustees of the Leland Stanford Junior University* (2011)⁶ it was questioned whether the Bayh-Dole Act gives automatic vesting of IP ownership to the 'federal contractors'.⁷ This case relates to a tussle

⁶*Board of Trustees of the Leland Stanford Junior University*, 131 S. Ct. 2188; 180 L. Ed. 2d 1; 2011 U.S. LEXIS 4183; 79 U.S.L.W. 4407; 98 U.S.P.Q.2D (BNA) 1761, 22 Fla. L. Weekly Fed S 1069

⁷In this case the Board of Trustee of the Leland Stanford Junior University sued a private company, Roche Molecular Systems, Inc, claiming that the latter has infringed its patent over a PCR-based procedure for measuring the amount of HIV in a patient's blood. The measurement process was developed by a staff member of Stanford, Holodniy. As a research fellow of the University, Holodniy had signed an agreement stating that he "agree[d] to assign" to Stanford his "right, title and interest in" inventions resulting from his employment there. To test the measurement, Holodniy's supervisor arranged for him to conduct his research at a private company, Cetus, to learn about the PCR procedure. As a condition of gaining access to Cetus, Holodniy was required to sign an agreement stating that he "will assign and do[es] hereby assign" to Cetus his "right, title and interest in . . . the ideas, inventions, and improvements" made "as a consequence of [his] access" to Cetus. Working with Cetus employees, Holodniy devised a PCR-based procedure for measuring the amount of HIV in a patient's blood. Upon returning to Stanford, he and other Stanford employees tested the

between Stanford, where the academic employee is employed and Roche Molecular Systems, where the invention was tested. As part of the arrangement to test the invention, the academic employee assigned his rights to Cetus, a private company, which was later taken over by Roche Molecular Systems. The main issue in this case is the effectiveness of the assignment and the effect of the Bayh-Dole Act. To whom would the intellectual property be vested in? In holding in favour of the defendant, Roche Molecular Systems, the Supreme Court of United States found that the assignment of rights from the academic employee to a private company Cetus for the purpose of testing his invention, was effective⁸ as since 1970, the court has respected the right of the inventor over his patent.

The Supreme Court noted that the language used in the Bayh-Dole Act procedure. Stanford secured three patents to the measurement process.

Subsequent to that, another private company, Roche Molecular Systems acquired Cetus's PCR-related assets. After conducting clinical trials on the HIV quantification method developed at Cetus, Roche commercialized the procedure.

⁸In so doing, the Supreme Court examined the legal history of inventorship in the country in the following passages:

" Since 1790, patent law has operated on the premise that rights in an invention belong to the inventor. See, e.g., Gayler v. Wilder, 51 U.S. 477, 10 How. 477, 493, 13 L. Ed. 504. In most cases, a patent may be issued only to an applying inventor, or--because an inventor's interest in his invention is assignable in law by an instrument in writing--an inventor's assignee".

suggested that there is no automatic entitlement of the Contractors over their inventions⁹. The Supreme Court further rejected the notion that mere employment is sufficient to vest title of an employee's invention to the employer¹⁰.

As there is no automatic divestiture of the invention in favour of the university, what is then the mechanism in which the ownership of the work is transferred to

⁹ *“Congress has in the past divested inventors of their rights in inventions by providing unambiguously that inventions created pursuant to certain specified federal contracts become the Government's property. Such unambiguous language is notably absent from the Bayh-Dole Act.”*

Instead, the Act provides that contractors may "elect to retain title to any subject invention," § 202(a), defining a "subject invention" as "any invention of the contractor conceived or first actually reduced to practice in the performance of work under a funding agreement," § 201(e)."

¹⁰“Stanford's contrary construction would permit title to an employee's inventions to vest in the University even if the invention was conceived before the inventor became an employee, so long as the invention's reduction to practice was supported by federal funding. It also suggests that the school would obtain title were even one dollar of federal funding applied toward an invention's conception or reduction to practice. It would be noteworthy enough for Congress to supplant one of the fundamental precepts of patent law and deprive inventors of rights in their own inventions. To do so under such unusual terms would be truly surprising. Had Congress intended such a sea change in intellectual property rights it would have said so clearly—not obliquely through an ambiguous definition of "subject invention" and an idiosyncratic use of the word "retain.”

the university? In the estimation of the Court, this is done through assignment of rights from the employee-researcher to the university-employer as currently practised in most universities in the US¹¹.

The outcome of *Roche* challenges the standard understanding that Bayh-Dole effectively transfers the ownership of IP developed from federal funds to the federal contractors, i.e. in this case the academic institutions involved. To that extent, the Malaysian Policy gives a clearer stand on who has the initial entitlement of rights over intellectual property created using government funds.

From the above discussion, it can be surmised that the Policy has set down several key aspects: the initial entitlement to the intellectual property; joint ownership of intellectual property where there is collaboration between universities and the industry and the government's march in rights. This has set the right tone for the development of intellectual property by the academic institutions and government research institutes.

EFFECTIVENESS OF INTERNAL INTELLECTUAL PROPERTY

¹¹“As just noted, universities typically enter into agreements with their employees requiring the assignment to the university of rights in inventions. With an effective assignment, those inventions--if federally funded--become "subject inventions" under the Act, and the statute as a practical matter works pretty much the way Stanford says it should. The only significant difference is that it does so without violence to the basic principle of patent law that inventors own their inventions.”

POLICIES

Besides the two national policy instruments, the government has also institutionalized intellectual property management in its periodic plan for the socio-economic development for the country. Beginning the Seventh Malaysia Plan (1996-2000), the government mandated that universities devise internal IP policies and management programmes to enable them to transfer their technologies to the industry. The government policy interventions led to the introduction of IP policies in some of the universities since the mid 1990s. These internal IP policies are yet to be tested in the Malaysian courts and hence its efficacy is not known especially if they are in conflict with the two national policy instruments.

The development in other countries on this is therefore of interest to Malaysia. In a US case that involves the interpretation of the Bayh Dole Act as well as internal university intellectual property policy, *Armin Rudd individually and D/B/A Abt Systems, LLC, and the University of Central Florida Board of Trustees on behalf of the University of Central Florida* (2011)¹², the United States District Court for the Northern District of Illinois, Eastern Division's determined whether certain research findings of a paid research/teaching fellow, Spireas, which were developed with the assistance of Ciba Geigy Corporation's facilities and state of

¹²*Armin Rudd individually and D/B/A Abt Systems, LLC, and the University of Central Florida Board of Trustees on behalf of the University of Central Florida*, 2011 U.S. Dist. LEXIS 4804.

the art equipment, could be owned by the university employer¹³.

Central to the dispute is the applicability of the St. John's College of Pharmacy and Allied Health Professions' IP policy that binds all academic staff and research students. Under the Patent Policy, Dr. Bolton has an obligation to disclose any patentable research findings and assign to the College any inventions resulting from his research at the College. D. Bolton has also agreed to share any licensing royalties out of the commercialisation of his inventions with the College¹⁴.

The defendants further challenged the Research Agreement they signed with the College, claiming that it was broad so as to

¹³Spireas supervisor, Dr Bolton, was an employee of Bolton University at that time. After the completion of the research and the conferment of his PhD, Spireas, together with Dr. Bolton filed four patent applications related to his PhD. Research. Prior to that Dr. Bolton resigned from University of Bolton.

¹⁴St. John's College sued Dr. Bolton on the ground of breach of contractual obligations under the College's Patent Policy i.e. breach of assignment obligations and breach of royalty sharing obligations. Further the College contended that Dr. Bolton has breached his fiduciary obligation to the College by misappropriating the inventions to his benefit. He was also accused of conversion, tortious interference with contract, fraud, and unjust enrichment. As a counterclaim, Spireas and Dr. Bolton disputed that the patents they filed were related to the PhD research conducted in the College as they included additional subject matters not present in the earlier filed patents by the College. The District Court, however, did not accept the contention and dismissed the counterclaim.

constitute an open-ended assignment of all an inventor's future inventions. The District Court found the argument to be without merit¹⁵.

Spireas turned to argue that patent policies were only enforceable with respect to patents applied for during a researcher's affiliation with the university. This was again dismissed by the Court because if accepted, "it would create undesirable incentives for those engaged in productive research to abruptly end their work and leave the university at the first hint that they had made a profitable discovery--or worse, to conceal and hoard scientific discoveries for later exploitation. The court perceives no public policy concern with permitting a university to enforce its rights to intellectual property when, as is the case here, those intellectual property rights are implicated by patent applications filed by its former

employees or students after they leave the university."

The College further claimed that both Bolton and Spireas had breached their fiduciary duty to disclose the patentability of their research findings to the College. Finding in favour of the College, the Court decided that "Bolton and Spireas were entrusted with St. John's resources and the autonomy and discretion to use those resources, because they possessed the special knowledge and expertise required to exploit those resources through useful research that might result in patentable discoveries."

In contrast to *Roche*, the *University of Central Florida* was decided purely on the interpretation of the internal IP policy. In upholding the validity of the Patent Policy, it was found that a staff that deliberately concealed inventions and subsequently misappropriated them for his own benefit to be not only in breach of his contractual duty to his university-employer but also his fiduciary duty to act in the interests of the employer. Such strong findings provide further support to the existing governance of IP within university's compound.

Roche became the centre of contention again in *Alzheimer's Institute of America, Inc. v Avid Radiopharmaceuticals, et al*, (2011), a decision by the United States District Court for the Eastern District of Pennsylvania. In this case, the central issue was whether the University's IP Policy operated to vest ownership in the inventor-assignor's employer in the context of inventions created by its academic staff. It was raised in this case that following

¹⁵ "Federal courts have consistently upheld the validity of patent-assignment obligations imposed on university students, faculty, and staff as a condition of their research activities at the university. See, e.g., *Regents of the Univ. of New Mexico v. Knight*, 321 F.3d 1111, 1117-20 (Fed. Cir. 2003); *Univ. of West Virginia, Bd. of Trustees v. VanVoorhies*, 278 F.3d 1288, 1297-98 (Fed. Cir., 2002); *Chou v. Univ. of Chicago*, 254 F.3d 1347, 1356-57 (Fed. Cir., 2001). These patent-assignment provisions do not implicate all of a researcher's future inventions "in gross"; instead, like the Agreements at issue in this case, they apply to inventions derived from research performed while the researcher is at the university."

Roche's case, the Bayh-Dole Act does not automatically vest patent ownership in the university-employer¹⁶.

Despite the express reference to '*Roche*', the United States District Court for the Eastern District of Pennsylvania distanced itself from *Roche* to hold that 'unlike the Bayh Dole Act, the effect of the Florida regulations is that it unambiguously vests ownership of its employees' inventions in the University'¹⁷.

¹⁶As reported in the case:

"AIA relies on a recent Supreme Court case for the principle that where the ownership of an invention is transferred from the inventor by operation of law, the inventor's rights are not automatically voided unless there is unambiguous language effectuating an automatic transfer of rights. See Bd. of Trustees of the Leland Stanford Jr. Univ. v. Roche Molecular Sys., Inc., U.S. , 131 S. Ct. 2188, 180 L. Ed. 2d 1, 2011 WL 2175210, at 4 (2011), aff'g 583 F.3d 832 (Fed. Cir. 2009). There, the Court found that the Bayh-Dole Act of 1980, 35 U.S.C. §§ 201(c), (e), 202(a), which allocates rights in federally funded inventions between federal contractors and the government, did not contain unambiguous vesting language. Rather, the Act merely gives contractors an option to retain rights to their work. "

¹⁷In the speech of the presiding Judge, Timothy J. Savage:

"The Roche Court held that the Bayh-Dole Act did not "automatically vest" title to federally funded inventions in federal contractors. It concluded that the Act does not disturb the centuries old principle that the rights

The major deciding factor in this case was the interpretation of the Florida Regulation which explicitly endows ownership of patents created by an employee-inventor to the university-employer¹⁸. As made

to an invention belong to the inventor. Here, the Florida regulation, unlike the Bayh-Dole Act, unambiguously vests ownership of its employees' inventions in the University. It states: "An invention which is made in the field or discipline in which the employee is employed by the University or by using University support is the property of the University and the employee shall share in the proceeds there from." R. 6C4-10.012(3)(c) (emphasis added).

¹⁸The learned Timothy J. Savage further declares that:

"Under Florida law, inventions developed or discovered by an employee in the course of employment with USF are the property of USF. Fla. Admin. Code Ann. r. 6C4-10.012(3)(c), implementing Fla. Stat. § 240.229 (superseded by § 1004.23) (authorizing state universities to secure patents and enforce patent rights). 21 USF employees are under a duty to disclose to the University any inventions made during the course of their employment there. R. 6C4-10.012(3)(a)(1). The University reserves the right to relinquish its ownership interest. The regulation provides that an employee may seek the University's waiver of invention rights, provided that any assignment or release of rights contains a provision making the invention available royalty-free for governmental purposes to the State of Florida. R. 6C4-10.012(3)(e)(2)."

explicitly clear by the learned Judge, ‘vesting’ confers the initial ownership at the point of conception, unlike transfer of right that takes place after that¹⁹.

In *Avid Pharmaceuticals*, the existence of the Florida Regulation has bolstered the ownership claims of the Alzheimer Institute of America. The Regulation contains stronger provision on IP ownership in the context of university employment. It is unfortunate that the District Court in *Avid Pharmaceuticals* did not address the anomaly created by *Roche*.

In the course of employment?

Another possible recourse for the universities is to assert that any inventions created in the course of employment belong to them. On this point, the Policy endorses the common stand on IP ownership of employee invention. If an invention is created in the course of an employee’s employment, the ownership of the IP shall vest in the employer. This is consistent with the Patents Act 1983. Section 20 of the Act that reads:

1. In the absence of any provisions to the contrary in any contract of employment or for the execution of work, the rights to a patent for an invention made in

the performance of such contract of employment or in the execution of such work shall be deemed to accrue to the employer, or the person who commissioned the work, as the case may be.

2. Where an employee whose contract of employment does not require him to engage in any inventive activity makes, in the field of activities of his employer, an invention using data or means placed at his disposal by his employer, the right to the patent of such invention shall be deemed to accrue to the employer in the absence of any provision to the contrary in the contract of employment:

Provided that the employee shall be entitled to equitable remuneration which, in the absence of agreement between the parties, may be fixed by the Court taking into account his emoluments, the economic value of the invention and any benefit derived from it by the employer.

Further to this, it is possible that an employee is not contractually bound to invent but by virtue of him/her using data or means placed at his disposal by his employer, the IP ownership accrues to the employer. It is interesting to note that the Policy has been couched in general terms. Some universities assert ownership only when the staff has made a ‘significant use’ of their administered resources. MIT for example, claims IP ownership when the IP is developed by MIT faculty, students, staff, visitors, or others participating in MIT

¹⁹ “Again, we emphasize the critical distinction between vesting of and transferring ownership rights. Vesting by law occurs at conception. Transfer takes place after conception, after ownership has vested. The Florida regulation does not require an employee to transfer his ownership of an invention. It effectively declares that the employee does not own the invention in the first instance”.

programs using significant MIT funds or facilities. The phrase “using data or means placed at his disposal” and ‘substantial use’ of resources carries different connotation and outcomes. There has not been any case law to illustrate the position of academic employee inventions, so cases in other countries will be useful.

One particular case is the Australian case, *University of Western Australia v Gray*²⁰, the court considered whether the UWA IP Policy has been validly passed or incorporated. In this case, Dr Gray claimed ownership over certain inventions created whilst he was working with the UWA. Dr. Gray’s right depends substantially on the UWA Patent Regulations. Unfortunately, when the issue was examined, French J found that the UWA Patent Regulations had not been validly passed or incorporated. In default, the position of academic employee is to be determined according to the common law applied. Under the common law, the test of ownership depends on whether the invention has been created by the researcher-employee ‘in the course of employment’ with the university-employer.

On this very important point, French J noted that in the context of an academic employee, there is no specific duty to invent, and/or to conduct research for the university-employer. In other words, is the main issue the duty to invent part and parcel of an academic’s duty? The learned Justice French compared the position of the academics from those researchers

²⁰*University of Western Australia v Gray* (No 20) (2008) 76 IPR 222; [2008] FCA 498 (UWA v Gray)

in commercial organizations that are specifically hired to conduct research and invent. Research conducted by academics in universities is typically ‘blue sky’ academic endeavour resulting in the “preparation of peer reviewed learned papers”. In the estimation of French J, the idea that academics have an additional duty to invent as a corollary to his duty to research conflicts with the notion of academic freedom. In other words, the academics’ scheme of service requires him to carry out research projects for the advancement of knowledge but he is not under a duty to invent useful technologies and tools for the betterment of the society. The Universities have no control over the direction and scope of the academics’ research unlike the position in private companies. Another aggravating factor that was used against UWA in this case is that the disputed project involved external funds and not internal university funds. Consequently, the private company that funded the project has greater right over it.

In commenting on *UWA v Gray*, Van Caenegem (2010)²¹, argues that to rationalize the findings of the trial and appeal court’s reasons, it is better that universities craft into their employment contracts, the duty to invent. He however cautioned that placing academics under a duty to invent would fundamentally threaten the role and position of universities in society. It would also sit awkwardly with academic freedom, in terms of research direction and publication.

²¹Van Caenegem, W., *VUT v Wilson, UWA v Gray* and University Intellectual Property Policies, (2010) 21 AIPJ 148.

Although the learned French J has confined his deliberation to the common law concept of ‘in the course of employment’, it has to be noted that the duty to invent, though not specifically expressed in academics’ contracts of employment, is implicit in the role of academic institutions nowadays. Academic institutions are no longer expected to conduct ‘blue sky’ research only but are also required to spearhead science and technology to move the country’s economic development. To that extent, the court in *Gray* overlooked the importance of producing ‘inventions’ within academic spheres.

CONCLUSION

From the Malaysian experience, the paradigm shift towards intellectual property comes in two forms; external government intervention and as well internal changes in corporate culture and academic research. The formulation of the Policy is definitely a step in the right direction. More fundamentally, the Policy differs on major policy issues from the US Bayh-Dole Act. This demonstrates that the Malaysian government is mindful of all the criticisms against the later Act. Though Malaysia is behind the developed countries by thirty years in terms of innovation policy, we can benefit from their learning curve and avoid all the pitfalls faced by them. The legal challenge on the application of the Bayh-Dole Act as well as the efficacy of the internal university IP Policies that occur in the US and Australia are developments that we need to take into account in our evolution

process. Although the Policy has clearly delineated IP ownership in favour of the employer-university, there is still a need to have institutional IP policies in case there is a dispute between the university employer and academic employee.

The policy move indicates that the government, in Malaysia, as well as other parts of the world, continues to underwrite the cost of basic research with the expectation that the result should be transferred to the market place. The role of universities in creating knowledge and innovation as the key driver of economic and social well-being becomes more critical. Phrases like ‘academic patenting’, ‘university entrepreneurship’ ‘spin-out companies’ become the buzzwords in this new equation.

What then is the impact of IP and technology transfer on the direction of research as has been raised by OECD? Should all patentable academic inventions be patented? What is the impact of patenting on the diffusion of public research? All of these developments demonstrate these concerns remain mere rhetoric with little consideration neither by the policy makers in the government nor by the academic institutions. The remaining issue is how adept are the academic institutions to this new role and how they can rise to the occasion.

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Academic Entrepreneurship and *Muamalat*: Risk and Money in Commercial Transactions from an Islamic Perspective

Matthew Witbrodt* and Rohimi Shapiee

Faculty of Law, Universiti Kebangsaan Malaysia, 43600 Bangi, Selangor, Malaysia

ABSTRACT

Academic entrepreneurship involves the entrance of academic scientists into commercial ventures and activities. The basis of any relationship founded upon commerce is rooted in the desire of both parties involved in the exchange to benefit from the transaction. *Shariah* law establishes guidelines and principles to be applied to commercial transactions in order to ensure that transactions are compliant with Islamic morals and teachings. Focusing upon the role of contemporary money in commercial transactions, the present article distinguishes between the Islamic economy depicted by *Shariah* and the contemporary economy, with particular emphasis upon the function and nature of contemporary fiat money-based currencies. The use of contemporary moneys in contemporary domestic and international commercial transactions is considered in light of Islamic prohibitions on *gharar*, or risk and uncertainty, with particular emphasis on the effects of inflation and international currency exchange ratio fluctuation on the value function of contemporary moneys. In conclusion, policy implications and recommendations concerning commercial exchanges arising from academic entrepreneurship are considered in light of seeking to minimize, if not eliminate, risks arising due to the nature of the moneys utilized in contemporary commercial exchanges.

Keywords: Academic entrepreneurship, commercial exchanges, fiat money, *gharar*, *muamalat*

ACADEMIC ENTREPRENEURSHIP AND *MUAMALAT*

Academic entrepreneurship has received increasing attention over the last three decades. This specific type of entrepreneurship involves academic scientists and organizations engaging in a

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E-mail addresses:

dr.mawitbrodt@gmail.com (Matthew Witbrodt)

rohimi_s@hotmail.com (Rohimi Shapiee)

* Corresponding author

variety of different commercial activities and ventures. It has led to a closer relationship between academic research and practical application, a relationship that was argued to have been lacking in previous decades (Lacetera, 2005). Successful examples of academic entrepreneurship have included Gatorade, a drink originally designed by the staff of the University of Florida to more effectively rehydrate athletes, and Google, founded by collaborative research between two doctoral students from the computer science department of Stanford University. The commercialization of academic research, development and technology lie at the heart of academic entrepreneurship.

The commercialization of academic endeavors requires commercial exchanges, or transfers, between the academician, institution or organization to the public. It involves the sale of goods and services produced as a result of the entrepreneurial activities. The production of goods in academic entrepreneurship is a central theme of entrepreneurship (Feller, 2005). The introduction of new goods is generally perceived to be a function of large and existing firms, while entrepreneurs tend to be involved with the innovation and improvements of the quality in existing goods (Audretsch, Keilbach & Tamvada, n.d.) or the production of goods that serve as substitutions for imported goods (Bae & Park, 2011). However, academic entrepreneurship is often service oriented with services relating to research and development; consultancy; and the transferring of technology and knowledge,

a result of the licensed use of patented or copyrighted processes. The decision to engage in academic entrepreneurship is risky as it could yield benefits or loss.

The potential benefits of academic entrepreneurship include increasing the revenue and wealth of the academic institution involved in or represented by such undertakings (Shane, 2004). The pros of academic entrepreneurship are also accompanied by risks, whether academic, reputational; or financial (Shattock, 2005). Academic or reputational risks are inherent in the potential effects of the academic institution or organization failing to live up to promises made during the pursuit of entrepreneurial activities. Academic entrepreneurship involves a significant amount of financial risks, particularly in relation to profits and losses, a facet shared amongst all entrepreneurial activities (Kaplan & Warren, 2010). As a result, the success or failure of the commercial activity or venture largely, if not completely, depends upon the successes or failures resulting from the transactions in which the entrepreneurial entity engages. Academic entrepreneurial activities, however, tend to be more risk averse than other entrepreneurs (Fini & Laceterra, 2010). The willingness to undertake risks is linked to the perceived strength of the academic research activities of the institution or organization (Shattock, 2005). One of the principal difficulties associated with academic entrepreneurship lies in a lack of understanding of professional practices and ideas associated with contemporary entrepreneurial and business

activities on the part of the academician, institution or organization engaging in academic entrepreneurship (Chell, Karatas-Özkan & Read, 2010). An understanding of the principal elements of risk in commercial exchanges is essential in minimizing it.

Within Islamic societies, the issue of risk in commercial exchanges is governed by *Shariah* law, which is established in accordance with principles and rules derived from the Qur'an; *sunnah*, or traditions of the Prophet Muhammad (SAW) contained within the text of *ahadith* compiled by Islamic scholars; *qiyas*, or analogies premised upon guiding principles contained within the Qur'an and *sunnah*; and *ijma*, or consensus amongst scholars (Kamali, 2009). *Fiqhmuamalat* is one of the principal branches of *Shariah* law and governs commercial transactions. Among the subject matter considered within the framework of *fiqhmuamalat* is the issue of *gharar*, or risk and uncertainty, and whether transactions can be considered permissible on the basis of superfluous risk and uncertainty on the part of one or both parties to a commercial transaction (Hassan & Mahlkecht, 2011). While individuals and organizations within Islamic societies are the more obvious beneficiaries of the consideration of transactions arising from academic entrepreneurial activities, from a *Shariah* perspective, it is actually a matter of concern to all who engage in such activities. Since the issues raised and approaches recommended are beneficial to any individual or organization engaging in academic entrepreneurship, the focus is

upon the specific nature of contemporary moneys and the use of such financial instruments in contemporary transactions .

The present article focuses upon the reduction, if not complete avoidance, of risks associated with transactions involving money as a counter-value for goods and services arising from academic entrepreneurial activities in accordance with Islamic guidelines established by *Shariah*. Firstly, the differences between the Islamic economy depicted in *Shariah* sources and the contemporary economy are surveyed. Secondly, the distinctions between the two economies are then considered in light of the *Shariah* prohibition upon *gharar*, with a particular focus upon issues concerning the continuing relevance and applicability of the Islamic prohibition in contemporary economic activities. Thirdly, issues concerning inflation, currency exchange ratios and the value of contemporary moneys are examined. The valuation of contemporary moneys is then considered in light of *Shariah* prohibitions against *gharar* in economic transactions. Finally, recommendations are made regarding the management of risks associated with contemporary moneys when engaging in academic entrepreneurship from a pragmatic and *Shariah* compliant perspective.

THE ISLAMIC ECONOMY DEPICTED BY SHARIAH AND THE CONTEMPORARY ECONOMY: ECONOMIC EXCHANGES AND TRANSFERS OF VALUE

In activities related to academic entrepreneurship, the transactions will

consist of economic exchanges, or transactions whereby goods and services are acquired and/or distributed. When analyzing contemporary practices in light of *Shariah* law, an individual or scholar must bear in mind that activities and practices have evolved since the compilation of the texts of the Qur'an and *sunnah*. As a result, the principles and guidelines contained within the two aforementioned bodies of text should be interpreted in a manner that reflects contemporary practices (Siegfried, 2001). Contemporary economies differ from the Islamic economy depicted in *Shariah* sources in regards to the nature of economic exchanges, the types of moneys utilized in economic exchanges, and the valuation of the moneys utilized in economic exchanges.

The first principal distinction that can be drawn between the economy depicted by *Shariah* sources and contemporary economies relates to the nature of the exchanges that take place. In *ahadith* referring to economic practices, two distinct practices are considered: barter exchanges and economic exchanges using money as a counter-value. Barter economies are premised upon the direct exchange of a set of goods, services or commodities for another set of goods, services or commodities whose respective values are perceived as equivalent by the parties of the transaction (Fine, 2002). The fact that no society has ever relied primarily upon a barter economy (Humphrey, 1985), as such economies have always existed alongside either gift or market economies (Humphrey & Hugh-Jones, 1992), is reflected in *Shariah* sources

by the consideration of economic exchanges involving money, albeit in the form of gold and silver which is explored further below.

The fact that contemporary transactions primarily, if not almost exclusively, involve the use of moneys as counter-values for goods, services and commodities is not a novel observation. However, no essential distinction exists between barter exchanges and contemporary exchanges, whereby the economic exchange is completed utilizing money as a counter-value (Schumpeter, 1994), since the transaction is concluded between two parties who view the value of the goods, services or commodities as equivalent to the money exchanged. Irrespective of the items and counter-values exchanged during a transaction, the issue of paramount importance is the perceived *value* of the items involved in the exchange, rather than the *characteristics* of the items and counter-values themselves.

The second principal distinction between the economy depicted in *Shariah* sources and contemporary economic exchanges concerns the type of money utilized in such exchanges. Two types of money were utilized in economic exchanges depicted by *Shariah* sources: commodity money; and *fulus* and *maghshush*. Commodity money simply consists of a specific good or commodity that is utilized as a unit of exchange (von Mises, 2009), representing a value against which all other goods, services and commodities are measured (Menger, 2009). *Shariah* sources indicate that gold and silver were utilized as commodity money, referred to as *dinar* and *dirham* respectively,

a practice which was common during those times. Precious metals had become a virtually universal monetary standard due to their durability, portability, divisibility, quality, opportunity cost and stability of value (Eachern, 2008), as well as factors relating to their utility, ornamental beauty, relative scarcity, geographic distribution, and high market demand (Menger, 2009). *Fulus* and *maghshush*, on the other hand, were typically coins minted from a less valuable metal, such as copper or brass, and accepted for the purposes of economic exchanges (Siegfried, 2001). The significant distinction between commodity money; and *fulus* and *maghshush* was that the latter were a form of token money that could represent a value greater than the actual value of the material utilised in the coin (Mukherjee, 2002), of which value was established by the government or issuing authority (Siegfried, 2001). The distinction between the two types of money was that gold and silver had a specific market value and were utilised for large purchases and international economic exchanges, while *fulus* and *maghshush* were intended for small local economic exchanges, such as buying small quantities of foodstuffs. The *fulus* and *maghshush* possessed a par value that was often regulated by the issuing authority; and were often utilized to provide smaller denominations of money for the purposes of providing change for payments received in silver and gold. The practice of Islamic societies is supported by archaeological research and findings concerning trade and commerce between Islamic societies and surrounding regions (Noonan, 1974).

Contemporary moneys are further distinguished from the moneys depicted in *Shariah* sources on the basis that they are fiat money. Although money was predominantly commodity based throughout history, such monetary systems began to disappear in the nineteenth century. The introduction of commodity-backed money began with the introduction of notes as a form of money, issued by warehouses in ancient Egypt (Green, 2009). Later it was introduced by merchants and banks in Europe (Furnham & Argyle, 1998), and this eventually led to the minting of coinage, which marked the beginning of government regulation and control of the money supply (Cesarano, 2008). Banks and governments, however, began to recognize advantages in monetary systems which were not backed by an underlying good or commodity (Moore, 2003). The virtual universal withdrawal from commodity backed money to fiat money began in the twentieth century, with many monetary systems consisting of fiat money by the signing of the Bretton Woods Agreement. This was following the Second World War that established par values for fiat moneys in relation to the US dollar, which was still commodity-backed money. Following the withdrawal of the US from the gold standard in 1971, fiat money had become the universal standard of currency (Bagus, 2010). Having completely separated currency from objective values associated with commodities, banks and governments could produce a virtually limitless supply of currency and credit money, with the banks making significant gains through loans and investment (Moore, 2003), while

the government reaped extensive gains from inflation, taxation and other revenues associated with its monopoly over the printing of currency (Hülsmann, 2008).

The third principal distinction between the moneys depicted in *Shariah* sources and the money utilized in contemporary transactions lies in the manner in which the moneys attain their value. Commodity money in practice was essentially a form of barter (Cencini, 2001), whereby specific commodities fulfilled the functions of a medium of exchange; a unit of account; and a store of value, (Greco, 2009). In simple terms, the value of commodity money was representative of the value of the underlying commodity, whose value was in turn determined by the market forces of supply and demand. Fiat money, on the other hand, has no intrinsic value. Fiat money initially gained its value from the trust and confidence of the public that the money would be accepted (Mihm, 2009), only to be reinforced later by legal tender laws that mandated such money must be accepted within the territorial jurisdiction of the issuing authority. Contemporarily, fiat money acquires its worth from a 'value convention', which is based upon local and national practices relating to exchanges and premised upon the cultures, customs and traditions of the collective. The 'value convention' remains intact as long as the banks and government institutions are able to maintain credibility, credence, reputation, confidence, social recognition and 'brand-name value' of the currency in the eyes of the public (Bonus, 2001). In the end, fiat

money is simply currency, where the store of value function has been dominated by its function as a medium of exchange. It is without an objective value premised upon an underlying commodity; the actual 'value' of the money today consists of a hope or expectation that the money will retain some type of purchasing power tomorrow (Shubik, 1999).

Despite the fact that *fiqhmuamalat* is readily applied to contemporary transactions, significant distinctions exist between the Islamic economies depicted in *Shariah* sources and contemporary economies. Firstly, the Islamic economies depicted in *Shariah* sources consisted of both barter exchanges and exchanges utilizing money as a counter-value, whereas contemporary economic exchanges are almost exclusively exchanges involving the use of money as a counter-value. Secondly, while the type of currencies utilized in the economies depicted by *Shariah* sources consisted of a combination of commodity moneys and token moneys, contemporary economies involve transactions that exclusively utilize money as a counter-value that differs little from *fulus* and *maghshush* in practice. Thirdly, the two monetary systems differ in regards to the manner in which the money utilized attains value. While commodity moneys retain a value consistent with the market value of their underlying commodity and token moneys possess intrinsic value, albeit inflated, fiat money attains its value from the trust, confidence and hope of the persons which utilize such moneys for the purposes of contemporary economic

exchanges. Finally, the distinction between contemporary moneys and commodity-based monies lies in the fact that the former attains a value which is purely abstract and financial in nature; whereas the latter attains a value linked to the market value of the underlying commodity, and therefore possess actual economic value. The question that needs to be addressed now concerns the manner in which *Shariah* principles and guidelines can be applied in light of such nuances.

GHARAR: PRINCIPAL THEMES AND APPLICATION

Fiqhmuamalat contains rules and guidelines concerning economic exchanges that are premised upon *Shariah* sources with the ambit of promoting or establishing an Islamic moral economy (Karim, 2010). Although *Shariah* sources recognize that engaging in commercial transactions will always involve elements of risk due to the nature of markets and business ventures generally, the prohibitions against *gharar* focus upon the elimination of unnecessary or avoidable risks in economic exchanges. Prohibitions against *gharar*, or significant risk and uncertainty in economic exchanges, exist alongside *maysir*, or gambling (Vogel & Hayes, 1998), and *riba*. This applies to a broad category of potential offenses resulting in the unjustified increase, addition or growth of benefits arising from a transaction (Chapra, 2008), as the fundamental elements of prescriptions concerning economic exchanges under *Shariah* law (Hitti, 2007). *Gharar* is closely linked to the prohibitions

upon *riba*, specifically *riba al-fadl*, as both seek to ensure just and fair transactions free from uncertainty resulting in unjustifiable benefits of one party to an exchange at the expense of the other (Chapra, 2011). Most contemporary definitions and explanations generally focus upon undue risk and uncertainty arising in relation to transactions (Abdul-Rahman, 2010; Zahraa & Mahmor, 2002; Vogel & Hayes 1998; and Farook & Shikoh 2011), irrespective of whether the uncertainty or deception was intentional or unintentional by either or both parties to a transaction (El-Gamal, 2006). However, unlike the prohibitions against *riba* and *maysir*, the prohibitions against *gharar* do not appear in the Qur'an, but stem from prohibitions contained within *ahadith* (Al-Saati, 2003). Therefore, the prohibition against *gharar* needs to be considered in light of the manner in which references to the prohibition are described within *ahadith*, in light of consensus reached amongst scholars concerning the interpretation of the prohibition, and the manner in which the prohibition should be applied to contemporary economic exchanges.

The prohibitions against *gharar* contained within *ahadith* are not precisely defined or explained within *ahadith* (Vogel & Hayes, 1998), although the examples contained within the texts provide a considerable basis for the use of *qiyas* to determine the parameters of the prohibition. *Ahadith* compiled by Imam Muslim indicate that the Prophet Muhammad (SAW) forbade transactions involving *gharar* (Siddiqi, 1987, 3615),

citing examples including the conclusion of a transaction involving garments without inspection or mutual agreement (3608-3613), exchanges involving unknown quantities of dates (3654-3655), transactions where the defects of an object of sale are not known or concealed from a party to a transaction (3661-3664), and the sale of fruits before they are ripe or their quality can be established (3665-2713). *Ahadith* compiled by Imam Bukhari address the issue of *gharar* in a similar fashion, establishing the prohibition of sales involving *gharar* by the Prophet Muhammad (SAW), such as the sale of fish in the sea and birds in the sky (Khan, 1984). Further examples cited include transactions involving items which are not in the possession of the seller (342-346), the sale of what was in the womb of an animal (353), transactions involving the sale of items without first being touched or examined (354-357), selling un milked livestock at a higher price due to the presence of an unknown quantity of milk (358-361, 373), transactions involving dates which have not been dried and may be susceptible to blight or spoiling (389), and the sale of fruits before being ripe, when their benefits are evident (396-403).

The interpretations by Islamic scholars of the prohibitions against *gharar* utilized in the present work stem from the points of relative consensus, or *ijma*, concerning *gharar* amongst scholars from the four principle Sunni *madhab*, or schools of thought. Although considerable disagreement exists between scholars of the four Sunni *madhab* concerning what level of

uncertainty may exist in a transaction before the transaction is rendered invalid under *Shari'ah* (Vogel & Hayes 1998; Al-Saati, 2003; and El-Gamal, 2001), consensus between the four Sunni *madhab* has been obtained regarding the general features and prohibitions associated with *gharar* in transactions. Essentially, *Shari'ah* principles concerning *gharar* mandate that the terms must be certain, defined and unambiguous, effectively prohibiting two specific types of transactions: the sale of items not yet in existence; and exchanges or contracts with significant uncertainty concerning duration or costs (Hamoudi, 2008). In the analysis of the prohibition of *gharar*, Al-Dhareer (1997) establishes four universal conditions for a transaction to be invalidated: the *gharar* must be major, although the determination of what constitutes 'major' differs between the *madhab*; the contract effected must be a commutative financial contract; *gharar* must affect the principal components of the contract, such as price and object of sale; and there is no need met by *gharar* that cannot be met otherwise.

The prohibition of *gharar* is understood by contemporary Islamic jurists and scholars to be based upon a cost-benefit analysis (El-Gamal, 2001). The relationship is of significant importance as it outlines two facets of an economic transaction that are inherently premised upon the value of the finished product, in the case of the buyer, and the value of the materials, labor and other expenses incurred when producing the good or service, in the case of the seller. Ibn Juzay compiled a list of ten instances

consisting of *gharar* which are expressly forbidden (Zahraa & Mahmor, 2002), three of which are of particular interest for the present discussion:

1. "Lack of sufficient knowledge regarding the type of the price or the subject matter."
2. "Lack of sufficient knowledge regarding the characteristics of the price or the subject matter."
3. "Lack of sufficient knowledge with regard to the quantum of the price or the quantity of the subject matter."

The terms 'cost', 'benefit' and 'price' all share a common foundation rooted in the assessment of the value of a good, service or commodity, particularly in regards to a sum of money, in contemporary economic exchanges.

The application of the principles associated with *gharar*, particularly in regards to assessments of value, need to be considered in light of the actual nature of any economic exchange, supported by both *Shariah* sources and their analysis, and secular scholars in the field of economics. The position of the buyer and seller are not absolute, as may be assumed in contemporary economic exchanges whereby a buyer is typically denoted as the person with money and a seller is typically the person with a supply of goods, services or commodities. The absolute position of the buyer and seller in an economic exchange contradicts the conclusion reached by Schumpeter concerning the lack of theoretical distinction

between barter exchanges and contemporary economic exchanges involving money; and the synonymous application of *Shariah* principles to both barter exchanges and exchanges involving money, as noted above. This provides a basis, if not an imperative, for the careful examination of the type, characteristics, and quantum of the moneys utilized in economic exchanges.

While Siegfried (2001) notes that the nature of moneys can give rise to issues concerning *gharar*, the premise of the relationship between *gharar* and money is not explained. The premise behind the application of prohibitions against *gharar* to contemporary moneys lies in the existence of a relative position of the buyer and seller in any given economic exchange, irrespective of whether money is utilized. In effect, any economic exchange involving money involves a transaction of x units of money for y units of a good, service or commodity, and *vice versa*. Therefore, a transaction can be described as one party selling/exchanging y units of goods, service or commodity for x units of money; or described as one party selling/exchanging x units of money for y units of goods, service or commodity, as both descriptions validly represent the nature of the economic exchange. Accordingly, both the money and the goods, services and commodities involved in the transaction can interchangeably be said to be items of value and counter-values; and objects of sale and price, thus subject to examination of their respective value, characteristics and quantum, as emphasized by Ibn Juzay.

Despite the lack of precise definition of *gharar* within *ahadith*, the use of *qiyas* by scholars within the four Sunni *madhab* has resulted in a considerable degree of *ijma* concerning the permissibility of risk or uncertainty in transactions. While contemporary economic exchanges typically involve the use of money to acquire goods, services or commodities, this facet of contemporary transactions does not prevent similar examinations or scrutiny of the type, characteristics and quantum of the moneys utilized in economic transaction. Quite conversely, *Shariah* prohibitions against *gharar* inherently encourage, if not establish an imperative for, such examinations of the moneys utilized in transactions to determine whether both parties to an economic exchange are giving and receiving items perceived to be of equivocal value.

CONTEMPORARY MONEY AND RISK: INFLATION, CURRENCY EXCHANGE RATIOS AND VALUE

In contemporary economic exchanges involving moneys as counter-values, the question that is raised in relation to *gharar* is the manner in which the money(s) utilized in economic exchanges attain their value. As noted previously, contemporary moneys are purely fiat moneys that attain their value in a purely abstract and financial form. When engaging in academic entrepreneurial activities, commercial activities involving economic exchanges are necessary in order for the venture to be deemed successful. Since the costs and benefits associated with economic exchanges are inherently

value-based assessments, the application of principles associated with *gharar* must take into account the manner in which moneys attain their respective empirical values in two distinct types of exchanges: domestic economic exchanges and international economic exchanges.

In domestic economic exchanges, local money is utilized as a counter-value to acquire goods, services or commodities. Meanwhile, in international economic exchanges, a minimum of two different local moneys are inevitably involved. In situations where goods, services and commodities are exchanged between parties in different countries, currency exchange ratios are utilized to determine the equivocal and desired value of the item(s) involved in the exchange. Irrespective of which of the local moneys is utilized in the transaction, the value of the goods, services or commodities involved in the transaction are gauged in reference to the value of such items in relation to the value of the local money, or currency, of the parties to the transaction. The distinction between the use of local monies in the two types of exchanges is that domestic exchange inherently require one ratio, the value of the good, service or commodity in relation to the value of the local money, whereas an international economic exchange requires multiple ratios, relating to the value of the good, service or commodity in relation to the value of the local money of each of the parties

to the exchange and the value of the local money in relation to the value of the foreign money utilized to complete the transaction. Given the fact that assessments of value in contemporary economic exchanges resulting from academic entrepreneurship may involve either local or international parties, it is necessary to explore the means by which contemporary moneys attain their value for the purposes of the two aforementioned economic exchanges.

The principle issues associated with the value of local moneys relate to inflation, or the decrease in value of the local money, and deflation, which is an increase in the value of the local money. The manner in which local moneys attain their value for the purposes of domestic economic exchanges, however, is considered from an inflationary perspective, rather than a deflationary perspective. The reason is that while deflationary episodes were prevalent prior to 1945, most contemporary governments and central banks endeavor to ensure that inflation continues, albeit at a managed and stable rate (Burdekin & Siklos, 2004). Inflation results in greater amounts of money being required to conclude an exchange. Inflation can be caused by cost-push inflation, whereby increases in wages and raw materials result in an increase in prices; demand-pull inflation, whereby an economy grows too quickly and demand begins to outstrip supply causing an increase in prices; monetary supply

fluctuation, whereby the government or central bank expand the existing pool of money in circulation; tax rates, such as sales tax and other indirect taxes; and expectations, whereby the fear of an economic downturn and the attempt of the general public to protect their individual living standards results in inflation (Tribe, 2011). Inflation, ever present within contemporary monetary systems, can be relatively low and stable. In certain instances, however, inflation can increase dramatically and unpredictably over a short period of time, leading to a dramatic decrease in the value of the local money. Such instances of hyperinflation is argued to occur solely following revolution, civil war and collapse of a government (Lipsey & Chrystal, 2007). The simple fact is that the existence of inflation causes varying degrees of uncertainty regarding the value of the currency utilised in economic transactions (Wannacott & Wannacott, 1990).

Contemporarily, the values of local currencies, for the purposes of international economic exchanges, are primarily defined in relation to the supply and demand for specific currencies in international markets, which is affected by numerous economic, political and psychological factors (Macesich, 1996). Economic factors are argued to include interest rates and foreign investment in the country in question; balance of payments, which applies to trade flows between two countries; domestic stock

exchange activity; and the demand for the exports of the country in question. Political factors include government policy and central bank intervention affecting currency value; and political stability (Whittington & Delaney, 2012). Finally, psychological factors affecting currency exchange rates include the perceived credibility of statements concerning intervention and inflation rates of the government and central bank (Gonçalves, 2008), as well as expectations concerning the future value of the currency or future trade performance. This can result in the strengthening or weakening of the currency exchange rate of a given country, referred to as a 'shadow exchange rate' (Becker, Gelos & Richards, 2000). As a result of the numerous factors that influence currency exchange rates, the rate of exchange between two currencies changes minute to minute and hour to hour (Burton & Brown, 2009).

The manner in which contemporary moneys attain their values for the purposes of economic exchanges highlights two common elements of significant importance relating to the valuation of moneys at the local and international levels. Firstly, various factors affect the valuation of moneys at the local and international levels. Market factors continue to play a role in the valuation of money, as demonstrated in regards to demand-push and cost-pull inflation in domestic valuation; and issues, such as the balance of payments and demands

for exports in the international valuation of currency. However, the non-market factors, or political and psychological factors, have a significant impact on the valuation of the money supply. The relationship between the two categories of factors effectively involves the ability of the government and central bank to regulate the money supply and maintain the economy; and whether people generally have faith and confidence in the credibility of the government and central banks to perform those functions. Secondly, as a result of the combinations of factors that can potentially affect the value of money, only one thing is certain: the value of money, at present and in the future, is uncertain.

DOMESTIC EXCHANGES AND INTERNATIONAL EXCHANGES: EFFECTS OF FLUCTUATION OF MONETARY VALUE ON COMMERCIAL TRANSACTIONS

As demonstrated in the previous section, theoretical issues exist in relation to the manner in which contemporary moneys attain their value. This is specifically related to the uncertainty surrounding the effects of the various factors upon the local and international value of the money(s) utilized in contemporary economic exchanges. The practical effects of the resulting uncertainties surrounding the value of contemporary moneys, however, are easily demonstrated. The following examples provide insight into the resulting issues, in practice, concerning both domestic and international economic exchanges. Utilizing relevant data and

statistics concerning monetary values and currency exchange ratios from 2011, the effects of the fluctuation in value are demonstrated in relation to spot exchanges and deferred payments. This is in the case of domestic exchanges; and international economic exchanges involving spot exchanges and forward contracts, as well as international economic exchanges generally.

Domestic Exchanges

In domestic spot exchanges, the two parties agree to an immediate transfer of goods, services or commodities based upon the

perceived equivocal value of the counter-value offered in exchange. As demonstrated in Table 1 below, relating to the calculated monthly inflation rate during 2011 for US and Malaysia, inflation occurs throughout the year with few exceptions. However, the actual effect upon the value of the money utilized is minimal over a short period of time in both cases, as demonstrated in table 2, and unlikely to amount to a significant devaluation while a spot exchange is being completed. Therefore, spot exchanges involving the use of local moneys are relatively free from the risks outlined in the prohibition upon *gharar* in *Shariah* law.

TABLE 1
Inflation Rates (Percentages), Calculated Monthly, for the US and Malaysia, 2011*

	US	Malaysia		US	Malaysia
January	0.48	0.59	July	0.09	0.19
February	0.49	0.49	August	0.28	0.19
March	0.98	0.09	September	0.15	0.19
April	0.64	0.29	October	-0.21	0.19
May	0.47	0.29	November	-0.08	0.09
June	-0.11	0.29	December	-0.25	0.09

TABLE 2
Monthly Calculations of the Effects of Inflation in 2011 on the Purchasing Power of the US Dollar and the Malaysian Ringgit, Demonstrating the Value of the US Dollar and Malaysian Ringgit Against the Same Money, Respectively, in December 2010

	US	Malaysia		US	Malaysia
January	0.995223	0.994134	July	0.970158	0.977990
February	0.990370	0.989287	August	0.967445	0.976135
March	0.980759	0.988398	September	0.966000	0.974284
April	0.974521	0.985539	October	0.968033	0.972437
May	0.969963	0.982690	November	0.968808	0.971562
June	0.971031	0.979848	December	0.971236	0.970688

*Information concerning inflation figures, based upon the consumer price index (CPI) for the United States of America, was obtained from the United States Department of Labour, Bureau of Labor Statistics, available online at <http://www.bls.gov/pub/special.requests/cpi/cpi.ai.txt>. Information concerning inflation figures, based upon the CPI for Malaysia, was obtained from Bank Negara Malaysia, Central Bank of Malaysia, available at <http://www.bnm.gov.my/files/publication/msb/2012/5/xls/3.5.8.xls>.

However, in the event of deferred payments, whereby money is received for goods, services or commodities after a prolonged period of time, the potential risks increase with the amount of time between the agreement and the completion of the exchange; and with the increase in the amount of money involved in the economic exchange. Over the course of one month, the value of each unit of US Dollar (USD) and Malaysian Ringgit (MYR) could have decreased by 1 cent or 1 *sen* respectively. While this amount seems relatively minor, one must remember that the greater the amount of money involved, the greater the amount of value is lost as a result of inflation. An agreement, concluded in December of 2010, to pay USD 50,000 or MYR 50,000 in March of 2011 would have a value equivalent to USD 49,037.95 and MYR 49,419.90, respectively, at the time that the agreement was concluded. To summarize, while economic exchanges involving deferred payments can be conducted, the more significant the amount of time and money involved in the agreement, the greater the risks faced by the parties to the exchange.

While the two previous findings hold true in the case of monetary stability, the same cannot be said of times involving financial crisis or hyper inflation. In Indonesia in 1998, for example, following the Asian Financial Crisis of 1997, the average monthly inflation rate was 4.96 percent, reaching as high as 12.67 percent in February of 1998 and resulting in an annual inflation rate of 78% for 1998

(Ramakrishnan & Vamvakidis, 2002). In certain circumstances, hyperinflation has occurred and resulted in the value of the currency plummeting to almost nothing. The effects of hyperinflation have been felt in Germany following World War I, with the monthly inflation rate reaching as high as 332 percent; in Serbia in 1993, where the annual inflation rate reached 302 million percent (Lipsey & Chrystal, 2007); and in Zimbabwe in 2008, where the inflation rate in July of 2008 was estimated at over 231 million percent and 516 quintillion percent in November of 2008 (Wiggin & Buker, 2012). Although hyperinflation is argued to occur only following revolution, civil war and collapse of a government (Lipsey & Chrystal, 2007), the simple fact is that the existence of inflation causes varying degrees of uncertainty regarding the value of the currency utilised in economic transactions (Wannacott & Wannacott, 1990). The rapid increases in inflation and comparative decrease in value of money has been demonstrated to be the result of contemporary moneys being based upon a fiat standard, rather than a commodity standard (Rolnick & Weber, 1997).

Following the Asian Financial Crisis of 1997, the inflation rate in Indonesia between January and February was 12.67 percent, indicating that IDR 200.00 in January of 1998 was the equivalent of IDR 225.34 by February of 1998. Again, if inflation occurred consistently over a 31 day period, the price would have to increase by IDR 0.82 per day to account for the decrease in value of the currency. In the case of hyperinflation,

the daily increases were significantly more drastic. In Germany, DM 200.00 in July of 1923 was the equivalent of DM 5,063.56 by August of 1923, indicating that prices would have to increase by an average of DM 156.89 per day to adjust for inflation. In the case of Serbia in 1993, the inflation rate for the month of December alone was over 1 million percent (Bethlehem & Weller, 1997), meaning that 200 Serbian Dinars (RSD) at the end of November of 1993 were (optimistically) the equivalent of RSD 20,000,000 in December of the same year, indicating that prices would have to increase by RSD 645,154.84 per day to adjust for inflation. The situation in Zimbabwe in 2008 is more difficult to measure, due to the lack of accurate reported information, but the price changes due to inflation represented an increase of almost 98 percent per day in November of 2008 (Groh, 2009), indicating that 200 Zimbabwean Dollars (ZWD) on day 1 would be the equivalent of roughly ZWD 396.00 on day 2 and ZWD 784.08 on day 3. During periods involving inflationary spikes or hyperinflation, neither spot exchanges nor deferred payments, involving local currency as a counter-value, could be deemed to possess minimal risk, as required in accordance with prohibitions upon *gharar*, due to the rapid devaluation of the local money. Therefore, the use of local money to conclude economic transactions during such periods should be restricted, if not avoided altogether.

International Exchanges

While spot exchanges are desirable during times of monetary stability in the case of domestic economic exchanges, the same cannot necessarily be said in the case of spot exchanges in the context of international exchanges. In international transactions involving a spot exchange, a spot exchange rate, or the rate of exchange applicable to immediate transactions involving currency, is applied to the economic transaction (Moosa, 2000). For the purposes of contemporary international transactions, however, a spot exchange does not necessarily need to be completed immediately as spot exchanges are allowed to be completed over a period of two days from the conclusion of the contract (Quirk *et al.*, 1988).

Table 3 demonstrates the resulting fluctuations in value between the USD and the MYR during September of 2011. While the fluctuations were relatively minor until 9 September, the value of the MYR against the USD fluctuated significantly from that point forward. While the fluctuations do not appear to be significant at first glance, it is important to highlight that most international exchanges involve considerably larger sums of money as a counter-value and, as stated above, payments can be made up to two days after a sales agreement is concluded. If agreement was reached between two parties regarding a spot exchange on 12 September 2011, involving a counter-value of USD 50,000.00, and payment was made on 14 September 2011, the two day period would result in the Malaysian seller receiving the equivalent of MYR 154,125.00, rather

than MYR 151,225 on the date of the agreement. Conversely, if the agreement had been reached on 26 September 2011 for the same amount and payment made on 27 September 2011, the one day period would have resulted in the Malaysian seller receiving MYR 157,690.00, rather than MYR 159,425.00 if payment had been made on the date of the agreement. To summarize, unless the spot exchange can be completed in one day, the risks associated with currency exchange fluctuations are indicative of potentially significant risks and are, therefore, impermissible in light of the prohibitions upon *gharar*.

While spot exchanges occur in international transactions, deferred payments are also frequently employed, involving the use of forward contracts. Rather than rendering payment within two days of the agreement or contract concerning a transaction, forward contracts specify payment to be made upon the date of the maturity, or completion of the

terms, of the contract (Ajami *et al.*, 2006). Forward contracts are typically drafted for the contract to mature at 30 days, 60 days or 90 days from the drafting of the contract, but can also extend to 6, 9 or 12 month periods in some instances (Quirk *et al.*, 1988). Even during relatively short-term forward contracts, such as 30 days and 60 days, the currency exchange fluctuations can have a significant effect upon the value of the remuneration received, as demonstrated in Table 4. If a forward contract was signed on 3 August 2011 and set to mature on 3 October 2011, again involving a counter-value of USD 50,000.00, the two month period would result in the Malaysian seller receiving MYR 160,475.00, instead of MYR 148,715.00 if the transaction had been a spot exchange and payment rendered on the day of the agreement. Conversely, if the agreement had been signed on 3 October 2011 and set to mature on 3 November 2011, the Malaysian seller would receive MYR 157,350.00, instead of MYR

TABLE 3
Daily Currency Exchange Rates from September 2011, Malaysian Ringgit to the US Dollar**

MYR : 1 USD		MYR : 1 USD	
2	2.970000	20	3.139000
6	2.987500	21	3.109500
7	2.985000	22	3.149500
8	2.988000	23	3.179500
9	2.996500	26	3.188500
12	3.024500	27	3.153800
13	3.046000	28	3.164500
14	3.082500	29	3.184800
15	3.090500	30	3.191000
19	3.106500		

**Information concerning currency exchange rates was obtained from the International Monetary Fund, available at <http://www.imf.org>.

160,475.00 if the transaction had been a spot exchange and payment made on the same day. Due to the amount of time that passes during forward contracts, between one month and one year typically, and the more substantial sums of money involved in such international exchanges, the risks and uncertainty regarding the value of the money, as a counter-value in the exchange, represents a major element of risk and provides a clear violation of *gharar* in light of the uncertainty inherent in the exchange.

While the previous examples were based upon relatively stable monetary systems and demonstrated the effect of minor fluctuations in exchange rates during spot exchanges, the fluctuations become exacerbated during financial crises. Prior to the Asian Financial Crisis, the exchange value of the Indonesian Rupiyah (IDR) to USD fluctuated between IDR 2,300.00 and IDR 2,500.00 between January 1997 and

July 1997, decreasing in value to almost IDR 6,000.00 to USD 1.00 by December 1997. Following the Asian Financial Crisis, the IDR exchange value decreased from IDR 10,000 to USD 1.00, on 20 January, to IDR 12,800 to USD 1.00, on 22 January 1998, decreasing further to IDR 14,800 to USD 1.00 by 23 January 1998. In the case of the Zimbabwean Dollar, the exchange rate dropped from ZWD 30,000.90 to USD 1.00 on 9 May 2008 to ZWD 160,000,000 to USD 1.00 on 11 May 2008. Although such extreme instances are rare, they are similar to common inflationary and deflationary exchange spikes in the sense that they are often unforeseen and unpredictable, arising from the fact that a multitude of economic and non-economic factors affect the exchange ratios for currency (Ajami *et al.*, 2006).

The reality of the effects of economic and non-economic factors on the value of

TABLE 4
2011 Bi-Monthly Currency Exchange Rates: Malaysian Ringgit to the US Dollar***

MYR : 1 USD		MYR : 1 USD	
3 January	3.064000	5 July	3.008500
18 January	3.059500	20 July	3.001500
2 February	3.043500	3 August	2.974300
18 February	3.038500	18 August	2.976500
3 March	3.033000	6 September	2.987500
18 March	3.044000	21 September	3.109500
4 April	3.025900	3 October	3.209500
19 April	3.029000	18 October	3.116500
3 May	2.970000	3 November	3.147000
18 May	3.031400	18 November	3.161200
2 June	3.027500	1 December	3.145500
17 June	3.047000	16 December	3.177000

***Information concerning currency exchange rates was obtained from the International Monetary Fund, available at <http://www.imf.org>.

money is demonstrated in Table 5. Utilizing a cross analysis of the inflation rates of the USD and the MYR, a theoretical exchange rate is proposed over the course of 2011 using the average currency exchange rate between the MYR and the USD as a reference point. The percentage based monthly inflation rate figures are utilized to determine the changes in the relative value of the USD and the MYR, in relation to domestic economic and non-economic factors leading to inflation (and deflation in the case of the USD), which are then applied to the currency exchange rate of the previous month. The table demonstrates the theoretical effects of the relative increase and decrease of the value of the MYR against the USD on the currency exchange rate,

all other things equal. The table, however, demonstrates that the fluctuations in the currencies arising from inflation, the result of local factors, and the fluctuation arising from currency exchange values, the result of international factors, result in completely different figures and contradictory increases and decreases in value in some instances. The disparity between the resulting figures is further indicative of the overwhelming uncertainty arising from the use of contemporary moneys in international exchanges, demonstrating that the systems utilized to value contemporary moneys will inevitably provide incongruent, if not contradictory, valuations of contemporary moneys in practice.

TABLE 5

Comparison of Theoretical Effects of Monthly Inflation on Exchange Ratios and Actual Exchange Ratios: Malaysian Ringgit to US Dollar****

	Inflation Rate US	Inflation Rate Malaysia	Resulting Change in Value (%) of MYR Against USD	Theoretical Average Rate of Exchange	Actual Average Rate of Exchange
December(2010)	N/A	N/A	N/A	N/A	3.124990
January	0.48	0.59	-0.001194	3.125027	3.065500
February	0.49	0.49	0.000000	3.125027	3.046020
March	0.98	0.09	0.008892	3.124749	3.034720
April	0.64	0.29	0.348988	3.113844	3.011500
May	0.47	0.29	0.179480	3.108256	3.016190
June	-0.11	0.29	-0.398843	3.120653	3.029320
July	0.09	0.19	-0.099810	3.151800	2.994760
August	0.28	0.19	0.089829	3.148969	2.985610
September	0.15	0.19	-0.039924	3.158398	3.084580
October	-0.21	0.19	-0.299431	3.167855	3.135170
November	-0.08	0.09	-0.169847	3.173235	3.154380
December	-0.25	0.09	-0.339694	3.184015	3.159760

****Information concerning the average monthly currency exchange rates between the Malaysian Ringgit and the US Dollar in 2011 was obtained from X-Rates, available at <http://www.x-rates.com>

Practical Effects of Value Fluctuation Considered

The practical realities associated with the use of contemporary moneys in economic exchanges demonstrate the nature of the risks associated with the value of such moneys. This is especially so in regards to inherent value-based assessments involved in any economic exchange including costs, benefits and price. The examples amply demonstrate the spectrum of risk associated with contemporary transactions. On one end of the spectrum lie spot exchanges conducted within a domestic market, which are relatively free from risks and uncertainties associated with *gharar*. Issues associated with the nature of contemporary moneys, including the effects of time on economic transactions in light of fluctuating inflation and currency exchange rates; contrasts between the valuation of moneys at the local and international levels. The risks associated with monetary system instability that has led to hyperinflation in some instances, gradually place other types of exchanges toward the other end of the spectrum, where *gharar* becomes an apparent and abhorrent element of the economic exchange due to the pervasive risks and uncertainties incurred. While deferred payments in domestic spot exchanges can potentially involve minimal risk, the amount of risk and uncertainty is directly correlated to the amount of money utilized as a counter-value in the economic exchange and the amount of time between the agreement and payment. Although international spot exchanges can also potentially contain minimal risk, this

can be accomplished only by minimizing the amount of time between the agreement and the payment. As demonstrated, even a two day period between the agreement and the payment in regards to a spot exchange can have considerable consequences. However, with regards to forward contracts and exchanges during periods of monetary system instability, such as sharp inflationary spikes and hyperinflation, the risks and uncertainties become paramount and should therefore be avoided.

PRACTICAL IMPLICATIONS AND RECOMMENDATIONS CONCERNING RISK MANAGEMENT ARISING FROM ECONOMIC EXCHANGES: A SHARIAH PERSPECTIVE

Academic entrepreneurship, like any commercial activity, will inevitably contain elements of risk and uncertainty. The characteristics and nature of contemporary moneys, however, add a significant amount of risk to such ventures. *Fiqhmuamalat* is the body of *Shariah* law dealing with economic transactions and effectively utilizes the prohibition against *gharar* as a means by which to manage and reduce the risks associated with any commercial venture. As a result of the problematic features of the use of contemporary moneys – such as inflation, constantly fluctuating currency exchange rates and problems concerning the valuation of contemporary moneys generally – the most basic activity of any business venture, that of the economic exchange, has inherently become the source of a significant amount of risk. However, the nature of risk

and uncertainty in relation to specific types of economic exchanges has been sufficiently delineated to provide guidance for academic entrepreneurs in relation to the manner in which to minimize the risk arising from commercial transactions.

As demonstrated, the spectrum of risk flows from minimal to pervasive; local exchanges to international exchanges; and spot exchanges to deferred payments or forward contracts, respectively. In a fashion similar to the function of *fulus* in early Islamic economies, contemporary moneys are most suited for small local transactions. Unfortunately, the reality is that for a venture to be successful, economic exchanges must be concluded and such exchanges utilize contemporary moneys, almost exclusively, as a counter-value. The analysis, however, has emphasized several important points about the reduction of risk in commercial transaction. Firstly, the shorter the period of time between an agreement relating to an economic exchange and payment, the less risk and uncertainty are incurred in the transaction. Secondly, while deferred payments in local exchanges inherently involve greater risk and uncertainty than spot exchanges, the risks can be minimized by establishing shorter terms between agreement and payment. Endeavoring to minimize potential losses of benefit from the transaction by reducing the amount of goods, services or commodities exchanged in individual agreements, possibly spreading the items exchanged over several individual transactions rather than attempting to merge them into one substantial transaction

agreement also helps. Thirdly, inflation and currency exchange rates must be monitored closely and regularly, with prices, costs and desired benefits being evaluated on a regular basis in light of the fluctuations. Fourthly, while the future value of contemporary money is inherently uncertain and its value can be reduced to almost nothing in a matter of days during periods of monetary system instability, the academic entrepreneur must be consciously aware of the financial stability of the monetary systems which may be encountered when conducting commercial transactions and avoid economic exchanges involving contemporary moneys issued in a territory experiencing a financial crisis. Finally, if opting to engage in international economic exchanges, endeavor to minimize risks by minimizing, to the greatest extent possible, the period of time between the agreement and the payment for the transaction.

The discussion of the concept of *gharar* in relation to economic transactions arising as a result of academic entrepreneurial ventures has contributed to discourse concerning academic entrepreneurship in three principal fashions. Firstly, the analysis has demonstrated the inherent risks associated with contemporary commercial transactions involving contemporary money as a counter-value. Secondly, the discussion of the nature and characteristics of contemporary money raises awareness about the issues associated with the valuation of contemporary moneys, particularly the potential effects upon cost, benefits and price over a period of time. Finally, the

present article can serve as a guide for ventures in academic entrepreneurship, whereby risks arising from commercial transactions can be minimized in a practical manner and economic exchanges can be conducted in a *Shariah* compliant manner. Future research could include determining whether other potential conflicts arise with *Shariah* principles, such as *riba* and *maysir*, in academic entrepreneurial activities purely due to the nature of contemporary moneys and whether Islamic guidelines contained within *fiqhmuamalat* may serve as a practical means by which to avoid the potential consequences associated with such issues.

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The Default Rules Relating To Joint Ownership of Patents – Pitfalls for the Unwary

Lim Heng Gee

Faculty of Law, Universiti Teknologi MARA, 40450 Shah Alam, Selangor, Malaysia

ABSTRACT

The issue of joint ownership of patents is vital in relation to university entrepreneurship and startups. Since the invention, which is the subject of commercial exploitation is likely to result from a collaborative effort or joint venture with a third party, there is likelihood that any patents issued from such collaborative efforts will be jointly owned. The parties involved in such ventures may logically believe that joint ownership means that the parties will jointly control the patents and share the profits from the joint venture corresponding to contributions – or at least equally. However, in the absence of any agreement relating to the above matter, the default rules as laid down in statutes and the case law will apply. The default rules relating to the rights of joint owners of patents vary from country to country, but it has long been recognised by the courts that “joint owners are at the mercy of each other”. In an ideal world, co-owners would have arrived at an amicable agreement regarding their respective rights, interests and duties in their joint patent even before the patent is granted or obtained. However, this is not so in the real world; it is not inconceivable that parties involved in applying jointly for patents would initially be more concerned with matters directly related to the grant of the patent. They may not be aware of or appreciate the features and incidents connected with joint ownership under the default rules and, therefore, would initially not realise the importance of the need to make contractual provisions regulating the rights and relationship between themselves. This paper illustrates the default rules relating to the rights of joint owners of patents in Malaysia, the United Kingdom and the United States. Where relevant, the default positions in other countries will also be referred to. This paper aims to show that the default rules may give rise to disastrous consequences,

and concludes by stressing the importance of a carefully thought-out ownership agreement, in order to avoid the various pitfalls arising from the statutory default rules.

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E-mail address:

henggeelim@yahoo.com (Lim Heng Gee)

* Corresponding author

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INTRODUCTION

Universities are now encouraged to actively promote and engage in entrepreneurship, and to seek commercialization of the results of any research and development. Research and development projects may be conducted solely by university researchers without outside involvement, but increasingly, universities participate in collaborative research and development projects with outside bodies – be it other universities, research institutions or private enterprises. Universities team up with collaborators in their research and development process for various reasons: to obtain additional finance, expertise, or much-needed entrepreneurial skills. These collaborators include both local and foreign partners.

The output of such collaborative research could be the creation of inventions and ultimately the grant of patents. The issue then arises as to who owns the patents and what are the parties' respective rights in the patent. In a carefully thought-out collaborative research venture, the parties would have addressed all these issues in a written agreement. In such a case, it is a matter of negotiation between the parties as to who should and would own the invention and any resulting patent. The parties might ultimately agree on joint ownership as it seems a fair solution, rather than having to quibble over ownership issues. Joint ownership of a patent may also arise in

other situations, such as when more than one applicant applies for a patent, or when a patent has been jointly assigned to more than one person. It could also occur by operation of law.¹

Like any other property, the owner of a patent has the rights to exploit the patented invention, assign or transmit the patent, and to conclude license contracts.² However, in a case where the patent is jointly owned by more than one owner, the question arises as to what the respective rights of the co-owners are. Does one co-owner have the same rights as the other, and can he exercise all his rights without the concurrence of the other? The intuitive response would be a resounding "Yes". The parties to such ventures may logically believe that joint ownership means that the parties will jointly control the patents and share the profits from the joint venture in proportion to contributions or at least will share equally in such profits. However, the reality is not that simple. If the parties have carefully delineated their rights under a contract, then all is well and good. However, sometimes, through advertence or ignorance, the parties may not have agreed on the rights and obligations each co-owner should have in relation to the patent. In that case, the rights would be governed by operation of the law. This will be referred to as the "default rules" – the rules laid down by statutes and the case law. The patent statutes and case law of many countries

¹In Malaysia, through the combined effect of section 18(3) and section 20, Patents Act 1983.

²See, for example, section 36, Patents Act 1983, Malaysia and section 30, Patents Act 1977, UK.

lay down a series of acts that a co-owner may or may not do without the consent of the other co-owner/s. These default rights and obligations may not be what the parties had in mind when they agreed to joint ownership.

The default rules depend on the applicable national law. This paper illustrates the default rules relating to the rights of joint owners of patents in Malaysia, the United Kingdom and the United States. Where relevant, the default positions in other countries will also be referred to. It aims to show that the default rules may give rise to unwanted and unanticipated disastrous consequences. The paper concludes by stressing the importance of a carefully thought-out ownership agreement, which would help avoid the various pitfalls arising from the statutory default rules. Although it is appreciated that most contracts would have to be negotiated on a case-by-case basis, nevertheless there are certain pointers which must be kept in mind.

THE THEORY UNDERLYING PATENT RIGHTS

The theory underlying patent rights is important, since it gives rise to several common law rules regulating the rights of co-owners inter se in the absence of agreement, which rights have now mainly been codified in patent statutes. Two theories about the nature of patent rights have been enunciated by the courts in the various jurisdictions: the “exclusion” theory, and – for want of a better term – can be referred to as the “whole unit” theory. Under the

“exclusion” theory, a patent is viewed as a right to exclude others from the right to make, use and sell the patented invention. It is only by virtue of a patent grant that the grantee has the right to prevent others from exploiting the invention. The grant does not give a positive right to the use of the invention. Such a right already exists at common law. Because of this right of exclusion, one co-owner cannot exclude other co-owners from the use of the patent. This is because the grant allows the grantee to exclude others, but not another co-owner. Therefore, each co-owner has the right to use the patent for his own benefit.³ Under the “whole unit” theory, however, the grant

³See *Mathers v. Green* LR 1 Ch. App. 29 (1865), per Lord Cranworth L.C., at 33,

"The letters patent grant to the three, their executors, administrators, and assigns, that they and every of them by themselves, their servants and agent, or such others as they may agree with, and on no others, shall, for the term of fourteen years, use, exercise, and vend the said invention. The rights conferred are a right to exclude all the world other than the grantees from using the invention. But there is no exclusion in the letters patent of any one of the patentees. The inability of any one of the patentees to use the invention, if any such inability exists, must be sought elsewhere than in the letters patent. But there is no principle, in the absence of contract, which can prevent any persons not prohibited by statute from using any invention whatever."

In the US, see, for example, *Talbot et al. v. Quaker-State Oil Refining Company* 41 USPQ 1 (CCA 3rd Cir. 1939), per Kirkpatrick, District Judge, at 2-3:

of the patent is regarded as a grant to the patentees jointly and not to each one of them individually. Therefore, the enjoyment of the rights under the patent can only be exercised by all the patentees jointly. This would mean that any exercise of the rights without the full consent of all the owners, for example, by the grant of a license by one owner, would give the other owners a right of action against him.⁴ However, the "whole unit" theory has not found favour with the courts in the United States,⁵ and it does

"In its essence all that the Government confers by the patent is the right to exclude others from making, using or vending the invention (Crown Die and Tool Co. v. Nye Tool and Machine Works 261 US 24, 35 (US Sup. Ct. 1922), and as to this essential attribute of the property each joint owner is in a very real sense at the mercy of the other. Each of them may use or license others to use the invention without the consent of his fellows, and without responsibility to such fellows for the profits arising from such use or licence."

⁴See *Pitts v. Hall* 19 F. Cas. 758 (CC ND N.Y. 1854), *per Hall*, District Judge, at 761.

⁵See, for example, *Lalace & Grosjean Mfg. Co. v. National Enamelling & Stamping Co.* 108 F. 77 (CC S.D.N.Y. 1901), *per Coxe*, District Judge, at 77-78,

"The complainant contends ... [f]irst, that the St. Louis Company could not convey to the defendant the right to make, use and vend without the consent of the complainant; ... The first of these propositions has never been directly passed upon by the Supreme Court, but the overwhelming weight of authority in this country and in England is against the view asserted by the

not seem to have been canvassed before the United Kingdom courts. Therefore,

complainant. Indeed, but one authority is cited in its support, Pitts v. Hall, 3 Blatchf. 201, Fed. Cas. No. 11,193, decided in 1854, which has never, so far as the court has been able to ascertain, been followed in a carefully considered case. It is not thought that the learned judge ... intended to express a definitive opinion upon the question now under discussion. He considered the question an open one, but disposed of the motion upon other reasoning, which, at that stage of the litigation, appears to be unanswerable. The authorities supporting the defendant's contention are too numerous to cite, but the argument in its support will be found sufficiently stated in the following: (citation omitted) ... See, also, the recent and well-considered case of Blackledge v. Manufacturing Co. 108 Fed. 71. It is thought that a rule so generally recognised will not be disturbed, but in any view it is too firmly established and has been enforced for too long a period to be disregarded by this court."

The case of *Herring v. Gas Consumer's Association* 9 F. 556 (CC E.D. Missouri 1878), which purported to distinguish *Pitts v. Hall*, seems to lend support to the "whole unit" theory - see Treat, District Judge, at pages 556-557, where he held that even though the defendant co-owner had, by virtue of the joint ownership, the right to use the patent, but he had no right, more than a stranger, to infringe the same. Therefore, the claim by the plaintiff co-owner for his proportion of the damages for infringement of their common patent was allowed. However, this is a strange decision, containing, as such, a contradiction in terms, and was rightly criticised in *Bell & Howell Co. v. Bliss* 262 F. 131 (CCA 7th Cir. 1919), at 136 as "not at all persuasive" and "difficult to comprehend".

the weight of authority is in favour of the “exclusion” theory, with all its implications as will be discussed below.

THE RIGHTS OF CO-OWNERS UNDER THE DEFAULT RULE

The default rules established by statute or case law relating to the rights of joint owners of patents vary from country to country, but it has long been recognised by the courts that “joint owners are at the mercy of each other”⁶. In the following discussion, reference will be made to the common law position, followed by an examination of the statutory provisions in the relevant statutes. It will be seen that the default rules are substantially statutory enactment of the common law rights.

The default rule relating to the right to assign or transmit rights.

In the United States, although section 262 of US Code, Title 35, Patents, does not

deal with the issue of assignments, the case law allows a co-owner unrestricted rights to assign his full interest, or any portion of it, without the consent of the other co-owner. For example, in *Lalance & Grosjean Mfg. Co. v. National Enamelling & Stamping Co.*,⁷ a patent which was originally granted to one Hubert Claus was assigned to the complainant plaintiff and the St. Louis Stamping Company, each holding a half interest in the patent. The St. Louis Stamping Company later assigned its half interest to some other parties who duly assigned it to the defendant. When sued for infringement, the defendant asserted its right to use the patent by virtue of its half interest in the patent. The plaintiff contended that the assignment to the defendant was invalid since the assignment was made without its consent. This contention was, however, rejected by the court, holding that the overwhelming authority was that such consent was not required.

Similarly, in the Canadian case of *Forget v. Specialty Tools of Canada Inc.*,⁸ the Supreme Court of British Columbia held that the co-owner of a patent may assign his whole interest in the patent without the concurrence of any other co-owner. However, the interest of the co-owner cannot be subdivided into two or

⁶ “In its essence all that the Government confers by the patent is the right to exclude others from making, using or vending the invention [citation omitted], and as to this essential attribute of the property each joint owner is in a very real sense at the mercy of any other... [Each joint owner’s] unlimited right to license others may, for all practical purposes, destroy the monopoly and so amount to an appropriation of the whole value of the patent.”

Talbot v. Quaker-State Oil Refining Co., 104 F.2d 967 (3d Cir. 1939) at 968. See also Phillips, Chief Judge, at 252, in *Willingham, et al. v. Lawton, et al.* 194 USPQ 249 (CA 6th Cir. 1977).

⁷*Lalance & Grosjean Mfg. Co. v. National Enamelling & Stamping Co.* 108 F. 77 (CC S.D. New York, 1901), per Coxe, District Judge, at 77.

⁸*Forget v. Specialty Tools of Canada Inc.* [1993] 48 CPR (3d) 323 (Sup. Ct. of British Columbia), per Rowan J., at 638-642, applying *Mathers v. Green* LR 1 Ch. App. 29 (1865) and *Steers v. Rogers* (1893) 10 RPC 245 (HL).

more parts, nor may it be licensed without the concurrence of all the owners of the patent. This is because the subdivision of an interest in the patent by a co-owner can lead to unfair results and chaotic situations. Furthermore, if one co-owner is entitled to license a patent, the situation would allow numerous licenses to be created, thereby destroying the value of the patent of his co-owners. The court distinguished the case of *Marchand v. Peloquin*,⁹ on the ground that

⁹*Marchand v. Peloquin* [1978] 45 CPR (2d) 48 (Quebec Court of Appeal). The headnote of the case is in English but the report is in French. From the headnote it would appear that the opinion of the court was that a patent conferred a negative right in the sense that it conferred a right to exclude others from the area of the patent. Therefore, co-owners had rights which would normally be exercised together or at least for their joint benefit. The court disapproved of the English cases of *Mathers v. Green* LR 1 Ch. App. 29 (1865) and *Steers v. Rogers* (1893) 10 RPC 245 (HL) to the effect that the practical consideration of these cases was that any other conclusion would permit one patentee to prevent the use of the invention altogether, or in the alternative to risk his skill and capital on terms of being accountable for profits without having to share losses. Such consideration did not apply now because if one patentee refused to permit use of the invention, the other could get a compulsory licence as an interested person. The court further held that the result of the British cases would lead to serious inconvenience because if one patentee could give everybody a right to use the patented invention, he could sabotage the exclusivity of his co-owners. The court then noted that in Britain the case law has been overturned by statute.

With respect, it is submitted that the Court in *Marchand v. Peloquin* seems to have come to an incorrect reading of the British cases. The statutory provisions mentioned by the court above are in fact enactment of the common law

the case could have been decided under the alternative ground of contract law.

The Patents Act 1987, Malaysia, gives the right to assign or transmit the rights in the patent separately. Therefore, no consent of other co-owners is required. This is in contrast to the statutory rights under the 1977 Patents Act of the UK, where consent of all co-owners is required before a share of the patent could be assigned.¹⁰ It is, however, unclear from the Malaysian provision whether a co-owner can assign a portion only of his share in the patent.

The default rule relating to the right to exploit.

Under the common law, each co-owner has the right to exploit the patent for his own use without the consent of the other co-owners. This was so held in *Mathers v. Green*,¹¹

position. Further, there was already a provision for compulsory licences under section 22 of the Patents, Designs, and Trade Marks Act, 1883.

¹⁰See s. 36(3), Patents Act 1977, UK. This a statutory enactment of the common law position - see the case of *Horsley & Knighton's Patent* (1869) 8 L.R. Eq. 475, per Lord Romilly M.R., at 477, where it was held that neither of two joint patentees was entitled to cause to be made in the register of proprietors any entry which purported to affect or prejudice the rights of the other. See also similar provisions in section 16(1)(c), Patents Act 1990, Australia; section 50(3), Patent Act 1970, India and section 46(3), Patents Act, Chapter 221, Singapore.

¹¹*Mathers v. Green* (1865) LR 1 Ch. App. 29. A patent was granted in the joint names of the plaintiff and the two defendants. The defendants used the patent independently of the plaintiff. The plaintiff contended that the intention, at the time of taking out the patent, was that the three grantees should have a joint interest therein. Sir John Romilly M.R., at first instance, held that

where on appeal, the decision by the Master of the Rolls declaring that the plaintiff was entitled to an equal share of the profits derived by the defendant joint owner was overruled. Lord Cranworth L.C. held that in the absence of any contractual provisions to the contrary, the defendant had the right to exploit the patented invention without having to account for the profits to the other co-owner. This was because the right conferred by a patent was a right to exclude the entire world other than the grantees from using the invention. However, there was no exclusion in the letters patent of any one of the patentees.¹² The principle enunciated in *Mathers v. Green* was approved and followed by the House of Lords in *Steers v. Rogers*,¹³ where the court stressed that a

the patent was the joint property of the plaintiff and the defendants and that he was entitled to an equal share of the profits of the manufacture attributable to the invention, as well as to an equal share of the royalties arising from a licence alleged to have been granted. Therefore, the plaintiff was entitled to an account of his share of the profit derived from the defendants' use of the patent.

¹²*Mathers v. Green* LR 1 Ch. App. 29 (1865), per Lord Cranworth L.C., at 33-34.

¹³*Steers v. Rogers* (1893) 10 RPC 245 (HL), per the Lord Chancellor at 251. Lord Halsbury, Lord Macnaghten and Lord Shand concurred. Unlike *Mathers v. Green*, *Steers v. Rogers* involved a situation where the patent was not initially granted in the joint names of the plaintiff and defendant. The defendant became a joint owner by a subsequent assignment. However, the House of Lords held that this made no difference to the duty of the joint owner who worked the patent. He did not have a duty to account to the other joint owner. See also *Wapshare Tube Co., Ltd v. Hyde Imperial Rubber Co. Ltd* (1901) 18 RPC 374 (CA), per

patent, unlike other chattels, was merely a right to exclude others from using it without the consent of the owner. However, even though a co-owner can exploit the patent without consent, he must do it personally or through an agent, and not through an independent contractor. This principle was laid down in the case of *Howard & Bullough v. Tweedales & Smalley*.¹⁴

Collins L.J., at 378, applying the rule that a co-owner could work the patent without the consent of the other co-owners.

¹⁴*Howard & Bullough v. Tweedales & Smalley* (1895) 12 RPC 519. Note that the case was argued essentially on the true construction of the terms of an agreement whereby the assignor of two patents reserved to himself the right to work them personally. However, this case has been used as authority that the right to use is confined to the co-owner or his agent. The reason for this is best given by Chitty J., at 528,

"But I point out that the distinction between the servant and agents and the independent contractor is not one of mere words, or one merely of law, but it is one of very great importance, having regard to the nature of these contracts. A man who only ... employs his own servants and agents, risking his own capital and the like, in the manufacture of the patented articles, stands in a very different position from the man who can, either through himself or his friends, get others to assist him and bring them in as independent contractors. I think, as I have said, the object of the proviso was to confer rights personal to ST, and ST, acting within them, can bring whatever capital he himself has (it may be partially borrowed money) for the purpose of making, but making by himself, or his agents or servants, the articles in question. But if he can go to other persons and get them, however large the firm may be, to manufacture

The law on this aspect of the right of a co-owner is similar in the United States. In *Vose v. Singer*,¹⁵ the court held that since co-owners must be regarded as having interests which are distinct and separate in nature, “they cannot for any legal use of them incur any obligation to each other.” In *Blackledge v. Weir & Craig Mfg. Co.*,¹⁶ the court held that one co-owner has the right to exploit the invention without the consent of the others, stressing the unfairness to the enterprising co-owner if it were to be otherwise. The only case where the court held that one co-owner could be sued for infringement by another co-owner is the case of *Herring v. Gas Consumer’s Association*.¹⁷ However this

for him, that I conceive to be a very different state of things; and, therefore, this distinction, which might at first to some minds seem to be a rather subtle one and rather a refinement of law, is ... one of very great importance to the parties.”

¹⁵*Vose v. Singer* (1862) 4 Allen (Mass.) 226, at 230.

¹⁶Relying on the UK cases of *Mathers v. Green* and *Steers v. Rogers*, and the US case of *Vose v. Singer*, see *Blackledge v. Weir & Craig Mfg. Co.* 108 F. 71 (CCA 7th Cir. 1901), *per* Woods, Circuit Judge, at 73. For similar decisions, see *Clum v. Brewer* 5 F. Cas. 1097 (CC D. Mass. 1855), *per* Curtis, Circuit Justice, at page 1103; *Aspinwall Mfg. Co. v. Gill* 32 F. 697 (CC D. New Jersey, 1887), *per* Bradley J., at 702; *Drake v. Hall* 220 F. 905 (CCA 7th Cir. 1914), *per* Seaman, Circuit Judge, at page 906; *Central Brass & Stamping Co. v. Stuber* 220 F. 909 (CCA 7th Cir. 1915), *per* Kohlsaat, Circuit Judge at 911-912; *Bell & Howell Co. v. Bliss* 262 F. 131 (CCA 7th Cir. 1919), at 136.

¹⁷*Herring v. Gas Consumer’s Association* 9 F. 556 (CC E.D. Missouri, 1878), see Treat, D.J., at 556-558.

case has been criticised and regarded as not persuasive in *Bell & Howell Co. v. Bliss*.¹⁸

Therefore, it is accepted that co-owners are free to use and exploit the patent without the consent of the other co-owners, unless the patent had been vested in a trustee in trust for them. In that case, the beneficiaries cannot freely exploit the patent. To hold otherwise would be to nullify the purpose of the trust, which is to “preserve the joint property and to prevent its practical destruction by co-owners”.¹⁹

In the absence of any agreement to the contrary, section 40 of the Patents Act 1983, Malaysia provides that joint owners of a patent may separately exploit the patented invention. This right is similar to that provided by section 36(2)(a) of the Patents Act 1977, UK, which gives a co-owner the right to exploit the patented invention without the consent of the others. It has to be noted, however, that the rights of free use of the invention provided by the UK Act is exercisable (unless otherwise agreed) by the co-owner and his agent.²⁰ This reflects the common law position discussed above. The term “agent” was held by Jacob J., and not to be used in a strict sense. The patentee was entitled to exploit his invention through others. However, where an independent contractor was used by one of the joint

¹⁸*Bell & Howell Co. v. Bliss* 262 F. 131 (CCA 7th Cir. 1919).

¹⁹See *McDuffee v. Hestonville, M. & F. Pass. Ry. Co.* 162 F. 36 (CCA 3rd Cir. 1908), *per* Buffington, Circuit Judge, at 38-39; cert. denied, 23 U.S. 719; 56 L. Ed. 629 (1911).

²⁰See also similar provisions in section 16(1)(b), Patents Act 1990, Australia; section 50(2), Patent Act 1970, India and section 46(2)(a), Patents Act, Chapter 221, Singapore.

proprietors to perform an act which would be an infringement of a patent if the default rule did not apply, it must be considered whether the act was in substance licensing or use by the joint proprietor for his own benefit.²¹

There is no mention in the Malaysian Patents Act 1983 of the right to exploit the patent through the vehicle of an agency. Nevertheless, it is submitted that by virtue of agency principles, the right to exploit the patent separately can be construed as including the right to exploit through an agent, since the acts of the agent are the act of the principal. However, the right to exploit separately does not extend to having the patent exploited by a sub-contractor, or to a partner of the co-owner, and he cannot form a company to exploit the invention on his behalf. It is specifically provided in section 36(2)(a) of the Patents Act 1977, UK that the statutory right to exploit the patent without the consent of the other co-owners can be overridden by agreement. Therefore, if there is an agreement whereby one co-owner is to be responsible for the commercial exploitation of the patent, with the net profits from sales or licensing to be divided equally, the construction of the agreement may oust the right to exploit it

²¹See *Henry Brothers (Magherafelt) Ltd. v. The Ministry of Defence and the Northern Ireland Office* [1997] RPC 693, upheld by the Court of Appeal [1999] RPC 442. *William Manley Hall Dixon v. The London Small Arms Company, Limited* (1876) 1 App. Cas. 632 is an instructive case to read in relation to the concept of when a contractor to manufacture and supply is to be regarded as an agent or an independent contractor.

personally without having to account for any profits.²²

The position is the same in the United States. Section 262 of Title 35, Patent provides that “In the absence of any agreement to the contrary, each of the joint owners of a patent may make, use, offer to sell, or sell the patented invention within the US, or import the patented invention into the US, without the consent of and without accounting to the other owners.”

The default rule relating to the duty to account

There is also no duty on the part of one co-owner to account to the other owners for any gains derived from his use of a jointly held patent. This was held to be so in *Mathers v. Green*,²³ where besides declaring that one joint owner could exploit the invention without the permission of the others, the court also rejected the contention that if the joint right of the patentees was conceded, the only mode of making it effectual was to give them a joint interest in the profits. Lord Cranworth held that in the absence of any contractual provisions to the contrary, the defendant had the right to exploit the patented invention without having to account for the profits to the other co-owners. The above principle with regards to the non-obligation to account to the other owners was adopted by the House of Lords in *Steers v. Rogers*.²⁴

²²See, for example, *Young v. Wilson* (1955) 72 RPC 351.

²³*Mathers v. Green* LR 1 Ch. App. 29 (1865).

²⁴*Steers v. Rogers* (1893) 10 RPC 245 (HL), at 251, *per* Lord Herschell L.C.,

In an early case in the United States, it was tentatively stated that one co-owner may have to account to the others for any profit derived from use of the patent. However, the statement was made obiter and the judge was at pains to stress that it was a mere speculation.²⁵ The contrary rule has now been firmly established.²⁶ It is pertinent

to note that the reason given for denying the other co-owner a right to a share of the profits derived by one co-owner was that it would result in one co-owner having to risk his skill and capital and the other co-owner the right to a share of the profits without a corresponding duty to contribute towards any risk.²⁷

"In the case of Mathers v. Green ... it was held that where a patent for an invention is granted to two or more persons, each one of them may use the invention without the consent of the others, and if he so uses it is not bound to account to the others for any share of the profits which he makes by its use. ... Now, ... counsel for the appellant maintained ... that that decision was not good law; but it appears to me to be both good law and good sense when the nature of patent rights is regarded. ... What the letters patent confer is the right to exclude others from manufacturing in a particular way and using a particular invention. When that is borne in mind it appears to me ... very clear that it would be impossible to hold, under these circumstances, that where there are several patentees, either of them, if he uses the patent, can be called upon by the others to pay to them a portion of the profits which he makes by that manufacture, because they are all of them entitled, or perhaps any of them entitled, to prevent the rest of the world from using it."

"The use of an invention by one of co-owners or by his licensees is not the exercise of the entire monopoly conferred by the patent. That can be effected only by the joint or concurrent action of all owners. The separate action of any one owner or of his licensees can be an exercise or use only of his individual right, which, though exclusive of all besides, is not exclusive of the other patentees, their assignees or licensees. On principle, therefore, there can be no accountability on the part of a part owner of an invention to other owners for profits made by the exercise of his individual right, whether it be by engaging in the manufacture and sale, or by granting to others licenses, or by assigning interests in the patent. His use of the invention in any lawful way is not an appropriation of anything which belongs to another. The separate rights of the other owners remain unaffected. They are equally free to use the invention in all legitimate ways for their individual profit. Each is entitled to the fruits of his endeavours, taking no risk and expecting no reward from enterprises in which he does not choose to join."

²⁵*Aspinwall Mfg. Co. v. Gill* 32 F. 697 (CC D. New Jersey, 1887), per Justice Bradley, at 702; appeal dismissed with cost, 40 US 669; 35 L. Ed. 597 (1891).

²⁶See, for example, *Vose v. Singer* (1862) 4 Allen (Mass.) 226, 230, and *Blackledge v. Weir & Craig Mfg. Co.* 108 F. 71 (CCA 7th Cir. 1901), per Woods, Circuit Judge,

²⁷See *Mathers v. Green* (1865) LR 1 Ch. App. 29, per Lord Cranworth, at 34,

"Is there any implied contract where two or more persons jointly obtain letters patent that no one of them shall

use the invention without the consent of the others, or if he does, that he shall use it for their joint benefit? I can discover no principle for such a doctrine. It would enable one of two patentees either to prevent the use of the invention altogether, or else to compel the other patentee to risk his skill and capital in the use of the invention on the terms of being accountable for half the profit, if profit should be made, without being able to call on his co-patentee for contribution if there should be loss."

see also *Vose v. Singer* (1862) 4 Allen (Mass.) 226, at page 230,

"It is difficult to see how an equitable right of contribution can exist among any of them, unless it includes all the parties interested and extends through the whole term of the patent right; and if there be a claim for contribution of profits, there should also be a correlative claim for losses, and an obligation upon each party to use due diligence in making his interest profitable. It is not and cannot be contended that these parties are co-partners; but the idea of mutual contribution for profits and losses would require even more than co-partnership. Nothing short of the relation of stockholders in a joint-stock company would meet the exigencies of parties whose interests may be thus transferred and subdivided. But even as between the original parties, as there was no mutual obligation to contribute for losses, or to use any diligence to make the property profitable, and as each party was at liberty to buy, use, and sell machines at his pleasure, and to sell his moiety of the right, or fractional

It is not clear from the Malaysian Patents Act 1983 whether there is a duty to account to the other co-owners for any profit derived from individual exploitation by a co-owner. The Act is silent on this, unlike the provision of section 36(2)(a) of the Patents Act 1977, UK, where the duty to account is excluded, as the provision specifically states that a co-owner can exploit the patented invention "for his own benefit and without ... the need to account to the other or others".²⁸ Section 262 of the US Patent Act also provides specifically that each co-owner has the right to exploit the patented invention without accounting to the other owners. Again, both these statutory provisions are mere reflections of the common law position. In relation to the duty to account in Malaysia, it would seem that having given the co-owners a right to separate exploitation of the patented invention without any conditions imposed, there may also not be a need to account.

parts of it, we think no obligation arose out of the part ownership, as being legally or equitably incident to it, to make contribution of profits. ... If the defendants have realised any profit in the manner alleged, it has been by investing capital in the purchase of machines, and the use of skill and labour in selling them; and they have taken the risk of losses."

²⁸See also section 16(1)(b), Patents Act 1990 Australia, section 50(2), Patent Act 1970, India and section 46(2)(a), Patents Act, Chapter 221, Singapore, which are in the same vein.

The default rule relating to the right to license.

In *Horsley & Knighton's Patent*,²⁹ one of two co-owners purported to assign by deed his share and interest in a patent, and by the same deed purported to release him from all claims by both the co-owners in respect of the patent. This deed was entered verbatim on the register. The court allowed an application by the other co-owner to have the entry expunged, as one co-owner could not dispose of the right of the other. From the opinion, it would seem that a valid license could only be granted by the acts of both co-owners. However, the Court of Appeal in *Wapshare Tube Co., Ltd v. Hyde Imperial Rubber Co. Ltd*³⁰ seemed to have implied

²⁹*Horsley & Knighton's Patent* (1869) 8 L.R. Eq. 475, 477, per Lord Romilly M.R.,

"Here is a patent granted to two persons, and therefore either of them may use it, but neither can dispose of the right of the other. ... Again, suppose a patent is vested in two persons who are both using it, and a man infringes the patent, upon which they both complain, and a large sum of money is paid to one of them by the infringer to be allowed to make use of the patent, is it meant to be said that he can immediately release all the rights which the other person may have for the injury he has sustained by reason of the user of the patent?"

³⁰*Wapshare Tube Co., Ltd v. Hyde Imperial Rubber Co. Ltd* (1901) 18 RPC 374 (CA). However, it has to be noted that this expression of the law was *obiter*, since the court had come to a conclusion that the defendants could not be sued as their claim to a legal title to a part share of the patent had been made out - see Collins L.J., at 377-378.

that such consent from all co-owners was not necessary.

The common law position in the United Kingdom is thus unclear. However, it is submitted that the reasoning of the court in *Horsley* is more in consonance with the principle of licensing, which is not a transfer of patent rights, but merely an agreement not to sue the licensee in respect of activities which fall within the license. The licensor, by the license, gives up his right to sue for infringement. However, this agreement does not bind the other co-owner, who, therefore, still retains the right to sue the alleged licensee. This is in accord with the accepted rule in personal property whereby, in the basic case of *Wilkinson v. Haygarth*,³¹ the judge held that one of two co-owners of a chattel could sue, giving the reason that "otherwise the license of one would bind both".

It is interesting to note that, although purporting to follow United Kingdom precedents, and hence showing consistency with respect to the other rights of a co-owner, with regards to the right to license, the US courts have shown a significant divergence from the United Kingdom precedents. In *Blackledge v. Weir & Craig Mfg. Co.*,³² the court, although relying on the

³¹*Wilkinson v. Haygarth* (1847) 12 QB 85; 116 ER 1085, 1090, per Lord Denman C.J.

³²*Blackledge v. Weir & Craig Mfg. Co.* 108 F. 71 (CCA 7th Cir. 1901), per Woods, Circuit Judge at 75-77,

"There is ... no ground for the distinction insisted upon between profits derived directly from the manufacture, use, and sale of the patented article by the owner and profits derived by him from

the sale of licenses. It is conceded that the part owner of an invention may sell his title or interest as a whole or in parts without being accountable to another owner for any portion of the consideration received. But it is clear that he might part with his entire title or interest by granting a license or licenses in terms which should forbid further licenses and further use by himself of the invention."

See also the earlier case of *Clum v. Brewer* 5 F. Cas. 1097 (CC D. Mass. 1855), *per* Curtis, Circuit Justice, at 1103,

"One tenant in common has as good right to use, and to license third persons to use the thing patented, as the other tenant in common has. Neither can come into a court of equity and assert a superior equity, unless it has been created by some contract modifying the rights which belong to them, as tenants in common."

Similar decisions were reached by the court in *Central Brass & Stamping Co. v. Stuber* 220 F. 909 (CCA 7th Cir. 1915); *Drake v. Hall*, 220 Fed. 905 (CCA 7th Cir. 1914), *per* Kohlsaadt, Circuit Judge at 911-912,

"As owner of a one-half interest in the patent, appellant had no standing to restrain appellees from manufacturing under their ownership of the other one-half thereof, or from authorising others to do so."

Aberdeen Hosiery Mills Co. v. Kaufman 96 USPQ 133 (D.N.Y. 1953), following *Talbot v. Quaker State Oil Refinery* 41 USPQ 1 (CCA 3rd Cir. 1939), *per* Leibell, District Judge, at 143,

"Although it is true that Kayser, as an owner of an undivided interest in the patent, had the right to issue licences on its own volition and without the consent of the other defendants ... the

United Kingdom cases of *Mathers v. Green* and *Steers v. Rogers*, and also the US case of *Vose v. Singer*, held that one co-owner has the right to license the invention without the consent of the others. This approach has been consistently applied.³³ However, this right to license does not extend to the granting of an exclusive license by one of the co-owners without the consent of the other owner or owners.³⁴ The case of *Ethicon, Inc. v. United States Surgical Corporation* which involved collaboration on a joint venture research is illustrative.³⁵ One of the collaborators, a Dr. Yoon, filed for a patent and named himself as the sole inventor. Dr. Yoon then granted an exclusive license to Ethicon, who commenced an infringement action against the defendant, US Surgical Corporation. After the infringement action was initiated, the defendant discovered that there was a second unnamed co-inventor, Dr. Choi. United States Surgical then obtained from Dr. Choi a "retroactive license" to

fact remains that there was an explicit authorisation from both Standard and Kaufman to act in their behalf in Kayser's licensing activities."

See also *Bendix Aviation Corp. v. Kury* 84 USPQ 189 (D.N.Y. 1950), *per* Byers, District Judge, at 192-193, where he reviewed the cases.

³³See, for example, *Talbot v. Quaker State Oil Refining Co.* 104 F.2d 967, 968 (3d Cir. 1939), *Schering Corp. v. Roussel-UCLAF SA*, 104 F.3d 341, 345-47 (Fed. Cir. 1997) and *Ethicon, Inc. v. United States Surgical Corp.* 135 F.3d 1456, 1468 (Fed. Cir. 1998).

³⁴See *Moore v. Marsh*, 74 U.S. (7 Wall) 515, 522 (1868).

³⁵*Ethicon, Inc. v. United States Surgical Corp.* 135 F.3d 1456 (Fed. Cir. 1998), *per* Rader, Circuit Judge at 1467-1468

practise the invention. The Court granted United States Surgical's motion to correct inventorship of the patent to include Dr. Choi as a joint inventor. United States Surgical then moved for dismissal of the infringement suit, arguing that Dr. Choi, as a joint owner of the patent, had granted it a valid license under the patent. The Federal Circuit Court of Appeals upheld the district court's ruling in favor of US Surgical and against Ethicon. The Court held that since the defendant had obtained a license from one of the co-owners, the issue of infringement does not arise.

In Malaysia, section 40 of the Patents Act 1983 provides that in the absence of any agreement to the contrary, a co-owner may only jointly conclude a license contract. This means that one co-owner cannot conclude a license contract without the consent of the other co-owner or owners. The position is the same in the United Kingdom, Australia and Canada.³⁶

The default rule relating to the right to commence legal proceedings.

Flowing from the "exclusion" theory and the theory that each co-owner holds his share separate and distinct from the other co-owners, the courts in the UK have held that

³⁶See section 36(3)(b), Patents Act 1977, UK, and section 16(1)(c), Patents Act 1990, Australia. For Canada, see *Forget v. Specialty Tools of Canada Inc.* [1993] 48 CPR (3d) 323 (Sup. Ct. British Columbia). See also similar provisions in section 50(3) Patents Act 1970, India and section 46(3), Patents Act Chapter 221, Singapore and Article 73(3), Patent Law, Japan.

one owner can institute an infringement suit against infringers without the consent of, or the need to join, the other co-owners. In *Sheehan v. Great Eastern Railway Co.*,³⁷ the plaintiff sued the defendants for an account of profit made by them, and for royalties alleged to be due from them for the use of a patent taken out by the plaintiff. The defendants objected that the plaintiff could not sue alone and that he ought to have made his co-owners parties to the action. The court held, however, that a person interested in a patent was entitled to sue, without making his co-owners parties to the action.³⁸ In *Turner v. Bowman*,³⁹ the plaintiff, one of two co-owners of a patent, was able to

³⁷*Sheehan v. Great Eastern Railway Co.* (1880-1881) 16 Ch. D. 59, *per* Malin, V.C., at 62-63, relying on Mr Justice Lindley's book on Partnership (4th Ed. vol. 1, pp 68,69), *Dent v. Turpin* 2 J. & H. 139 (trade marks case).

³⁸Note that for the defendants, it was argued that it was stated in the claim that the plaintiff had parted with shares in the patent to several persons, and the utmost claim that he had amounted to no more than one-sixth of the patent, the other five-sixth of the patent having been parted with. If the plaintiff now succeeded in obtaining any royalties for the use of his invention, they would not belong to him, but to others as well, who would be obliged to take proceedings to recover the amount of the shares due to them, and if the plaintiff should not succeed in getting a decree, then the owners of the other five-sixth would be able to proceed against the defendants. They were, therefore, liable to be harassed by other persons who were not before the court. Hence, they argued that the action was not properly constituted, and that all the persons interested in the patent ought to be made parties.

³⁹*Turner v. Bowman* (1924) 42 RPC 29, *per* Astbury J., at 41.

proceed in his infringement suit without any objection, although an inquiry as to damages was ordered to be stood over in order that all the co-owners could be before the court. As to the right to recover damages, it would appear that each co-owner is only entitled to recover damages in proportion to the share of the patent owned by him.⁴⁰

The opposite approach, however, has been adopted in the United States. The rationale for it is explained in *Willingham, et al. v. Lawton, et al.*,⁴¹ where the principal issue was whether the owner of a two-thirds undivided interest in a patent could maintain an action for infringement without the voluntary joinder of the other co-owner. The court gave three reasons for the rule that all co-owners should be joined in a patent infringement suit, i.e., the interest of a co-owner in being able to license third-parties under his or her patent without harassing suits by other co-owners; the interest of a co-owner in avoiding the estoppel effect of a judgment declaring the patent invalid in which he or she did not participate; and the interest of a defendant in avoiding multiple suits concerning infringement of the same patent. The court, however, held

⁴⁰However, in *Smith v. The London & North Western Railway Co.* (1853) Macr 203; 6 HPC 926, the court held that where two persons were tenants in common of a patent assigned to them, and if one of the co-owner died, actions for infringements committed in the deceased's lifetime survived to the surviving co-owner, who was entitled at law to recover the whole damage. See Lord Campbell, Macr 203, at 207 (6 HPC 926, at 930).

⁴¹*Willingham, et al. v. Lawton, et al.* 194 USPQ 249 (CA 6th Cir. 1977), per Phillips, Chief Judge, at 252-253.

that co-owners could, by contract, waive their rights to be joined as co-plaintiffs. In *Ethicon, Inc. v. United States Surgical Corp.*,⁴² the Court of Appeal for the Federal Circuit again confirmed the principle that all patent co-owners must join as plaintiffs in an infringement suit. The effect of this ruling is that one co-owner can stop another co-owner from suing infringers by refusing to join in the legal proceedings. The non-consenting co-owner can take advantage of the situation by the simple device of offering a non-exclusive license to the putative infringer to stymie any attempt by the other co-owner to enforce the jointly held patent, as vividly illustrated in the *Ethicon* case above.

Under the Malaysian Patents Act 1983, one of several co-owners may sue separately. There is nothing in the Act indicating whether, if the other co-owners refuse to join in the action, they should be made nominal co-defendants. This is clearly spelled out in the United Kingdom Act. Under section 66(2) of the 1977 Act of the UK, one of two or more joint proprietors of a patent may bring an action for infringement of the patent without the concurrence of the others. However, the other co-owners must be made parties to the proceedings, either as plaintiffs or nominal defendants.

⁴²*Ethicon, Inc. v. United States Surgical Corp.* 135 F.3d 1456 (Fed. Cir. 1998), per Rader, Circuit Judge at 1468. See also *International Nutrition Co. v. Horphag*, 257 F.3d 1324 (Fed. Cir. 2001) and *Israel Bio-Engineering Project v. Amgen, Inc.*, 475 F.3d 1256, 81 USPQ2d 1558 (Fed. Cir. 2007).

THE PITFALLS

From the discussion above, it can be seen that if the parties are silent regarding their rights and obligations under a jointly held patent, the default rules will apply. This may have consequences which may not be foreseen or desired by the co-owners. Take the case of a joint venture research between University A and Company X. The research agreement provides that any invention and patent resulting from the joint venture will belong to both parties jointly. Nothing else is laid down regarding their specific rights in the patent. Depending on the law of the jurisdiction relied upon, the potential problems associated with the default rules relating to joint ownership of a patent are as described below:

Exploitation of the invention:

In principle, both University A and Company X, if they are unable to come to any agreement, could manufacture and sell competing products. However, the reality of the situation may be that Company X, with its financial and manufacturing capacity, will be in a better position to exploit the patent without the consent of University A. Obviously, University A would also be able to exploit the patent without the consent of Company X. However, from a practical point of view, without any in-house manufacturing capacity of its own, this right is meaningless. This applies whether the governing law relating to the patent is the law of the United Kingdom, United States or Malaysia.

Sharing of profits:

To compound the inequities further, Company X does not have to share the profits obtained from commercializing the patent with University A. The end result is that Company X will be able to generate profits from the jointly owned patented invention, without having to share the profits with University A. University A may end up with nothing but the entitlement to a hollow claim that it is a joint owner of a particular patent. The consequence is the same whether the applicable law is that of Malaysia, the United Kingdom or the United States.

Licensing:

Both in Malaysia and the United Kingdom, University A will not be able to solve the problem above by the device of licensing its rights to another entity to commercialize the patented invention. In both these countries, any grant of a license must be with the consent of all co-owners, in this case, University A and Company X. It is highly unlikely that Company X, having exploited the patented invention itself, will consent to the grant of a license to a potential competitor.⁴³

⁴³Note that under sections 37(1)(c) and 37(2)(c) of the Patents Act 1977, UK, power is given to the Comptroller, upon a reference made to him, to decide on the question of whether a licence should be granted where there is a deadlock between the co-owners. Similar powers are found in section 47, Patents Act Chapter 221, Singapore and section 51, Patents Act 1970, India. However, besides the legal expenses and time involved, there are many other disadvantages when relying on these provisions to resolve deadlocks – see Yang, Joseph (2003)

The situation regarding licensing is different if the applicable law is that of the United States. Here, each co-owner may grant a non-exclusive license without the consent of the other, and without having to pay the other co-owners any of the monies received. Here, again, the lack of experience and industry connections may result in University A being at a disadvantage. Furthermore, the inability to grant an exclusive license may result in potential third parties' hesitance to enter into any licensing contracts when it is a known fact that they would not have exclusive rights to commercialize inventions, and on top of that, could potentially be subject to competition from others.

Assignment of share of patent:

Assuming University A is unhappy with the situation above, can it attempt to sell off its share in the patent to a third party? Based on the default rule in the United Kingdom, University A would be unable to assign its share unless Company X agrees to the transfer. Company X would likely be unwilling to consent, as the result of such a decision would mean that a potential competitor would co-own the patent, possibly to Company X's disadvantage because of the default rule.

University A may now be caught without any recourse except to sell its share in the jointly-owned patent to Company X, if at all Company X is willing to buy from

'Enforcement of jointly owned IP rights: traps for the unwary', available at <http://www.accessmylibrary.com/article-1G1-111694272/enforcement-jointly-owned-ip.html>.

University A. Being in an advantageous position because of the default rules, Company X may not consent to buying out University X's share in the patent – there is no reason to do so.

The situation, however, is different in Malaysia and the United States. In both these countries, University A may be able to assign its share in the patent without the consent of Company X. This may result in a lose-lose situation, where both University A and Company X end up worse off.

Suits against infringers:

If the applicable law of the contract is that of Malaysia or the United Kingdom, University A may institute legal proceedings against any infringer of the jointly held patent without the consent of Company X. However, if the applicable law of the contract is that of the United States, University A can institute a patent infringement action only if Company X agrees to be joined in the action. This could result in infringers being left unpunished, or leads to an unfair situation where one party benefits from the infringement. This scenario would arise, for example, if Company X were to grant a license to the infringer in return for payment of royalties. As mentioned earlier, University A will not be entitled to a percentage of the royalties paid to Company X.

WHAT SHOULD BE DONE TO AVOID THE PITFALLS

Joint ownership of a patent is usually not recommended because of the problems mentioned above. However, if the parties

feel that joint ownership is necessary, or if one party insists on it, several steps can be taken to ensure that pitfalls are avoided. The most important thing to keep in mind is that an agreement to jointly own a patent without more is a recipe for disaster. Hence, the respective rights and obligations of the parties associated with the patent must be clearly and specifically spelled out in the agreement. In other words, there is a need to modify the default rules to reflect the intentions and wishes of the co-owners so that one party is not at a disadvantageous position. More importantly, such a contractual agreement will prevent the application and unwanted consequences of the default rules. The terms that should be considered and agreed upon should relate at least to the following:

- Who should have the right of exploitation
- What are the rules relating to the assignment of one of the co-owner's share in the patent
- Should a partial assignment be allowed?
- Should there be a right of pre-emption, at a fair market value?
- The right to use the patented invention for future Research and Development
- The right to share in the profits
- The basis for sharing of profits – the division and percentage of profits must be spelled out, regardless of which party exploits the patent.
- Who should have the right to license?
- What percentage of the royalties paid under the license should each party have

- Legal proceedings – who has the right to institute legal proceedings, rules as to contribution to expenses, division of damages awarded in any successful actions
- Choice of law clause
- Responsibility for maintenance of the patent

Another viable option is for the parties to agree for any patents resulting from the joint collaboration to be assigned to a company to be set up and owned by the joint collaborators. The rights of members of the company will have to be carefully set out in the articles of association of the company. The company, being the sole owner of the patent will then be in a position to exploit the invention itself, license others or bring infringement proceedings without the need to obtain consent from anybody else. Whatever profits gained by the company will then be divided among the members in accordance with the articles of association.

CONCLUSION

The issue of joint ownership of patents is vitally important in relation to university entrepreneurship and startups. Since the invention, which is the subject of commercial explication, is likely to result from a collaborative effort or joint venture with a third party, there is a high likelihood that any patent issued from such collaborations will be jointly owned. In the absence of agreement to the contrary, the default rules, with all its pitfalls, apply. The consequences of joint ownership need to be carefully

considered; as such ownership arrangements may bring about inequitable and unequal results. The default position becomes even more complicated when patents are obtained in different jurisdictions, each with its own default rules. Thus, the rights of joint owners will need to be specifically spelled out in the agreement to ensure that unintended consequences are avoided. To be forewarned is to be forearmed. Awareness of the default rules relating to joint ownership of patents will enable parties in joint collaborations to insert provisions regulating their rights and obligations to the exclusion of any undesirable default rules, resulting in a win-win situation.

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The 3C's: Competition, Communications and Convergence

Safinaz Mohd Hussein

Faculty of Law, Universiti Kebangsaan Malaysia, 43600 Bangi, Selangor, Malaysia

ABSTRACT

Competition law has become the latest hype in Malaysia since the enforcement of the Malaysian Competition Act 2010 in January 2012. However, this is nothing new, as competition regulation in the communications industry has been around since 1999 under the Communications and Multimedia Act 1998. Competition law involves the promotion or maintenance of a competitive market, which has various objectives and benefits. This paper examines the definition of competition, communications and convergence, and how competition law is affected by the converging communications industry.

Keywords: Competition law, communications, convergence, Communications and Multimedia Act

INTRODUCTION

The 3C's: Competition, Communication and Convergence "Competition encourages efficiency, innovation and entrepreneurship", states the Malaysian Competition Act 2010. The Competition Act 2010 regulates business-related competition in Malaysia, however, the communications and multimedia industry is the first industry in Malaysia to have a detailed, specific regulation to govern competition in its industry through the Economic Regulation of the Communications and Multimedia

Act 1998 (CMA 1998). Preceding the CMA 1998, competition was regulated in the form of guidelines issued to the telecommunications industry as stated in the National Telecommunications Policy. The CMA 1998 introduced industry-specific provisions to regulate competition in the industry. The Economic Regulation of the CMA 1998 regulates licensing, general competition practices and access to services. Regulating competition in an industry like the communications industry, where natural monopoly exists, is important to ensure the survival of new players. For example, this is apparent in the area of access to services where the incumbent has an advantage over its competitors, as the incumbent owns the infrastructure vital for connection, especially

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E-mail address:

finaz@ukm.my (Safinaz Mohd Hussein)

in the local loop (the local loop is the part of the network located between the main distribution frame and the terminal installed in the user's premises). Hence, competition law ensures that all players are given an equal chance to survive in the industry, as well as monitors anti-competitive practices.

This paper will first explore the objectives and benefits of competition law, before defining what it constitutes, specifically in reference to market definition. The purpose is to show what competition law and market definition are, before defining communications and convergence. This exercise of defining concepts is to show how convergence in the communications industry affects the first essential step in the assessment of competition.

OBJECTIVES AND BENEFITS OF COMPETITION LAW

Competition law promotes and maintains competition in the market. It regulates the behavioural and structural conduct of players in the market through anti-monopoly prohibitions, concerted conduct laws and merger laws. Around the world, the development of competition law has largely been geographical in nature. The existence of competition can be traced as early as the Roman Empire in Article 59(2) of the Constitution of Emperor Zeno of 483 AD, which prohibited price-fixing and monopolization of clothing, fishes, sea urchins and other goods, for which the punishment was perpetual exile (Whish, 2003). However, the cradle of modern competition law has been stated to be the

US Sherman Act of 1890 (Furse, 1999; Singleton, 1992), where the word 'anti-trust' is used in reference to competition. This Act developed from attempts (made in the US) to demolish 'trusts' or anti-competitive cartels or groups of the main manufacturers, in particular industries that had banded together to strengthen their hold on such industries with the goal of ensuring that high prices and amenable terms and conditions were retained. The US legislation is aimed at breaking such trusts; and hence the term 'anti-trust' is utilized (Singleton, 1992).

The competition law in various jurisdictions have their respective objectives, including: for the maintenance of effective competitions stated in the European Community (EC) competition rules (OECD, 2003; Roth, Rose, 2001); for the achievement of 'workable competition' (Furse, 1999); or and to inhibit and break up concentrations of economic power (Encyclopedia of Competition Law, 2004). In Malaysia, the importance of competition law arises from the need to foster fair trade practices, which in turn contributes to greater efficiency and competitiveness in the economy. It was stated (at that time that) in the draft of "Malaysian Fair Trade Practice Law (FTPL)" (as it was known at that time), that it aims to prevent anti-competitive behaviour such as collusion, price-fixing, and the abuse of market power (Eighth Malaysia Plan; Kementerian Perdagangan Dalam Negeri dan Hal Ehwal Pengguna, 2003). Today, the Competition Act 2010 states that, "it is an Act to promote economic development by promoting and protecting the

process of competition, thereby protecting the interests of consumers...the process of competition encourages efficiency, innovation and entrepreneurship, which promotes competitive prices, improvement in the quality of products and services and wider choices for consumers”.

In summary, the purpose of competition law is for the promotion and/or preservation of competition in the market. Though this is expressed through a different usage of words and terms applied by various laws in different jurisdictions, the laws have similar objectives as mentioned above. The promotion and preservation of competition is achieved through the elimination of conduct, which would suppress competition, and includes behaviours such as collusion, cartel, price-fixing, market allocation and the abuse of market power.

However, there is an ongoing argument that suggests that in certain jurisdictions, the objective of competition law might be for the protection of competition, while in some others, it might be for the protection of competitors. This means that there is a difference between protecting competition and protecting competitors. There is also a proposition that competition law should protect competition and consumers, instead of protecting competitors in the market (Fox, 2003). Although it is true that ultimately, the welfare of consumers is of central importance in of competition law, the result of cases has sometimes been inconsistent and contradicts this view (Whish, 2009). The different objectives and purposes enunciated by various competition laws are

a good articulation of the different concerns placed by different countries. The concerns placed by a particular legislation can be on consumer protection, redistribution, protection of the competitors or even a single market imperative (Whish, 2009). Therefore, it can be said that there is no one conclusive objective or a one-size-fits-all approach when the objectives of competition law are concerned. The question of objective is very subjective and often ‘fluid.’ Nevertheless, the purposes and objectives of competition law correspond closely to its many benefits. The success of competition has been associated with lower prices, better products, wider choices and greater efficiency (Whish, 2009). De-monopolisation, liberalisation and privatisation result in lower prices, better products and greater efficiency because players need to compete with each other to remain in the market. The failure to be innovative and produce better products with lower prices, for example, will cause the player its placing in the market. Though there is no single conclusive objective, it is safe to assume that the objective of competition includes the breaking-up of concentration, the prevention of anti-competitive practices or the prevention of abuse of market power. The benefits of competition are clear: With lower prices and better products, the market works better to the advantage of the consumer.

COMPETITION LAW

It is of vital importance to define what competition law is, in order to see whether

the Economic Regulation of the CMA 1998 embraces the necessary elements of competition in line with international standards.

Competition law protects competition, and in an industry where growth is rapid, competition is vital to ensure the healthy growth of the industry. A system of competition law will likely deal with the following three issues:

1. The prevention of firms from entering into agreements which have the effect of restricting competition, either between themselves or between them and third parties (horizontal and vertical agreements);
2. The control of attempts made by monopolists or firms with market power to abuse their position and prevent new competition from emerging (abusive non-pricing and pricing principles) and the maintenance of workable competition in oligopolistic industries (tacit collusion, oligopoly and parallel behaviour);
3. The prevention or modification of mergers between independent undertakings, which may concentrate the market and diminish the competitive pressures within it. (Whish, 2009; Taylor, 2006)

To define what competition law is, it is only natural to see what the term “competition” refers to. Competition can be defined according to its literal meaning, and its meaning within the economic theory (Gerla, 1996). Literally, the word

‘competition’ means “the act of competing, struggle or rivalry” or “a contest for some prize, honour or advantage. “To compete” means “to outdo another for supremacy or profit,” (Random House Dictionary). In the commercial context, “competition” refers to the striving for custom and business of people in the market place. The Oxford Dictionary of Law defines “competition law” as “the branch of law concerned with the regulation of anti-competitive practices, restrictive trade practices, abuses of dominant position or market power.” These definitions suggest that competition is all about struggle or rivalry, and the law that deals with competition has to address matters associated with the struggles and rivalries of firms or undertakings in businesses. These matters relate to two broad categories of anti-competitive practices or restrictive trade practices and abuses of dominant position or market power.

Various statutes that govern competition law do not provide a definition for the term competition. However, the observations gathered from these statutes find that although no definition was made, the term ‘competition’ is explained in terms of what the law seeks to do, the processes and benefits involved. For example, the United Nations Conference on Trade and Development (UNCTAD) Model Law On Competition (United Nations, UNCTAD *Series on Issues in Competition Law and Policy*, 2004) does not give a definition on competition, but rather states what ‘competition law’ seeks to do. The UNCTAD Model Law On Competition states, “Competition law

is a law that seeks to prevent distortions of competition resulting from anti-competitive arrangements between enterprises or from the abuse of market power by dominant firms. (United Nations, UNCTAD Key Terms and Concepts, 2004). On the other hand, the Treaty for the Functioning of the European Union (TFEU), which is the main source of competition law in the EU states the process involved in assessing competition, namely, market definition is the key to the application of competition rules (European Commission, 1997). The United Kingdom (UK) Competition Act 1998 does not provide a definition for the term competition, nevertheless, the UK Competition Commission described competition as “a process of rivalry between firms ... seeking to win customers’ business over time.” (UK Competition Commission, *Merger References: Competition Commission Guidelines*, 2003; UK Competition Commission, *Market Investigation References: Competition Commission Guidelines*, 2003). Based on the above, the UNCTAD’s description of competition law referred to it as a process, principle or mechanism without any explanation as to what the word “competition” means. The same is true for the TFEU for its deficiency in providing a characterization on the term “competition”. However, credit should be given to the UK Competition Commission for its description of competition. It provides a basic idea of what competition is: “... a rivalry...to win...”

In the US, the term “competition” used to be defined according to its dictionary definition: “rivalry among firms for business of consumers”. However, in the 1970s, this method of defining competition changed, and a new definition of competition emerged. This new definition arose from judges and commentators belonging to or influenced by the Chicago School, which defines competition as “an allocation of resources in which economic welfare ... is maximized”. However, it is also suggested that defining competition by its literal dictionary meaning is both sound in law and economics. As Harry S. Gerla stated,

Rivalry as competition is sound law because principles of statutory interpretation imply that competition means rivalry when that term or concept is utilized in the antitrust statutes. Rivalry as competition is sound economics because contemporary studies indicate that promoting rivalry will increase the internal efficiency of firms, spur innovation and help develop world-class competitive industries.

(Gerla, 1996)

This development of defining competition in the economic sense also seemed to have an influence in Australia.

In Australia, the Australian Trade Practices Act 1974 (ATPA) (as it was known then) also does not give a definition of competition. However, it was held in *Re*

Queensland Co-op Milling Association Ltd.; Re Defiance Holdings Ltd. (1976) 8 ALR 481 that under the ATPA 1974, the term "competition" is defined as that meaning similar to the meaning of competition in economic theory. Nevertheless, it was not further defined what competition in economic theory is, rather the essential features of competition in the economic sense were provided:

1. Competition is a dynamic process and not a situation;
2. In a competitive market, no individual player or group of players could set the price of its product or services, to choose its level of profits by producing less and charging more, or to exclude the entry of other competitors;
3. Barriers to entry in a competitive market are low or non-existent, and the threat of entry of a competitor puts pressure on the firm or firms already in the market to keep ahead by developing new products, new technology, more efficient services or improved cost efficiency (see *Re Queensland Co-op Milling Association Ltd.; Re Defiance Holdings Ltd.* (1976) 8 ALR 481; 25 FLR 169);
4. Whether or not a market is a competitive market depends largely on the structure of the market and the determining elements of market structure:
 - a. The number and size distribution of independent sellers, especially the degree of market concentration;
 - b. The height of barriers to entry, which is the most important

element of market structure in the determination of competition;

- c. The extent to which products of the industry are characterized by extreme product differentiation and sales promotion;
- d. The character of 'vertical relationships' with customers and with suppliers and the extent of vertical integration; and
- e. The nature of any formal, stable and fundamental arrangements between firms which restrict their ability to function as independent entities (see *Re Queensland Co-op Milling Association Ltd.; Re Defiance Holdings Ltd.* (1976) 8 ALR 481; 25 FLR 169 at 189; *General Newspapers Pty Ltd v Telstra Corp* (1993) 45 FCR 164 at 181; 117 ALR 629 per Davies J. and Einfeld J).

The Australian Independent Committee of Inquiry for the National Competition Policy (The Hilmer Committee) stated that:

Competition law or policy is not about the pursuit of competition for its own sake. Rather, it seeks to facilitate effective competition (Whish, 2003) in the interest of economic efficiency (Corones, 1994) while accommodating situations where competition does not achieve economic efficiency or conflicts with other social objectives.

(Whish, 2003)

Thus, there are two theories under the economic theory of competition. They are the price theory, which relates to the demand, supply and prices of goods and services, and the organisational theory, which relates to market structures, behaviour of firms and the effectiveness of the market in relation to consumer interest. What is the relationship between competition and the economic theory? A simple analogy can be drawn from the literal definition of the term “competition” and the economic theories mentioned above. As seen earlier, competition literally means, “to compete, struggle or rival”. This, in relation to the price theory refers to competition of firms for the demand, supply, and prices of goods and services. Under the organisational theory, firms fight to literally outdo one another in the market. This determines the market structure and behaviours of firms.

Not surprisingly, the position in Malaysia is not very different. Competition is not defined in both the Communications and Multimedia Act 1998 and the Competition Act 2010. Instead, reference as to what competition is has been made in the Guidelines on Substantial Lessening of Competition (MCMC, 2000). The Guideline states that competition is “the process of actual or potential rivalry between firms in a market. The level of competition in a market is simply the level of this rivalry” (MCMC, 2000). The Guideline lists the factors, which the Malaysia Communications and Multimedia Commission (MCMC) will take into account as indicators of the level of competition in the industry. These factors are:

1. The number of independent suppliers: The more the number of suppliers, the higher the level of competition;
2. The degree of market concentration: The lower the degree of market concentration, the higher the level of competition. Lower market concentration acts as an indicator of relatively less market share of competitive rivals, which in turn forces rivals to respond independently to price signals;
3. The level of product or service differentiation: The lesser the differentiation in the product or service, the easier it is to substitute them, and thus, the higher the level of competition;
4. The extent of vertical integration with firms in upstream and downstream markets: Vertical integration can provide opportunities for an integrated firm to extend market power in one market into the market in question. This might include conduct which impacts the independence of its rivals, for example by manipulating prices in intermediate markets or by imposing conditions in intermediate markets. This could lead to lower levels of rivalry and competition;
5. The nature and enforceability of any arrangements between firms in the market, which restrict their independence of action: These types of arrangements may reduce the level of rivalry and competition in the market;
6. The height of barriers to entry and exit: Entry or exit of potential rivals into the market should be low to indicate a

higher level of competition (MCMC, 2000).

Similarly, the Organisation for Economic Co-operation and Development (OECD) has provided similar indicators to those provided by the MCMC on the evaluation of competition in the telecommunications industry. The OECD divided the indicators into categories of market structure and supplier behaviour. Market structure includes market share and entry barrier. Market share indicators are measured by volume-based (call minutes, or number of subscribers), value-based (revenues) and capacity-based (number of lines installed) calculations. Entry barrier (ease of entry) is measured by the number of firms in the market, the existence of regulatory restrictions (for instance, licensing limitation), control of essential facilities, and vertical integration (the existence of vertically integrated firm and its price levels). Supplier behaviour indicators are calculated in the rivalry in price, anti-competitive behaviour and collusion and diversification and speed for innovative services (OECD, 2003).

Comparing the indicators for the evaluation of competition provided by the OECD and MCMC, the similarities are evident. To illustrate, Table 1 (in Appendix) on indicators for the evaluation of competition provided by OECD and MCMC gives a comparison on the similarities used by both parties.

After examining the various statutes that govern competition law, certain observations can be gathered. Firstly, the range of statutes on competition law do not define the term

“competition”, but rather, competition law is referred to as a process which involves certain steps, for example market definition, or what competition law seeks to do – to prevent distortions of competition, or to prevent competition, which is a process of rivalry to win customers. These explanations of competition in the statutes mentioned earlier can therefore be broadly divided into two categories: the prevention of anti-competitive conduct, and the abuse of dominant position. Secondly, in defining competition, reference is made to its literal meaning and what competition is in the economic sense. This seems to be accepted in the US and in cases decided in Australia. Thirdly, in a jurisdiction where regulating competition is more advanced, the lack of definition of competition does not seem to affect the workings of the law. Cases have developed to fill in those gaps that the statutes failed to fill. Australia is a good example where the court in *Re Queensland Co-operative Milling Association Ltd.; Re Defiance Holdings Ltd* (1976) 8 ALR 481 asserted that competition is to be defined in its economic sense. As stated earlier, the position in Malaysia is of no difference. The Communications and Multimedia Act 1998 (CMA 1998) and the Competition Act 2010 do not define the word “competition”. It is referred to as a process, which refers to the process of actual or potential rivalry between firms in the market, and this rivalry is an indication of the level of competition in the market. It is therefore submitted that this definition as applied in the Guideline on Substantial Lessening of Competition in the

Communications and Multimedia industry be applied when defining “competition” in Malaysia. It is also similar to the literal definition of competition as applied in the US. The application of a literal definition would be easier for a country where competition law is still new, and there is a lack of case laws. It is also recommended that this approach be extended when defining “competition” under the Competition Act 2010 to ensure consistency in the enforcement of competition in Malaysia.

MARKET DEFINITION

Market definition is important in the assessment of anti-competitive conduct. Defining the market is the key to the application of competition rules. It is considered the essential firststep in the assessment of competition-related behaviour. In order to assess the effects of an agreement or practice on competition, and whether or not there is a dominant position, or an abuse of that position, or whether a player has market power to affect competition, it is essential to first define the **relevant market**. This is seen in decisions made under Article 101 and 102 of the TFEU. In the case of *Europemballage Corp. And Continental Can Co. Inc. v. E.C. Commission* [1973] E.C.R. 21, it was stated that the definition of the relevant market is required in the assessment of competition-related abuses. The relevant market constitutes the identification of product or service substitutes. It includes all possible substitutes of a product or service within a region that provide a significant

competitive constraint on the supplier of the product or service (Bishop, Walker, 1999).

The European Commission in its Notice on the Definition of Relevant Market for the Purposes of Community Competition Law, December 1997 in Paragraph 17 stated that:

“Market definition is a tool whose purpose is to identify in a systematic way the competitive constraints that the undertakings involved face. The objective of defining a market in both its product and geographic dimension is to identify those actual competitors of the undertakings involved that are capable of constraining their behaviour and of preventing them from behaving independently of any effective competitive pressure. It is from this perspective, that market shares may provide meaningful information for the purposes of assessing dominance or for the purposes of applying Article 85. The question to be answered is whether the parties’ customers would switch to readily available substitutes or to suppliers located elsewhere in response to a hypothetical small (in the range of 5% to 10%) but permanent relative price increase in the products and areas being considered. If substitution were enough to make the price increase unprofitable because of the resulting loss of sales, additional substitutes and areas are included in the relevant market. This would be done until the

set of products and geographical areas is such that small, permanent increases in relative prices would be profitable.”

This is also referred to as the Small but Significant Non-transitory Increase In Price, or SSNIP Test.

The application of the SSNIP Test in the Malaysian communications industry is stated in the Malaysian Communications and Multimedia Commission's report on the assessment of dominance in the communications market (MCMC, A Report on a Public Inquiry: Assessment of Dominance in Communications Market, 2004). The Malaysian Communications and Multimedia Commission stated that the SSNIP test would be used to identify relevant communications market. If the hypothetical monopolist is prevented from increasing by a readily available alternative or substitute, this product or service is included in the relevant market. The test is then applied again to the wider market including the substitutes identified. The test is repeated until a set of products or services is reached where such a price increase would indeed be profitable. The smallest set of substitutes thus established is then defined as the relevant market (MCMC, A Report On A Public Inquiry: Assessment of Dominance In Communications Market, 2004). In a converged market, the possible substitutes for a product are usually more in number, and therefore the market would be larger as compared to when there is no convergence.

Therefore, market definition is an

important tool for assessing the competitive impact of an agreement, practice, market conduct or concentration. This is established in most jurisdictions, including Malaysia. Defining the market is the first step to the assessment of any competitive impact of an agreement, conduct or concentration. In defining the market, the concept of substitutability is applied widely, and in reaching all possible substitutes the SSNIP Test is used. This seems to be the commonly accepted order of application.

CONVERGENCE AND COMMUNICATIONS

Having laid down what competition law is and the importance of defining the market, it is further necessary to see the correlation between competition law, market definition and communications and convergence. In the age of convergence, communications play an important role in society. However, convergence has an impact on competition law, including on the market definition, institutional arrangements and dominant position. The conventional method of addressing these issues may have to change with convergence, especially in the communications industry.

Communications. The word “communications” is commonly used to refer to the converging industries of telecommunications, broadcasting and information technology (IT). Various jurisdictions employ different terms to the communications industry. “Communications” for this purpose refers to a method of communication that utilizes

electronic technology. The EU applies the word “electronic communications”. It is explained as,

Services provided for remuneration which consist wholly or mainly in the transmission and routing of signals on electronic communications networks, including telecommunications services and transmission services in networks used for broadcasting, but excluding services providing, or exercising editorial control over, content transmitted using electronic communications networks and services (European Parliament and Council Directive (EC) 2002/21, Article 2(c)),

and,

Transmission systems and, where applicable, switching or routing equipment and other resources which permit the conveyance of signals by wire, by radio, by optical or other electromagnetic means, including satellite networks, fixed (circuit-and-packet-switched, including Internet) and mobile terrestrial networks, networks used for radio and television broadcasting, power line systems and cable TV networks, irrespective of the type of information conveyed (European Parliament and Council Directive (EC) 2002/21, Article 2(a)).

Applying these two definitions, electronic communications may be regarded as being closely related to activities that consist of conveying, transmitting or routing. It is similar to the transportation in which data is taken from one point to another. However, the element of “electronic form” makes it different from transportation or other types of transmission, where they possess a more ‘physical’ nature. In electronic communications, objects are not transmitted in their original form. The objects are translated or transformed into signals, which are then ‘transported’ or conveyed through the networks and translated back into their original form upon reaching their destinations (Nihoul, Rodford, 2004).

In Malaysia, the Communications and Multimedia Act 1998 (CMA 1998) utilizes the term “communications” rather than “electronic communications” as applied in the EU to refer to the industries that underwent convergence. The CMA 1998 defines “communications” under section 6 as “any communication, whether between persons and persons, things and things, or persons and things, in the form of sound, data, text, visual images, signals or any other form or any combination of those forms.” It can be concluded that electronic communications involves the transmission of signals, which may include sound, data or images.

There seems to be no consensus in the use of the terms which have reference to the conveyance of signals, data, sound, text, images between persons, or from

one point to another by electronic means. It may be referred to as “electronic communications” or “communications”. However, when the term “communications” is used, it must be differentiated from the customary form of communication that relates to the print. Nevertheless, whatever the term used, communications or electronic communications refers to the form of communications that is used in the convergence era, which does not discriminate the technology used in conveying the information. This is paramount, as there is no longer a distinct periphery between telecommunications, broadcasting and the IT industries. In fact, the electricity industry may also be part of this electronic communications industry in the near future (Hardy, McAuslan, Madden, 1994).

Convergence: Concept and Definition.

Convergence refers to the ability to deliver different types of services on the same network. In other words, different types of technology can ‘talk’ to one another with little or no need of any conversion steps to establish technical compatibility (Hardy, McAuslan, Madden, 1994). Convergence can be seen when there is a fusion in technologies and industries. This can be observed in the broadcasting, telecommunications and information sectors where there no longer exists a significant difference between telecommunications, broadcasting and IT services. These services seemed to be the same – for example, both the Internet and broadcasting are carried by mobile carriers.

Convergence becomes a challenge in the communications industry if the traditionally separate industries of telecommunications, broadcasting and IT remain regulated separately. In this case, problems can be expected, as industry-specific regulators will find difficulty in isolating their individual jurisdictions.

This phenomenon, referred to as ‘convergence’ attributed to the amendment of the old regulatory framework in Europe. The European legislators set out to draw regulatory consequences from this occurrence. They wanted to assess whether the existing rules are still appropriate. Hence, the new regime, the “New Regulatory Framework” (NRF) gave electronic transmission equal treatment regardless to which sector they previously belonged to. However, content-related issues remain regulated according to the sector in which the activities in question fit (Nihould, Rodford, 2004).

In Malaysia, the Malaysian Communications and Multimedia Act 1998 (CMA 1998) aims to support convergence in line with the global development in this industry, and more importantly, to make Malaysia a communications hub. The CMA 1998 does not demarcate the boundaries within the converging industries of telecommunications, broadcasting and IT. The CMA 1998 has consolidated the regulation of these three industries into the communications and multimedia industry. Its aim is to ensure the prolonged application of the Act. However, internationally, the World Trade Organisation (WTO) rules

continue to be developed on the basis of the distinction between broadcasting and telecommunications - a state of affairs which, according to Paul Nihoul and Paul Redford, is contrary to the needs of convergence (Nihould, Rodford, 2004). A regulatory regime, which attempts to keep these boundaries distinct may be faced with difficulties when separation is no longer capable, because the services are intertwined with one another. The EU for example, has combined these industries via the New Regulatory Framework (NRF), and they are now known as the electronic communications industries. The same is seen in Malaysia with reference to the communications and multimedia industry.

Effect of Convergence on Competition.

Convergence affects competition law in the assessment of market definition. Market definition is the first step to the assessment of anti-competitive behaviour. When convergence occurs, the boundary of the market is altered. The market may become larger, hence 'diluting' the anti-competitive nature of a particular behaviour. Another effect relates to the nature of law itself, where for instance, if the law that regulates competition is an industry-specific law, convergence will raise issues relating to the applicability of this industry-specific law when industries start to merge. Rapid and complex technological advancement in the communications sector results in the complicated exercise of market definition. Competition and regulatory authorities experienced enormous strain in defining and analyzing the relevant market (market

definition is important in the assessment of anti-competitive conduct, and it is considered the "essential first-step" in the assessment of competition related behavior) in which they have to undertake a dynamic and prospective (forward-looking) approach (Garzaniti, 2003). In this respect, it has been suggested by Bazanella and Gerard (Garzaniti, 2003) that "the complexity of the convergence process will require competition authorities to possess expertise not only in the application of competition rules, but also in the sectors concerned." It is also acknowledged by the European Commission that any attempt made by the competition authorities or national regulator to define a particular product market in the communications sector in their guidelines or notices would involve the risk of the definition becoming inaccurate and irrelevant given the pace of technological change in this sector (European Commission, *SMP Guidelines*, 2002; European Commission, *Access Notice, 1998*).

CONCLUSION

Most statutes that regulate competition do not have a specific definition of the term "competition". In the US, it was stated that it is not wrong to define competition by both its literal and economic sense. This seems a sound argument. In any case, it is more important to understand what competition law does and its importance to the market. Thus, competition law is seen as a process which prevents anti-competitive behavior and abuse of dominant position, and as a process it involves the assessment

of concepts like market definition and dominant position, which is further used as a tool for the evaluation of competition.

Though convergence is not directly associated with competition, it is important because it is a phenomenon that is taking place in the communications industry. The relevant competition laws regulating the communications industry should be tailored to address converging communications industry, rather than regulating on the basis on traditionally separate industries of telecommunications, broadcasting and IT.

Lastly, in addressing competition in the communications industry, the assessment of competition should not abandon the notion of convergence for the simple reason that convergence changes the market definition, which is the first step in the assessment of anti-competitive conduct.

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APPENDIX

Indicators for the Evaluation of Competition provided by OECD and MCMC

Category	MCMC		OECD	
	Indicators	Parameters	Indicators	Parameters
Market Structure	Degree of market concentration	Lower degrees of market concentration indicate relatively less market share of competitive rivals, which forces rivals to respond independently to price signals. Hence, higher level of competition.	Market share and its trends	Volume-based: Call minutes, number of subscribers Value based: Revenue Capacity based: Number of lines installed
	Number of independent suppliers	The more the number of suppliers, the higher the level of competition.	Entry barrier / Ease of entry	Parameters for absolute barriers: Number of firms, regulatory restrictions, control of essential facilities, extent of economies of scale and scope.
	Nature and enforceability of arrangements between firms in the market, which restrict independence of action	These types of arrangements may reduce rivalry and competition in the marketEntry or exit of potential rivals into the market should be low to indicate a higher level of competition.		Parameters for strategic barriers: Advertising & capital intensity.
	Extent of vertical integration with firms in upstream and downstream markets	Vertical integration can provide opportunities for integrated firms to extend market power in one market into the market in question. This might include conduct which impacts the independence of its rivals.		Vertical integration/Parameters for exclusionary barriers: Existence of vertically integrated firm and its price levels, including non-discriminatory access to wholesale products.

<p>Supplier behaviour</p>	<p>Nature and enforceability of any arrangements between firms in the market, which restrict their independence of action</p>	<p>These types of arrangements may reduce the level of rivalry and competition in the market.</p>	<p>Absence of anti-competitive behaviour and collusion provision of innovative services.</p>	<p>Rivalry in price competition: Pricing trends, the extent of reaction to a price change, existence of price leadership.</p> <p>Rivalry in non-price competition: Level of marketing & advertising costs, coverage of services or networks.</p> <p>Indirect measure: The existence of recent entry or exit, the extent of such movement in the past.</p> <p>Anti-competitive practices: Number and time spent for agreements on LLU by incumbent, existence of carrier pre-selection and number portability, number of complaints reported.</p> <p>Existence and level of collusion (subjective assessment according to context).</p>
	<p>Level of product or service differentiation</p>	<p>Less differentiation in the product or service enables the ease of substitution, thus, a higher level of competition.</p>	<p>Profitability and its trends</p>	<p>Rate of diversification (differentiation) and speed for innovative services.</p> <p>Trends in profits across firms.</p>



“Legal Eagle” Entrepreneurship Education for Law Students: Special Reference to International Islamic University Malaysia

Zuhairah Ariff Abd Ghadas^{1*}, Herna Muslim² and Zarinah Hamid²

¹*Ahmad Ibrahim Kulliyah of Laws, Civil Law Department, International Islamic University Malaysia,
Jalan Gombak, 53100 Kuala Lumpur, Malaysia*

²*Kulliyah of Economics and Management Sciences, International Islamic University Malaysia,
Jalan Gombak, 53100 Kuala Lumpur, Malaysia*

ABSTRACT

In Malaysia, entrepreneurship education in higher learning education is not new. The government has taken great efforts to transform the country's economy into a knowledge-based one and entrepreneurs have been identified as one of the key elements to the development of the knowledge economy. Lots of funds have been allocated by the government to propagate the importance of graduates to become entrepreneurs and less dependent on employers. For the law graduates in Malaysia, the job opportunities are multi structured whereby they could either be in the judiciary, corporate and banking sectors or conduct private practice. In most circumstances, law graduates will be attached to private practices and this eventually will lead to most of them opening their own legal firms. Despite the nature of legal firms, lawyers can not avoid the standard business practices such as preparing cash flow reports, the business and succession plans and audited account reports. There are also many lawyers who set up businesses of different natures rather than legal, such as construction and trading companies. As such, it is highly perceived that business skills are also important to law undergraduates in preparing them for life after graduation. One of the ways to do this is through entrepreneurship education. This paper intends to discuss the perception and reception of law students on entrepreneurship education/skills. A quantitative research methodology is adopted to identify the level of interest and/or willingness of law undergraduates at the Faculty of Laws, International Islamic University Malaysia to learn entrepreneurial skills and to be involved in business once they graduate.

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E-mail address:

zuhairah@iiu.edu.my (Zuhairah Ariff Abd Ghadas)

* Corresponding author

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INTRODUCTION

The increasing number of public and private institutions in Malaysia has stimulated the graduate population growth. As the number of graduates exceeds the market demand, the unemployment rate of fresh graduates also increase. This is due to the lack of job opportunities available (Ismail, 2011). Thus, entrepreneurship seems to be one of the solutions to reduce the dependency of graduates to be employed. In order to become entrepreneurs, the students need entrepreneurship education to acquire the entrepreneurial skills especially on how to launch a new venture (Lebusa, 2011).

In the U.S., entrepreneurship education has been introduced since 1938 with the development of applied education in entrepreneurship. The “small business or entrepreneurship development” course was offered by the University of Illinois prior to 1953 while the University of South Dakota offered the course in 1954. The first course in entrepreneurship was introduced by Dwight Baumann, an engineering professor at MIT in 1958. By the end of 1960s, entrepreneurship education has been disseminated throughout the world (McMullan and Long, 1987). It was reported that, approximately 25 higher learning institutions in the U.S. were offering entrepreneurship courses by 1970, while in 1980, the number tremendously increased to more than 150 institutions (McMullan and Long, 1987; Lautenschläger and Haase, 2011). In 1985, the demand for entrepreneurship education had increased continuously, where there were 245 institutions of higher education

with 253 schools offering entrepreneurship courses found in U.S. (McMullan and Long, 1987). By early 1990s, the importance of entrepreneurship education became highly significant in the European, Asian, and African institutions (Frederick *et. al.*, 2007; Zakaria *et. al.*, 2011).

The awareness on the importance of entrepreneurial education has triggered policy initiatives like Higher Education Innovation Funds (HEIF), Cambridge-Massachusetts Initiative (CMI), Higher Education Academy (HEA) Subject Centres, National Council for Graduate Entrepreneurship (NCGE), Enterprise Insight (EI), and so on to increase the number of institutions offering entrepreneurship programs (Gstraunthaler and Hendry, 2011). Furthermore, the research in this field also has been developed with at least 45 refereed academic journals made available which are related to enterprise and entrepreneurship. In fact, entrepreneurial education has also triggered the interest of non-business institutions whereby, new kinds of ‘e-ship’ like music entrepreneurship, nutrition entrepreneurship, statistics entrepreneurship, nursing entrepreneurship, and engineering entrepreneurship have been launched by campuses outside the Business schools (Frederick *et. al.*, 2007).

In Malaysia, the development of entrepreneurship education can be traced to the pre-independence period. During the colonialisation of British in Malaya, the economic activity was segregated according to racial lines, where the Indian migrant workers worked in the rubber

plantation, Chinese in tin mines with some in trading, and Malays in the low income agricultural sector. This was to facilitate the administrative operation of the British. Upon independence, Malays as Bumiputera were given “special rights” in the form of religion, economics, and politics in order to upgrade their economic status and subsequently achieve an equitable society. However, these “special rights” did not manage to reduce the economic inequality between the Malays and other races mainly the Chinese, so the New Economic Policy (NEP) was introduced in 1970. The NEP was mainly instituted with three main objectives; to increase the ownership and participation of the Bumiputeras in the corporate sector, to increase participation of Bumiputeras in high-income occupations, and to reduce the income gap as well as alleviate poverty (Ariff and Yanti, 2002).

The government also established a Bumiputera Commercial and Industrial Community (BCIC) in order to produce more entrepreneurs and professionals among Bumiputeras (Ariff and Yanti, 2002; Ninth Malaysia Plan, 2006). In the last decade of the 1990s, various entrepreneurship programmes and initiatives such as the National Development Policy (1990-2000), Vision 2020 and the New Economic Model (NEM) which are not confined to Bumiputeras only have been implemented by Malaysian government in order to train and develop a self reliant nation to face the challenges brought on by globalization and the uncertain economic environment (Othman *et. al.*, 2012). This is an important

agenda as globalization has intensified the economic competitiveness among countries and slowly transformed the nation towards the knowledge economy (Zakaria *et. al.*, 2011).

The transformation to knowledge economy is needful for Higher Education Institutions (HEIs) to play an important role in providing entrepreneurship education for the development of entrepreneurial attitudes and skills among the youths (Zakaria *et. al.*, 2011; Keat *et. al.*, 2011). The participation of the younger generation in entrepreneurship could encourage them to become job creators rather than job seekers upon their graduation (Zakaria *et.al.*, 2011 as cited in Jesselyn and Michell, 2006). In fact, According to Chan *et.al.*, (2009), in the case of Malaysia, the youths who choose entrepreneurship careers tend to survive unemployment during the economic crisis. As such, it is perceived that entrepreneurship courses should not be taught to business students only. This is due to the fact that, many great ideas are developed by those from non-business majors (Frederick *et. al.*, 2007).

ENTREPRENEURSHIP EDUCATION

According to Jones *et. al.* (2004), entrepreneurial education refers “*to the process of providing individuals with the ability to recognize commercial opportunities and the insight, self-esteem, knowledge and skills to act on them*” (p.146). Referring to McMullan and Long (1987); Garavan and O’Cinneide (1994), one of the major problems of entrepreneurship education is

the lack of standardization in the program syllabus. The content of entrepreneurship education and program varies based on the personal preference of the trainer on the definition and scope of the entrepreneurship. The variation basically stems from the lack of consensus in defining the meaning of 'entrepreneur'. Moreover, Lautenschläger and Haase (2011) highlighted that the disparity also appears in terms of objectives, content, pedagogy as well as supply and expectation of entrepreneurial education itself.

Lautenschläger and Haase (2011) emphasize the economic and social goal of the entrepreneurship education because these objectives will reflect the teaching method and structure of entrepreneurship courses. According to Jones and English (2004), the curriculum should fulfill two objectives, namely personal and enterprise development objectives. The personal development objectives basically focus on the nurturing of entrepreneurial skills and perspective of students, whereby the students have to compare the ideal concept of an entrepreneur with the skills and attitudes that they possess. Meanwhile, the enterprise development is focusing on how to identify the opportunity, the process of venturing into new businesses (developing strategy, creating business plan, looking for capital, etc), as well as harvesting strategy. More importantly, these objectives need to be operated simultaneously. On the other hand, Heinonen and Poikkijoki (2006) have identified three objectives that should be part of the entrepreneurial curriculum, namely;

learn to understand entrepreneurship, learn to become entrepreneurial, and learn to become an entrepreneur. Lebusa (2011) identified two major objectives from fifteen leading U.S. entrepreneurship programs, which are to increase the student's awareness and understanding of entrepreneurship as a process as well as a career option. From these objectives, Lebusa (2011) as cited in Jamieson (1984) has proposed a three-category framework:

1. **Education about enterprise:** *Deals mostly with awareness creation, and has the specific objective of educating students on various aspects of setting up and running a business mostly from a theoretical perspective.*
2. **Education for enterprise:** *Deals more with the preparation of aspiring entrepreneurs for a career in self-employment with the specific objective of encouraging participants to set-up and run their own business.*
3. **Education in enterprise:** *Deals mainly with management training for established entrepreneurs and focuses on ensuring the growth and future development of the business.*

The above discussion highlights that one of the needs of entrepreneurship education is for the Higher Education Institutions to develop the entrepreneurial capacities and mindsets of students through the programs that can develop and sharpen their skills of identifying and exploiting opportunities as well as training them to set up a businesses and manage their

growth. The entrepreneurial skills should nurture the student’s ability to solve the problem innovatively, instill creativity and self-confidence, as well as encourage high readiness for changes (Lebusa, 2011).

The success of entrepreneurial education is highly dependent on the teaching technique applied in the entrepreneurship programmes. Frederick *et. al.*. (2007) show discontentment towards the teaching techniques and the evaluation process of the entrepreneurship course which have been practiced by the typical university-based business schools. The business schools are seen only teaching students how to be employed and not to be employers (Frederick *et. al.*, 2007) because too much attention is given to qualitative and corporate techniques (Jones and English, 2004) rather than human beings as a whole (Heinonen and Poikkijoki, 2006). According to Heinonen and Poikkijoki (2006), the concentration towards human beings as a whole should be included in the entrepreneurship education because it involves the integration of knowledge (science), skills, and behaviour (art).

Heinonen and Poikkijoki (2006) and Shariff *et. al.*. (2011) urge educators to apply the learning enterprises approach which is hands-on experience or action based oriented as their teaching methodology and to pay special attention to incorporating experience, skill and knowledge instead of just the conventional approach which is teacher-centered learning. Keat *et. al.*. (2011) argued that, the main problem of the teacher-centered approach which

is predominantly implemented by most universities in Malaysia is the lack of personal entrepreneurial experience of the entrepreneurship lecturers themselves. The lack of involvement in real business has made it difficult for them to relate theory with real issues in entrepreneurial matters especially those related to the induction of ventures. Thus, action-based methods are believed to encourage problem solving, creativity, innovation (Jones and English, 2004; Lautenschläger and Haase, 2011) and are considered very much helpful in peer evaluation (Jones and English, 2004). In fact, students can get experiential learning only when they apply those concepts like leadership, management, and accounting into real-life practice. Besides, the trial and error during this process will help them clearly understand the concept in the classroom (Gstraunthaler and Hendry, 2011).

Heinonen and Poikkijoki (2006) also promote the entrepreneurial-directed approach as one of the teaching techniques in entrepreneurial education. This technique refers to the co-learning between teachers and students, where “*the student has ownership of her or his learning and the teacher acts as a supporter and facilitator of the process*” (Heinonen and Poikkijoki, 2006, p.85). According to them, the integration of the entrepreneurial process, experiential-learning process and entrepreneurial-directed approach enable the learning process of entrepreneurial behavior to be conducted in the class setting. In fact, based on Pihie and Sani’s (2009) research, it

has been found that, running a real business, visit to business locations, and interviews with entrepreneurs are the three techniques in entrepreneurial directed approach which are most preferred by students.

Other than that, the entrepreneurial internship programme also could stimulate the intention of students towards becoming an entrepreneur (Keat *et. al.*, 2011). The techniques and programmes are seen to be effective as they expose students to the nature and practice of the real business industry. In addition, the skills and the high level of self efficacy from the experience of those activities will motivate students to start their own business (Pihie and Sani, 2009).

ENTREPRENEURSHIP EDUCATION IN MALAYSIAN HIGHER LEARNING INSTITUTION

In the Multi Media University (MMU), to nurture the entrepreneurship attitude and skills among the students, the entrepreneurship course is offered by the programme called Bachelor of Multimedia (Media Innovation and Entrepreneurship). In fact, all MMU students regardless of their course have to take the "Introduction to Cyberpreneurship" subject. Universiti Utara Malaysia (UUM) also offers courses to motivate students towards becoming entrepreneurs, namely; the Student Enterprise Program (SEP), Bachelor of Entrepreneurship (a degree program), Basic Entrepreneurship Course and Co-Curricular Entrepreneurship activities (Faudziah and Habshah, 2006). The entrepreneurship programme at UUM is quite different

because it merges several entrepreneurship processes into one programme. The entrepreneurship processes include "the environmental influences and the processes of planning, researching, and developing entrepreneurial education and training" (Zakaria *et. al.*, 2011). Similar to UUM, Universiti Tenaga Nasional, also offers a degree in entrepreneurship in its Bachelor program. In Universiti Putra Malaysia (UPM), the entrepreneurship course is offered in its Bachelor of Business Administration Programme, whilst in Universiti Malaya (UM), the course is offered under the Department of Business Strategy and Policy. Other Higher Education Institutions in Malaysia generally offer the entrepreneurship course in the Master of Business Administration (MBA) programmes (Faudziah & Habshah, 2006).

METHODOLOGY

The total respondents in this study is 114 and they consist of third year and final year law students from Ahmad Ibrahim Kuliyyah of Laws. The law students have been chosen because many of them will be involved in private corporate and companies which relate to entrepreneurship after they graduate. In fact, as the number of clients of firms grew and their experience expands, many of the lawyers end up opening their own companies. The respondents comprise 38 male students and 76 female students. Local students represent the majority of the total respondents (95.6%), while the international students only cover 4.4% of the total sample.

The study is based on a survey conducted in 2011. The data from the survey questionnaire is analyzed using SPSS version 18. It is based on five hypotheses namely;

- The law students who have interest to learn entrepreneurship skills tend to be entrepreneurs after they graduate.
- The law students who are involved in entrepreneurial programs either by IIUM or outside IIUM tend to be entrepreneurs after they graduate.
- The law students who want to be entrepreneurs tend to support the entrepreneurship education taught at the University.
- The law students who have interest in entrepreneurial skills tend to support the entrepreneurship education taught at the University.
- The law students who are involved in entrepreneurial programs tend to support the entrepreneurship education taught at the University.

THE SURVEY

The study employed a descriptive research design in which the self-administered questionnaires were conducted on students from Ahmad Ibrahim Kuliyyah of Laws, IIUM between September and October 2011. The data was gathered using the convenience random sampling where the questionnaires were distributed during the end of the class. The students were given 10 to 15 minutes to fill up the survey. The

sample consists of 114 students in which 38 of them were male (33.3%) and 76 were female (66.7%). They varied from third year students which is 51.8% (59 students) and final year students, 48.2% (55 students). In terms of nationality, most of the students surveyed were locals (95.6%) whilst the International students represented only 4.4% of the total sample. The data was then analyzed using the Cross tabulation test.

The questionnaire was adapted mainly from Pihie (2009) and Pihie and Sani (2009). However, it has been simplified because at this preliminary stage, the objective is just to get the general idea of the perception and reception of non-business students particularly law students on entrepreneurship and entrepreneurship education.

The questionnaire utilized open ended questions as well as close ended questions particularly dichotomous and nominal polytomous type of questions. It was constructed based on 11 questions which measured the demographic of students, the involvement of students in the entrepreneurial programme, the interest of students to have careers as entrepreneurs after graduation, the reception of students to entrepreneurship education being introduced in the University, the interest of students towards learning entrepreneurial skills, and the student's preference on the types of entrepreneurial courses and the techniques in learning entrepreneurial skills.

THE FINDINGS

It is expected that the students who are interested to be entrepreneurs will be more aware about entrepreneurial skills since they will look for entrepreneurial knowledge and equip themselves with necessary entrepreneurial skills before they enter the real business world. Table 1 indicates the percentage of students' interest in entrepreneurial skills and their interest to be entrepreneurs after graduation. It is shown that, from 96 students who are interested in entrepreneurship skills, 81% of them are willing to be involved in business after their graduation. Indeed, for those who have no interest in entrepreneurship skills, only 11% of them have planned to be involved in business after they have graduated. This suggests that the students who have planned

to be entrepreneurs after they graduate are highly aware about the importance of acquiring entrepreneurial skills.

The bar chart in fig.1 shows that, financial incentives are the main reasons for students choosing entrepreneurship as a career. About 41.2% students believe that being entrepreneur is the only way they can gain more income and andthe fastest way to be rich. However, for some students, the purpose to be involved in business is to be self employed (13.2%) where they can make decisions freely without being controlled by any authority. Moreover, family also plays a vital role in shaping the entrepreneurship interest within the students themselves (4.4%). Basically, the students with business oriented families have the tendency to become entrepreneurs since

TABLE 1
The Percentage of students' interest in entrepreneurial skills and the interest to be entrepreneurs after graduation

	Want to be Entrepreneurs	Refuse to be Entrepreneurs
Interested in Entrepreneurial Skills	78 (81%)	18 (19%)
Not Interested in Entrepreneurial Skills	2 (11%)	16 (89%)

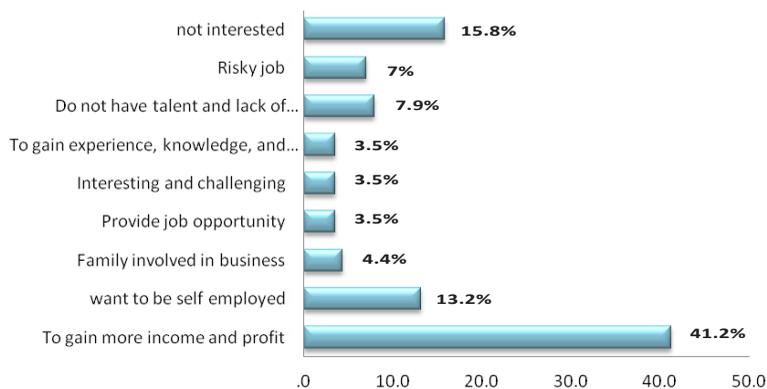


Fig.1: Reasons for choosing entrepreneurship as career

they have to continue their family business. Other than that, there are also students who perceive a career in entrepreneurship as an interesting and challenging job through which they can gain experience, knowledge, and communication skills (3.3%).

Furthermore, the students awareness towards entrepreneurship is also determined through their involvement in entrepreneurship programs either by university or outside sources like Persatuan Usahawan Muda Malaysia (PUMM), Youth Entrepreneur Society (YES) , Kreative Entrepreneurs Association Malaysia (KREAM), and etc. Based on the data in table 2, it shows that 84% of students who are involved in entrepreneurship programs and 59% of students who were never involved in any entrepreneurship programs have the interest to pursue their career in business. Thus, it demonstrates that involvement in

entrepreneurship programmes is not the only factor that drives students to pursue their career in business.

Even though the law students are in favor of being entrepreneurs (70%) as depicted in table 2, yet, only a few of them have ever attended the entrepreneurship programs. The bar chart in fig.2 shows that the number of students who are not involved in any entrepreneurship programs exceeds the number of students who have joined the programme by 12%. The lack of involvement of law students may due to the heavy academic workload that they have to carry throughout the semester. For law students, they have to complete a minimum 151 credit hours (for civil stream) and a minimum 161 credit hours (for Shariah stream). The workload is much higher as compared to the total credit hours that students in economics, business, and

TABLE 2
Students involvement in entrepreneurship programs and the interest to be entrepreneurs after graduation

	Interested to be Entrepreneurs	Not Interested to be Entrepreneurs
Involved	42 (84%)	8 (16%)
Not Involved	38 (59%)	26 (41%)
Total	80 (70%)	34 (30%)

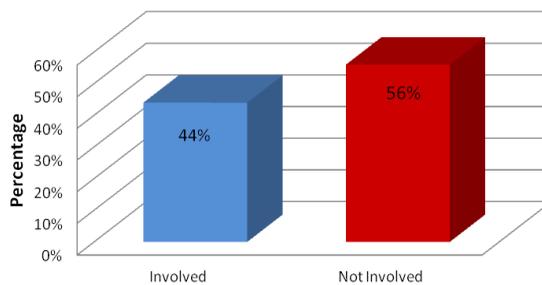


Fig.2: Students involvement in entrepreneurship programs

ICT have to fulfill (130-140 credit hours). Besides, the nature of the entrepreneurship program itself may not suit their interest.

Despite their lack of involvement in the entrepreneurship programs, most of them still believe that entrepreneurial education should be taught at the University.. According to table 3, from a total of 114 law students, 83% agreed that entrepreneurship education be taught at the University while only 17% of them did not agree. The data in table 3 also shows that law students highly support that entrepreneurial education be taught at the university regardless of whether they are interested to be an entrepreneur (89%) or otherwise (71%). It exhibits their strong reception towards entrepreneurial education.

Table 4 presents the relationship between interest in entrepreneurial skills and the reception of entrepreneurial education. It shows that students who are interested in learning entrepreneurial skills (90%) tend

to support that entrepreneurial education be taught at IIUM. Only 10% of them feel otherwise.. These students may prefer to learn business skills on their own or from other short courses available outside IIUM. However, among those who have no interest in acquiring entrepreneurial skills, 50% of them support thatr entrepreneurial education be taught in IIUM. It shows their fair reception towards entrepreneurial education.

Table 5 shows that there is no correlation between students' involvement in entrepreneurship programs and their support for entrepreneurial education. This is based on the findings whereby 88% of those who have been involved in entrepreneurship programs support entrepreneurship education. Surprisingly, 80% of those who have never been involved in the programs, give their support towards entrepreneurship education at IIUM. Perhaps the students could not attend the entrepreneurship programs due to limited access and lack of

TABLE 3
Students planning to be entrepreneurs and their support towards entrepreneurial education

	Support The Entrepreneurial Education	Do Not Support The Entrepreneurial Education
Interested to be entrepreneurs	71 (89%)	9 (11%)
Not Interested to be entrepreneurs	24 (71%)	10 (29%)
Total	95 (83%)	19 (17%)

TABLE 4
Students interest towards entrepreneurial skills and their support towards entrepreneurial education

	Support The Entrepreneurial Education	Do Not Support The Entrepreneurial Education
Interested in entrepreneurial skills	86 (90%)	10 (10%)
Not Interested in entrepreneurial skills	9 (50%)	9 (50%)
Total	95 (83%)	19 (17%)

publicity. Besides, it may also be due to the contents and nature of the programmes that do not suit the interest of students as well as the timing of the programmes which may not be compatible with the student’s schedule.

In order to identify which entrepreneurial courses are preferred by law students, five courses have been offered for them to choose, namely; how to set up business, financial management, taxation, consumer behavior, and decision making. They are allowed to choose more than one course and as a result, a total of 337 responses have been received. Based on the bar chart in Fig.3, the three most preferred entrepreneurial courses chosen by the law students are; financial management (27%), how to set up business (23.4%), and decision

making (20.2%). These three courses are basically the essential knowledge needed to run any business. The least preferred choice is consumer behavior which received 14% responses.

Without good teaching techniques, it is difficult for entrepreneurship education to succeed. Therefore, the questionnaire had a question related to teaching techniques and students were asked to identify which method was the most preferred one by law students. The techniques included workshops, running a real business, site visits, lectures/presentations, interviews with entrepreneurs, and talks by entrepreneurs. From 317 total responses received, it was found that the major techniques preferred by law students include running a real business (24.6%) followed by workshops

TABLE 5
Student’s involvement in entrepreneurship programs and their support towards entrepreneurial education

	Support The Entrepreneurial Education	Do Not Support The Entrepreneurial Education
Involved	44 (88%)	6 (12%)
Not Involved	51 (80%)	13 (20%)
Total	95 (83%)	19 (17%)

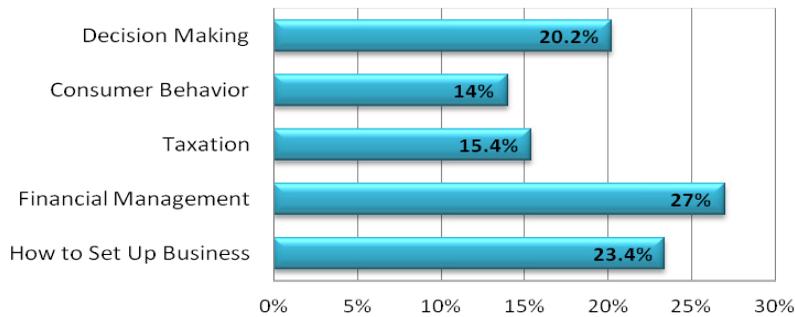


Fig.3: Students entrepreneurial courses preferences

(23.7%), as revealed in fig.4. These two techniques basically have high level of practicality. Meanwhile, the teaching technique which is more theory based such as lectures or presentations is less preferred by the respondents and garnered only 8.8 %. This is supported by Keat *et. al.* (2011) who argued that, the main problem of teacher-centered approach which is predominantly implemented by most universities in Malaysia is the lack of personal entrepreneurial experience by the trainers/teachers themselves. The lack of involvement in real business has made it difficult to relate theory with the real

issues in entrepreneurial matters especially the ones which relate to the induction of ventures. Fig.4 also shows that the least preferred technique is interviews with entrepreneurs (7.6%).

The five hypotheses were validated based on hypothesis testing of two population proportions. Table 6 summarizes the computed test statistic values and the decision that were arrived at with regards to these five hypotheses. Except for hypothesis 5 which could be retained at $\alpha = 12\%$, the first four hypotheses were validated based on the sample evidence at $\alpha = 1\%$.

TABLE 6
Summary of Decisions on Hypothesis Testing

No.	Hypotheses	Test statistic z-value*	Decision [#]
1	The law students who have interest to learn entrepreneurship skills tend to become an entrepreneur after they graduated	5.968987	Based on sample evidence, this hypothesis is validated
2	The law students who are involved in entrepreneurial programs either by IIUM or outside IIUM tend to be an entrepreneur	2.8518	Based on sample evidence, this hypothesis is validated
3	The law students who want to be entrepreneurs tend to support the entrepreneurship education taught at the University	2.3801	Based on sample evidence, this hypothesis is validated
4	The law students who have interest on entrepreneurial skills tend to support the entrepreneurship education taught at the University	4.1358	Based on sample evidence, this hypothesis is validated
5	The law students who are involved in entrepreneurial programs tend to support the entrepreneurship education taught at the University	1.1821	Based on sample evidence, this hypothesis is validated

*Test statistic z is computed based on the following formula:

$$z = \frac{p_1 - p_2}{\sqrt{\frac{p_c(1-p_c)}{n_1} + \frac{p_c(1-p_c)}{n_2}}}$$

[#]For hypotheses 1 until 4, the level of significance is $\alpha = 1\%$ while for hypothesis 5, the level of significance is $\alpha = 12\%$ (since the *p*-value for hypothesis 5 is 0.1190)

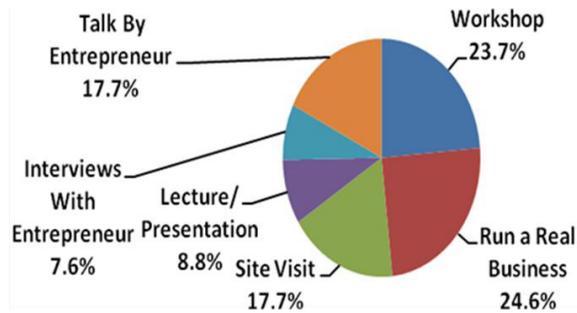


Fig.4: Students preference on teaching techniques

CONCLUSION

In conclusion, the study showed that the law students who have interest in acquiring the entrepreneurial skills as well as those who are actively involved in entrepreneurial programs are inclined to become entrepreneurs after they graduate. Besides, the proposal to teach entrepreneurship education at IIUM was well received by the law students especially those who intend to become entrepreneurs, those who are willing to learn entrepreneurial skills, and those who are involved in entrepreneurial programs.

The discussion shows that entrepreneurial course should be integrated into the Kuliyyah of Laws courses as a subject or as an audit course since the students are aware of the importance of entrepreneurship knowledge in their life based on their business interest upon graduation. However, there is a lack of involvement in entrepreneurship programs by law students. This may be due to the nature, promotion, and the timing of the existing entrepreneurial programs.

Therefore, the content and teaching techniques of the current entrepreneurship

program should be revised and improved to produce better entrepreneurship programs in the future. The high quality programs will produce successful entrepreneurs who will contribute towards the betterment of economic wellbeing in the future. In addition, entrepreneurial education should be continuously updated to reflect the current trend of the real business world.

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Analysis of the Tests Developed by the Courts in Determining the Existence of an Employee or an Independent Contractor Relationship in the Imposition of Vicarious Liability in Malaysia

Ahmad Masum

College of Law, Government & International Studies, Universiti Utara Malaysia, 06010 Sintok, Kedah, Malaysia

ABSTRACT

Employers are said to be vicariously liable for the torts of their employees which are committed during the course of employment. It is critical that business owners correctly determine whether the individuals providing services are employees or independent contractors. Employers or 'masters' will only be liable for the torts of their employees or 'servants' as they are called in law. They will not usually be liable for the torts of their independent contractors (subject to some exceptions). It is, therefore, necessary to establish the status of the person who committed the wrongful act. The task of the court is to interpret the contract of employment. In order to make such a distinction, the courts have adopted certain tests. However, the courts have been unable to formulate a concise definition of the terms 'employee' and 'independent contractor' that will furnish an accurate test to be applied in determining whether one is acting for another as servant or as an independent contractor. In Malaysia, the courts generally favour the control test. While the control test may have been persuasive in the past, in modern industrial society, with its increasingly sophisticated division of labour, the test is not always effective. In many cases employees may have technical skills and knowledge not shared by their employers. The purpose of this article is to examine these tests and the problems posed by the tests used by the Malaysian courts in an attempt to draw a distinction between an employee and an independent contractor in the context of vicarious liability.

Keywords: Contract of employment, course of employment, employers, employees, independent contractors, servants, torts, vicarious liability

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E-mail address:

asmad@uum.edu.my (Ahmad Masum)

INTRODUCTION

Vicarious liability is where one person is made liable for the tort of another person

(Cooke, 2009). The commonest example of vicarious liability in tort is that of an employer for the torts of their employee. Two things are necessary for such liability to arise. There must be a particular relationship between the employer and the employee. A distinction is drawn between employees and independent contractors. The employer is liable for the torts of the former but not those of the latter (subject to some exceptions) (Cooke, 2009). Second, the tort committed must be referable to the employment relationship (Cooke, 2009). This is expressed by saying that the tort must be committed in the course of employment. The principle that an employer is vicariously liable for the torts of an employee committed in the course of their employment, but not for those of an independent contractor has caused severe difficulties for the courts and continues to do so.

A number of tests have been used as an attempt to draw a distinction. Traditionally, a distinction was made between a contract of service (employee) and a contract for services (independent contractor) (Cooke, 2009). A contract may specify that the person doing the work is an independent contractor, or that the contract is a contract for services, but this is not conclusive and it is open to the court to consider, as a matter of fact, the precise nature of the employment (Harpwood, 2009). The courts have now abandoned the search for any single factor to act as a test and will now look at all the circumstances of each particular case (*Hall (HM Inspector of Taxes) v Lorimer* (1994) IRLR) 171).

In Malaysia, despite the availability of all these tests the courts generally favour the control test (Norchaya Talib, 2010). Workers have been held to be non-employees on the basis that the defendant was not responsible for payment of wages and did not have control over the manner in which the work was to be performed (Norchaya Talib, 2010). In the majority of cases there is no difficulty in determining whether a worker is an employee i.e. office clerical staff, live-in domestic held etc. However, it should be admitted wholeheartedly that sometimes it may be difficult to ascertain whether a worker is deemed to be an employee or otherwise.

This article examines the tests formulated by the courts in determining the existence of a contract of service as opposed to a contract for services and the problems posed by these tests. The next section shall focus on the justification for vicarious liability bearing in mind that holding a person liable for the wrongful acts of others demands justification. The third section shall focus on employee versus independent contractor, with particular emphasis on how this could affect the discussion on vicarious liability. The fourth section turns the attention to the tests that have been formulated in an attempt to draw a distinction between an employee and an independent contractor in the context of vicarious liability.

Throughout the article the author shall use the terms 'employee' or 'servant' and 'independent contractor' or 'self-employed' in the context of vicarious liability, and

avoid the use of the term 'primary liability'. It is important to draw a distinction between primary liability and vicarious liability. This can be illustrated by medical negligence cases. For example, a health authority may be vicariously liable for the torts of its employee and it may also be primarily liable where it fails to provide adequate levels of staffing in one of its hospitals and an accident results.

JUSTIFICATION FOR VICARIOUS LIABILITY

Vicarious liability obviously conflicts with a basic principle of tort, that wrongdoers should be liable for their own actions. Why then do we have it? Various explanations have been put forward. However, it is not easy to find a real justification for a master's liability for the unauthorised wrongs of his servant. The justifications that have been put forth in this regard are generally not convincing. Broadly, these justifications stand on the 'benefit and burden principle' and are supported on the basis of an economic analysis of the situation (Ali Mohammad Matta, 2004). Some of these justifications are: employers have the necessary control; employers benefit from the work of their employees; an employer being negligent in selecting an employee; etc (Elliott & Quinn, 2007).

Regardless of the justifications stated above, any certainty in the justification for the theory is doubtful as held in *Imperial Chemical Industries Ltd v Shatwell* ((1965) AC 655 at p.685) where Lord Pearce said:

"The doctrine of vicarious liability has not grown from any very clear, logical or legal principle but from social convenience and rough justice. The master having (presumably for his own benefit) employed the servant, and being (presumably) better able to make good any damage which may occasionally result from the arrangement, is answerable to the world at large for all the torts committed by his servant within the scope of it..."

From the above statement, it would suffice to note that the modern approach is entirely pragmatic and is based on social convenience and rough justice. It would appear that certainly where the employer's business is in the form of public service, such as operating a public bus service, policy dictates that the employer should be liable even for unauthorised acts of his employee.

EMPLOYEE VERSUS INDEPENDENT CONTRACTOR

One of the features of employment law in Malaysia is the distinction between employees and independent contractors. An employee is a servant. Where the status of an employee is established, the individual will be entitled to a considerable level of statutory and common law protection. In Malaysia there are several legislations governing the relationship between an employer and an employee. We have the

Employment Act 1955, Industrial Relations Act 1967, Occupational Safety and Health Act 1994 and many more. An employee is said to be under a 'contract of service' or a 'contract of employment' (Sec 2 of the Employment Act 1955, Sec 3 of the Occupational Safety and Health Act 1994 and Sec 2 of the Industrial Relations Act 1967). This is a very different concept for an independent contractor in a 'contract for services'.

There are a number of reasons why it is important to establish whether an individual is an employee or independent contractor. For example, not all individuals working within a business are employees in the eyes of the law. Where they do not have employee status they will often be treated as self-employed and will not receive the benefits of employment protection measures applicable to employees. In the context of this study, it is important to point out that an employer is vicariously liable for the torts of an employee committed in the course of their employment, but not for those of an independent contractor (subject to some exceptions such as: the employer authorising the commission of a tort; torts which do not require intentional or negligent conduct; negligence of the employer; and non-delegable duties) (Harpwood, 2009).

TESTS DEVELOPED BY THE COURTS IN DETERMINING WHO IS AN EMPLOYEE AS OPPOSED TO AN INDEPENDENT CONTRACTOR

The common law has developed a number of tests for distinguishing those who have a contract of employment from those who are

self-employed (Sargeant & Lewis, 2010). It is important not to see these tests as mutually exclusive, but rather developments in the law as a result of the courts being faced with an increasingly complex workplace and a greater variety of work situations. What we have today in form of the formal tests that have been developed remain useful indicators regardless of some shortcomings.

The 'Control Test'

An early test developed by the courts was the control test (*Yewens v Noakes* (1880) 6 QB 530 & *Walker v The Crystal Palace Football Club Ltd* (1910) 1 KB 87). It was developed on the premise that a servant is one who serves. Service implies: submission to another; acceptance of an inferior status; a master is entitled to give the servant orders; a servant must carry out such orders; and a master can tell the servant what to do, how to do it and when to do it (Fairclough, 2004). This test was laid down in the case of *Short v J & W Henderson Ltd* ((1946) 62 TLR 427 at p.429) where Lord Thankerton said that there were four factors to be considered in determining the existence of contract of service. First, the power of selection by the employer; secondly, the power in determining salary or other remuneration; thirdly, the power to or right of the employer to control the method in which the work was done; and fourthly, the power and right of the employer to terminate the employee's services.

In Malaysia, the courts generally favour the control test (Norchaya Talib, 2010). For example, workers have been held to be non-

employees on the basis that the defendant was not responsible for payment of wages and did not have control over the manner in which the work was to be performed. In *Zedtee Sdn Bhd v Maduraya Sdn Bhd* ((2004) 7 MLJ 461) by applying this test the court held that Bawan was an independent contractor and so the defendant was not liable for his acts of trespass and conversion. The importance of the 'control test' can be seen from the recent decision of the court in the case of *Wu Siew Yong v Pulau Pinang Clinic Sdn Bhd & Anor* ((2011) 3 MLJ 506) where the court held that there was no employer-employee relationship between the first and second defendants. The negligent and wrongful act complained of by the plaintiff was in relation to the personal acts of the second defendant in the treatment, management and care of the plaintiff in which the second defendant retained full control. Therefore, the first defendant could not be said to be vicariously liable.

Apart from the two cases cited above, reference can also be made to the recent decision of the Court of Appeal in the case of *Maslinda bt Ishak v Mohd Tahir bin Osman & Ors* ((2009) 6 MLJ 826). The issue in this case was whether the first respondent (a member of RELA (Angkatan Relawan Rakyat Malaysia) who snapped the photographs of the appellant while urinating was done 'in course of duty' and thus the second (the Director General of RELA), third (Director of the Jabatan Islam Wilayah Persekutuan Kuala Lumpur ('JAWI')) and fourth (the Government of Malaysia) respondents were vicariously

liable. The Court of Appeal held that the first respondent was not there on his own volition but on instruction. He not only was under the direct supervision of RELA, but on that particular night the first respondent was also subject to the direction of JAWI, with his duties shuttling from ensuring the security of those who participated in the exercise and to keeping an eye on those arrested. As the first respondent took the unauthorised photographs, whilst in the course of the work or employment for which he was instructed to carry out, at a time when the operation was in progress, the second, third and fourth respondents must be held vicariously liable.

Based on the cases cited above, it is clear that the courts in Malaysia have taken note of the importance of the 'control test' in determining the existence of employer-employee relationship. However, the author is of the opinion that there is a need not only to pay attention to the 'control test' as a determining factor. At the end of the day, each case should be decided on its own peculiar facts especially in the interest of justice and fairness. In other words, the facts presented in each case must be viewed and any tests applied should correspond to the modern working practices.

Perhaps the 'control test' was appropriate in the time of unskilled workers and rigid social classifications (Fairclough, 2004). However, the control test began to fail as a single conclusive test with the development of skilled workers. Such work does not require the master or employer to tell the employees how to do his or her work. In

addition, with the advent of independent contractors the control test is blurred when such a contractor consents to a degree of control but does not consent to actually becoming an employee. Working practices have changed over the years, and as industry has become more technical and required more expertise, it has become obvious that the control test alone will not suffice. As Cooke J. stated in the case of *Market Investigations v Minister of Social Security* ((1969) 2 QB 173) "... control will no doubt always have to be considered, although it can no longer be regarded as the sole determining factor".

Furthermore, in modern conditions the notion that an employer has the right to control the manner of work of all his servants, save perhaps in the most attenuated form, contains more of fiction than of fact (Rogers, 2006). It is clearly the law that such professionally trained persons as the master of a ship, the captain of an aircraft and the house surgeon at a hospital are all servants for whose torts their employers are responsible, and it is unrealistic to suppose that a theoretical right in an employer, who is likely as not to be a corporate and not a natural person, to control how any skilled worker does his job, can have much substance (Rogers, 2006). It has now been recognised that the absence of such control is not conclusive against the existence of a contract of service and various attempts to find a more suitable test have been made.

The 'Organisational Test'

This test, sometimes called the 'integration test', was designed to get around some of the problems experienced with the control test. The basis of the 'organisational test' is its assumption that under a contract of service a person is employed as an integral part of the business. On the other hand, under a contract for services, an individual's work is done for the business but is not integrated into it. It is only an accessory to it. In *Stevenson, Jordan and Harrison Ltd v MacDonald and Evans* ((1952) 1 TLR 101 at p.111), Lord Denning said:

"One feature that seems to run through the instances is that, under a contract of service, a man is employed as part of the business, and his work is done as an integral part of the business; whereas, under a contract for services, his work, although done for the business, is not integrated into it but is only accessory to it."

From the above statement, it is not entirely clear when a person is integrated into an organisation and when they are not. It is difficult to anticipate where the dividing line may be drawn: for example, what of the dependent contractor? If a person is self-employed, but works continuously for one organisation, is he to be treated as integrated into the organisation or not? To what extent, for example, is the catering assistant who works for an outsourced company be treated as an integrated part of the organisation in

which he is located? (Sargeant & Lewis, 2010).

Looking at the position in Malaysia, although the courts generally favour the control test as mentioned earlier, there have been instances where the courts have also acknowledged the existence of the 'organisational test'. In *Mat Jusoh bin Daud v Syarikat Jaya Seberang Takir Sdn Bhd* ((1982) 2 MLJ 71 & *Lian Ann Lorry Transport & Forwarding Sdn Bhd v Govindasamy* (1982) 2 MLJ 31) applying the organisational test laid down by Lord Denning in *Stevenson, Jordan and Harrison Ltd v MacDonald and Evans* ((1952) 1 TLR 101), Salleh Abas FJ. held that it is clear that what was done by Lim and the workmen procured by him was done as an integral part of the defendant's business and he therefore had no hesitation to hold that the plaintiff was an employee of the defendants.

Based on the discussion and cases cited above, one could argue that the 'organisational test' seemed to be an attempt to cope with the difficulties posed by the growth of technical and skilled work which may not be the subject of close control by an employer. Although it may be used as an indicator of a person under a contract for service, it cannot be conclusive. Indeed the problem with this test and the control test is that they do not sufficiently distinguish between the employed and the self-employed (Sargeant & Lewis, 2010). It is arguable that it is possible for workers without a contract of employment to be closely integrated into an organisation and closely controlled by that organisation. To

some extent this has been recognised by the Court of Appeal in *Franks v Reuters Ltd* ((2003) IRLR 423).

The 'Multiple Test'

This test is a further recognition that there is no one factor that can establish whether a contract of service exists. In different situations, the various factors can assume greater or lesser importance. This test concludes that no single test can, in itself, determine employment status. It accepts that all tests have value and merit and are useful as general guidance. It is based on the principle that in each and every case it is necessary to weigh all the factors and ask whether it is appropriate to call the worker an employee. According to McKenna J. in *Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance* ((1968) 2 QB 497), the test asks for three questions: (a) Did the servant agree to provide his work in consideration of a wage or other remuneration? (b) Did he agree, either expressly or impliedly, to be subject to the other's control to a sufficient degree to make the other master? (c) Are the other provisions of the contract consistent with it being a contract of service? McKenna J. also pointed that "a man does not cease to run a business on his own account because he agrees to run it efficiently or to accept another's superintendence" (Bell, 2003).

In addition, more recently, the important factors appear to be that of personal performance and mutuality of obligation (Sargeant & Lewis, 2010). McKenna J. (*Ready Mixed Concrete (South East) Ltd v*

Minister of Pensions & National Insurance (1967) 2 QB 497 at p. 517) illustrated the complexity of the decision:

“An obligation to do work subject to the other party’s control is a necessary, though not always a sufficient, condition of a contract of service. If the provisions of the contract as a whole are inconsistent with it being a contract of service, it will be some other kind of contract, and the person doing the work will not be a servant. The judge’s task is to classify the contract... he may, in performing it take into account other matters than control.”

Based on the illustration above, the problem with this approach, which may be insoluble without a more precise statutory definition, is that it can lead to inconsistencies of approach. For example, which factors should be taken into consideration by the courts? Should we basically view the list as not being exhaustive and thus no single factor determines the distinction between employed and non-employed status? Are all the factors above given equal scrutiny? With all these questions in mind, the test has been viewed as having its own shortcomings.

In the context of this study, it is important to note that the courts in Malaysia have taken note of the existence of the ‘multiple test’. In *Tan Eng Siew & Anor v Dr Jagjit Singh Sidhu & Anor* ((2006) 1 MLJ 57), James Foong J. acknowledged in his judgment the existence of all the

three tests and went further by stating that having examined the evidence and applying all the tests as elaborated, he found that no such special relationship existed to attribute vicarious liability on the second defendant. In analysing the decision of the court, it would suffice to note that what is somewhat confusing is the court stating that in any event the post-surgery care given to the plaintiff was on the instructions of the consultant. This suggests that if they had been negligent, liability could still be excluded by the hospital, which would be inconsistent with the basic principle of an employer being vicariously liable for his employee’s torts. We must remember that the ward nurses, medical attendants and physiotherapist were employees of the hospital. However, according to the decision of the court, these personnel did not commit any tort on the plaintiff.

The ‘Economic Reality Test’

In many ways, this test is an extension of the ‘multiple test’. It was formulated in the case of *Market Investigations v Minister of Social Security* ((1969) 2 QB 173) by Cook J. and asks the fundamental question whether the worker is in business on their own account? It then considers such factors as control, whether the worker provides his own equipment, whether he hires his own helpers, what degree of financial risk he runs, whether the worker has responsibility for investment and management of the work and what, if any, opportunity the worker has to profit from the sound management of the task (Bell, 2003). In the later case of *Lee*

Ting Sang v Chung Chi-Keung ((1990) IRLR 236) the Privy Council stated that whilst there was no single test for determining employment status, the standard to be applied was best stated by the test from *Market Investigations*.

This test of economic reality, i.e. looking at the contract as a whole to decide whether the individual was in business on his own account, was an important development in distinguishing between those under a contract of service and others. The element of control is still important, but there is a need to take into account the other factors that make up the contract of employment. For example, where there is ambiguity it is relevant to know whether the parties to the contract have labelled it a contract for services or a contract of service. This test enables the courts to see through labels. This is what the parties to the contract call themselves. However, we have to bear in mind that labels can be deceptive. The fact still remains that such labels will not prevent a court from looking behind them to ascertain their true status (*Davies v New England College of Arundel* (1977) ICR 6).

The Mutuality of Obligation Test

This test has been used on a number of occasions, particularly to try to determine the status of part-time, casual or “agency” workers. For example, it was used in the case of *O’Kelly v Trusthouse Forte plc* ((1983) 3 All ER 456) to prove that part-time casual catering workers were not employees, since the court found that the company were under no obligation to provide work, and the

workers were under no obligation to accept work if it were offered. The importance of this factor was confirmed by the House of Lords in the case of *Carmichael v National Power Plc* ((1999) ICR 1226) which made it clear that both control and mutuality of obligation are essential features of a contract of employment. Moreover, the test for mutuality of obligation must be applied in a contractual manner; in other words, the worker must be under a contractual obligation to accept work and the company under a contractual obligation to offer it. An attempt by the Court of Appeal in *Carmichael* ((1998) IRLR 30) to mollify the test by introducing the element of reasonableness was firmly rejected by the House of Lords.

In Malaysia, the application of the mutuality of obligation test perhaps could be seen in the case of *Employees Provident Fund Board v Bata Shoe Company (Malaya) Ltd* ((1968) 1 MLJ 236) where the Court of Appeal specially mentioned that the five tests are simply there to help the court to determine the answer to the ‘fundamental test’. As such the application is really a matter of common sense and whether or not there was a contractual service and between who was a pure question of fact. Based on the decision of the Court of Appeal above, the author would like to reiterate that one could rule out the possibility that a sham may be found where the parties to a contract have a common intention that the document or one of its provisions is not intended to create the legal rights which they set out whether or not there is a joint intention to

deceive third parties or the court. Perhaps what is needed here is to consider whether the words of a written contract represent the true intentions or expectations of the parties not only at the inception of the contract but, if appropriate, as time passes.

The mutuality of obligation test is the most problematic of all the tests and its widespread use has led to situation where the distinctions between temporary, casual and fixed-terms workers are often confused with self-employed. For example, problems can arise with individuals who enter into occasional short-term engagements where there is no obligation to provide, and perform, work, or who work regularly for someone whilst maintaining there is no continuing obligation to provide or accept work.

CONCLUSION

Although the courts have wrestled with formal tests in an attempt to define the existence of a contract of service especially in the context of distinguishing between an employee and an independent contractor, the facts still remains that no single conclusive test has been found. All the tests discussed throughout this study are with some shortcomings. However, regardless of these shortcomings, the formal tests that have been developed remain useful indicators in helping the courts to hold employers vicariously liable for the wrongful act of their employees. For instance, the control test is still applicable. It is not the single determinate factor in a contract of service, but recent cases have

returned to it for guidance (*Montgomery v Johnson Underwood Ltd* (2001) IRLR 269 & *Motorola Ltd v Davidson* (2001) IRLR 4). The control test lives on and remains good law, albeit no longer the single determinant of employment status. Also, the organisational test still remains a useful test particularly where the employee is a professional or skilled employee (*Cassidy v Ministry of Health* (1951) KB 343). As for the mixed test, perhaps it could be argued that in a practical sense this test still remains relevant because it represents the court's desire to expand the scope of contract of service beyond the old idea of control (*Hull (HM Inspector of Taxes) v Lorimer* (1994) IRLR 171). The economic reality test is also still considered relevant in that it enables the court to distinguish between those under a contract of service and others. This could be done through labels i.e. what the parties to the contract call themselves. But again, such labels will not prevent a court from looking behind them to ascertain their true status.

Furthermore, it could be said that of all these tests; in Malaysia, the courts generally favour the control test (*Employees Provident Fund Board v Bata Shoe Company (Malaya) Ltd* (1968) 1 MLJ 236 & *Employees Provident Fund Board v MS Ally & Co Ltd* (1975) 2 MLJ 89). However, in recent years the courts have appeared to adopt a somewhat different approach. Rather than applying formalistic tests, there are several instances of the courts taking a more holistic approach. The application of this holistic approach can be seen in the case of *AXA Affin Assurance Bhd v Natural Avenue*

SdnBhd ((2009) 8 MLJ 517) where one of the issues in this case was whether the learned arbitrator committed an error of law in holding that the driver of the insured vehicle one Abdul Aziz was an employee and not an agent of the respondent. In response to this issue, Wan Afrah J. held that to his mind there was an error on the face of the law to hold that Abdul Aziz (the driver) did not act as an agent for the respondent and that the respondent was not vicariously responsible for his negligence and at the same time the learned arbitrator held as a finding of fact that Abdul Aziz was negligent. From this decision, it could be argued that the court took the view that each case should be decided on its own facts rather than following the “mechanical tests”.

Based on the overall discussion of the local cases, the author would like to submit that we ought to be very careful of the application of the “mechanical tests” in determining whether a person is an employee or an independent contractor for the purpose of the imposition of vicarious liability. Perhaps the approach that the courts should adopt in dealing with this pertinent issue is to take the view that each case should be decided on its own facts. Apart from that, there could also be other policy considerations which could act either as a “counterweight” as a reason or additional reason to impose liability. Of course the author is fully aware of the discomfort some judges have with making decisions based on policy considerations of what is fair and just. However, we ought to remember that we have inherited these “tests” on the basis

of common law approach, thus it would not be wrong to give emphasis to policy considerations rather than resorting to the “mechanical tests”. It is important to note that English Courts had thus been unable to forge a legal rule without reference to policy considerations.

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Corporate Responsibility for Environmental Human Rights Violation: A Case Study of Indonesia

Achmad Romsan^{1*} and Suzanna Mohammed Isa²

¹*Faculty of Law, Sriwijaya University, Oganlir, South Sumatra, Indonesia*

²*Faculty of Law, Universiti Kebangsaan Malaysia, 43600 Bangi, Selangor, Malaysia*

ABSTRACT

The volcano mudflow of 2006 in Sidoarjo, East Java was one of the most devastating environmental disasters in Indonesia. Many argue that it was the failure of PT. Lapindo during the drilling process but the verdict of the District Court of South Jakarta decided that it was a natural disaster. Environmental crime provision is stated in The Environmental Management Act 2009 No. 32 but this stipulation does not reduce the number of corporate environmental crimes as there are other factors involved such as enforcement. The protection of people's environmental human rights is also recognized under The Law of 1999 No. 39 on Human Rights. Regrettably, prosecuting corporate environmental crime from the angle of human rights is at a dead-lock due to the fact that the Indonesian Human Rights Court is only authorized to prosecute genocide crimes and crime against humanity. Nevertheless, the corporate sector should take the responsibility to restore the ecosystem where disasters have occurred. In view of this gap, some primary data, like statutes, regulations and international conventions; also secondary data such as articles, reports and news papers have been obtained from literature study and internet sources and are descriptively and qualitatively analyzed. This article aims to rationalise that the jurisdiction of the Indonesian Human Rights Court should include environmental crime in The Law of 2000 No. 26 in Human Rights Court and provide output for the decision makers in Indonesia to consider that environmental crime is a crime against humanity.

Keywords: Corporate crime, corporate liability, environmental pollution, environmental human rights, Indonesia

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E-mail addresses:

aromsan@yahoo.com (Achmad Romsan),

zie@ukm.my (Suzanna Mohammed Isa)

* Corresponding author

INTRODUCTION

*PT. Lapindo*¹ is the Indonesian oil company which holds a license to explore and exploit the oil resources in Indonesia. *Sidoarjo*, near *Surabaya* is one of its oil drilling sites. The

disaster occurred on 29th May 2006 when *PT. Lapindo* failed to stop the mud flowing from a gas exploration well. Consequently, approximately 10,000 houses and 600 ha of land and villages were submerged, farmland was devastated, businesses and schools closed and livelihoods lost as the mud inundated the surrounding area causing 50,000 people to be displaced.² The mud continued not only to flow from the first rupture, but the daily amount gushing out increased from an initial 5,000 m³ per day to up to 150,000 m³ per day.³ It was reported that the weight of the mud on the ground had pressed down the affected area by approximately one meter deep.⁴

It was a natural disaster claimed some *Lapindo's* experts but many have indicated that it was most likely to have occurred as a consequence of *PT Lapindo Brantas's* failure to install a casing around the well to the levels required under Indonesian mining regulations.⁵ Many lent their assistance to build a two meter high dam, for example the Indonesian subsidiary Dutch Company Van Oord, 1400 army personnel and a team from The United Nations Disaster Assessment and Coordination (UNDAC). That was not a sustainable solution due to the rainy season. Efforts were undertaken by *PT. Lapindo's* technicians to stop the mudflows, but those also failed.⁶ It was predicted that the mudflow was similar to oil deposit which may last up to 30 years.

The disposal into the River Porong and to the sea affected the river ecosystem and the aquaculture industry, and the high level of salinity caused the land

overflowed by mudflow to become infertile. WALHI (*Wahana Lingkungan Hidup*), an environmental organization predicted that the disposal of mud into the river would destroy 4,000 hectares of fish and shrimp ponds and threaten the livelihoods of thousands of fish farmers in Sidoarjo, Madura, Surabaya, Pasuruan and Probolinggo.⁷

As a non-governmental environmental organization, WALHI on May 1, 2007 filed a case to the District Court in South Jakarta and sued *PT. Lapindo Brantas Incorporated* together with 11 other defendants on the ground that the defendants had committed an unlawful act (*Perbuatan melawan hukum*) which caused significant damage to the environment and loss of income to those affected. The District Court of South Jakarta⁸ was not in line with WALHI's argument that *PT. Lapindo* had committed an unlawful act and decided that the hot mudflow was a natural disaster. On the other hand, a report by geologists and scholars concluded that it was not a natural disaster but the failure caused by *PT. Lapindo* during the drilling process.

This article employed some data covering primary data, like statutes and regulations and also secondary data such as articles, reports and news papers. All data collected are analyzed descriptively and qualitatively. The objectives of this article are to provide some input for the politicians and decision makers to consider that environmental crime is a crime against humanity and also to rationalise that the jurisdiction of the Indonesian Human Rights Court should include environmental crime

in The Law of 2000 No. 26 on Human Rights Court. This article is divided into in several parts. The first part deals with the volcano mudflow as described in introduction. The discussion moves on to legal problems relating to environmental human right protection versus economic development in Indonesia as discussed in part two. Part three discusses whether volcano mudflow in Sidoarjo, East Java is a corporate environmental crime. Part four discusses the question of whether corporate environmental crime is a crime against humanity and a final conclusion is given.

ENVIRONMENTAL HUMAN RIGHTS PROTECTION VS. ECONOMIC DEVELOPMENT IN INDONESIA: THE LEGAL PROBLEM

During the early years of Suharto's administration of New Order (*Orde Baru*) (1967-1972), in order to stimulate economic growth, in 1967, Suharto's administration opened its doors to foreign and domestic investment and several investment laws were enacted afterward.⁹ The peak of national economic development began with *Repelita IV* (1984-1989), known as the era of industrialization where economic growth acceleration would only be attained if supported by sustainable industrial development. This program would have continued until its "take-off" era in *Repelita VI* (1994-1999). However it could not be realized due to the economic crisis which in turn became a political crisis that finally led to the fall of Suharto's regime in 1998.

Under the reformation government, the National Development Program (PROPENAS/Program Pembangunan Nasional), a five year development program which is similar with that of *Repelita/Rencana Pembangunan Lima Tahun* (during Suharto time) was introduced and implemented into the "Yearly Development Plan" (REPETA/*Rencana Pembangunan Tahunan*). At the regional level, the related governments have to formulate a five year development program namely "Strategic Plan of Development" (RESTRAL/*Rencana Strategi*) to implement PROPENAS. Notwithstanding, each provincial and district governments in Indonesia have different development priorities based on their RESTRAL.

In general, there are five priority areas of development formulated in the PROPENAS,¹⁰ but there is no room for green development as the foundation for good governance includes political stability, the rule of law, control of corruption and accountability.¹¹ Issues related to environmental management and natural resources are given priority since local governments are instructed to increase their local revenues. This kind of development reflected the situation of Indonesia during the early years Suharto's administration. As a result, air, water, land pollution, forest fire, and deforestation resulted in environmental problems generating social unrest and led to conflicts in society. There have been many community-led environmental disputes relating to industries brought to District Courts but less than

one percent of environmental crimes in Indonesia end in punishment.¹² However the number increased to 1.33% during the enactment of The EMA 1997 No. 23. Meanwhile in September 2011, of the 33 cases of environmental-related crimes, 21 cases were declared “free from the charges,” 4 cases ended in jail sentences and in eight cases the perpetrators were placed under probation.¹³ It was reported that in 2011, after the promulgation of The EMA 2009 No. 32, the Indonesian Ministry for Environment handled 171 public complaints; 42 cases were verified by the Ministry Office for Environment, 129 complaints were delegated to the authorized instances who were in charge of those environmental matters, 20 complaints where the responsible owners were given administrative sanctions, 14 complaints were solved by alternative disputes resolution and 8 complaints were followed up with criminal charges (4.67%).¹⁴

In addition, in the anticipation of various kinds of environmental crimes the Ministry for Environment in Jakarta has improved institutional capacity building through an MoU with the Indonesian Police (*Kepolisian RI*) and the Indonesian Public Prosecutors (*Kejaksaan Negeri RI*) on 26th July 2011. Then, on 5th September 2011 a MoU was signed between the Court of Certified Environmental Judges and Environmental Investigators, and the Indonesian Supreme Court. Ratification and adoption of various international conventions and declaration such as the Basel Convention,¹⁵ The United Nations Convention on Biological Diversity,

the Stockholm Declaration,¹⁶ Rotterdam Convention and Nagoya Protocol¹⁷ were conducted to strengthen the protection and environmental management regulations. In addition, the General Guideline on The Handling of Transnational Conflicts was drafted to assist the regional governments in handling transnational conflicts.¹⁸

There is a dilemmatic environmental problem in Indonesia regarding the uneven development program which only focuses on the inner lands of Java, Madura, Bali and Lombok. Ironically, poverty is concentrated in Java, the most populated island (two-thirds of the Indonesian population is centralized in the inner islands of Java, Madura, Bali and Lombok).¹⁹ The interrelated problems abbreviated as “4Ps” for Population, Poverty, Pollution and Policy are factors that generate environmental problems.²⁰ Dense population generates poverty. Poverty generates pollution. Population, poverty and pollution generate policy. Policies also create problems for the environment. Environmental problems relate to economic, politics, social and culture. While law and its supplemental instruments will only be effective if supported by funding and good institutional framework, its enforcement can give rise to problems once implemented in society. Environmental Management Acts (EMAs) cannot fully be implemented as a number of provisions need further implementing regulations and subsidiary legislations. Consequently the EMA cannot thoroughly solve environmental matters. The second factor affecting law enforcement is law enforcers, for example police,

prosecutors, judges and civil service police (*Polisi Pamongpraja*), who are not able to work properly and professionally due to lack of facilities when they are on duty and small salaries.²¹ Additionally, the human resource in law enforcement is not compatible to the vast area of Indonesia and the last factor is the legal culture of the society which sometimes is contradictory to the objective of the law, for example: bribery, corruption, and carrying knives etc and so forth. In short, the entire situation above affects the process of environmental conflict resolution.

VOLCANO MUDFLOW IN SIDOARJO EAST JAVA INDONESIA: IS IT A CORPORATE CRIME?

According to the South Jakarta District Court,²² the volcano mudflow in Sidoarjo East Java is a natural disaster and not an unlawful act (*perbuatan melawan hukum*) of PT. Lapindo's staff during the drilling process under Article 1365 Indonesian Civil Code. The geologists' statements during the proceedings were used as strong evidence for the Judge's verdict. Based on the Presidential Decree No. 14 of 2007 and Presidential Decree No. 48 of 2008 all the damaged infrastructures, railways, telephone lines, power lines, gas pipe lines, school buildings, community health centres (*puskesmas*) were to be-constructed and financed by the state budget (*Anggaran Perbelanjaan Negara/APBN*). The cost for reconstructing the infrastructure is more expensive than paying compensation to the victims. The Court also ordered PT. Lapindo, based on humanity reasons, to

pay compensation for submerged properties within the well-drilling area. The damage outside the drilling area was not under the responsibility of PT. Lapindo but the Government of Indonesia.²³

Many²⁴ argue that the volcano mudflow which emanated in 2006 was due to PT. Lapindo's failure during the drilling process and should be regarded as a corporate crime as regulated under Article 46 of The EMA 1997 No. 23 on Environmental Management²⁵ which stipulates:²⁶

1. If the offense referred to in this chapter is conducted by or on behalf of the corporation, company, association, foundation or other organization, criminal charges are made and criminal sanctions and procedural measures referred to in Article 47 shall both be imposed against the legal entity, company, association, foundation or other organizations concerned and to those who gave orders to commit criminal acts or the one who acts as the leader in the act or to both of them.
2. If the offense referred to in this Chapter, is conducted by or on behalf of the corporation, company, association, foundation or other organizations, and performed by people, either in employment or other relationships, which act within the legal entity, company, association, foundation or other organization, criminal charges are made and criminal sanctions imposed on those who give orders or act as a leader regardless if they are the people,

or the employees who committed the crime individually or collectively.

3. If charges are made against a legal entity, company, union or other organization, calls for court summons and the call letters were delivered to the address of the board in their residence, or where the board does their daily work.

The weakness in Walhi's claim with regard to the element of fault attached to Article 1365 of the Indonesian Civil Code for environmental compensation odds with Article 46 of the EMA 1997. Article 1365 of the Civil Code is a popular article which regulates the unlawful acts (*perbuatan melawan hukum*) where due to one's fault others are harmed and therefore compensation must be given. The fault element of the doer is necessary for the plaintiff to prove in order to claim compensation under Article 1365. If the fault element is used in claims relating to environmental pollution it would be very difficult to be proven since pollution and environmental degradation do not occur immediately but can only be gradually seen in the future. Besides the extent of the pollution is also uncertain. There are a number of parameters and factors surrounding the occurrence of such pollution that depletes environmental quality. For example food supply, climate, hatch date, body size, reproductive output and so forth as in the studies conducted by Cooch, Lank, Rockwell and Cooke,²⁷ and William, Cooch, Jefferies and Cooke.²⁸ One case of pollution will be able to be a reference for

another pollution case, for example, the *Buyat* case, North Sulawesi, Indonesia. The marine environment of a bay was found to be polluted by mercury eight years later, in 2004, after the first dumping of mine waste activities of the Newmont Corporation in 1996.²⁹ Whilst in the *Way Seputi* River case in Lampung, southern part of South Sumatra, the quality of the river was polluted in less than a year.³⁰ In the case of Sidoarjo, the victims were mostly peasants who did not have resources, like money, power and knowledge. If they were required to prove that their economic loss was due to the fault arising from the failure of PT. Lapindo, this would put them in a quandary.

Further development understanding of an unlawful act is not only contrary to law and the rights of other parties but also may include any act contrary to appropriateness that must be considered in the association of the community in conjunction with a personal or property of others.³¹ This principle is identified as a 'no liability without fault,' a principle which was popular and dominated the law of compensation in the common law up to the 19 century.³² In the mid 19 century, however, the principle above was not regarded as the sole principle applied in compensation matters. Rabin said that "the concept of negligence as a basis for determining liability in cases of inadvertent harm was used to pre-existing notions of moral blameworthiness underlying liability for international harms to create a comprehensive theory of liability based on fault."³³ There is an erosion of fault from the victim to the doer or from principles of

‘no liability without fault’ to ‘liability based on fault’. This has evolved a new principle of compensation which latter on became popular with ‘strict liability’ which is an appropriate principle used in environmental matters, such as pollution and environmental degradation.³⁴ The strict liability principle there-fore reincarnates in the Indonesian Environmental Management Act (EMA), for example Article 20 of The EMA 1982,³⁵ Article 35 of The EMA 1997 No. 23,³⁶ and Article 88 of The EMA 2009 No. 32.³⁷

The shifting of burden of fault from the victim to the doer will lighten the people’s encumbrance when the cases are brought to Court.³⁸ Since there is no case to which the Indonesian Judges have referred to strict liability as regulated in the EMA, therefore the reference to the US Courts where strict liability principle has been used in environmental-related cases such as *Atlas Chemical Industries Inc. v. Anderson*,³⁹ *Phillips Petroleum Co. v. Hardae*,⁴⁰ *Burn v. Lamb*,⁴¹ and *Biakanja v. Irving*.⁴² In England this principle was applied in *Ryland v. Fletcher* case (1887). In the renowned case of *Ryland v. Fletcher* (1887) the court decided that a person who brings dangerous substances onto his property and allows them to escape to adjoining land resulting in damage there will be held strictly liable. The defendant was thus liable for damage caused by the escape of water from a reservoir on his land.⁴³

In relation to Article 1365 of the Civil Code proved to be the stumbling block in the case of the oil spill caused by the Super Heavy Tanker Showa Maru in the Malacca

Straits in 1975 in a suit for environmental compensation. Indonesia as the victim had to prove that the polluted marine and ecosystem of the eastern coast of Sumatra was due to the fault of Showa Maru’s captain. Mean-while, in the case of Sidoarjo volcano mudflow, PT. Lapindo as the plaintiff had submitted expert geologists’ statements to defend itself, whilst Walhi provided statements from environmental law experts who referred to corporate crimes under Article 46 of the EMA 1997, newspaper clippings and news reported on TV that the judge considered as informal legal evidence according to the Indonesian Penal Proceeding Code.⁴⁴ The situation was made worse when two tests on the mud characteristic conducted by different labs showed different result. The first test lab (belonging to the Government) showed that the mud was non-toxic while the second test lab (a public university lab) illustrated that the mud was toxic. In this context, there is a “Blackstone ratio” which is 10:1 derived from idiomatic expression in criminal law introduced by William Blackstone in his Commentaries on the Law of England published in 1760s “better that ten guilty persons escape than that one innocent suffers.”⁴⁵ Under this condition, the judge freed the alleged perpetrator although many research findings claimed that it was not a natural disaster but failure or negligence committed by PT. Lapindo. Nevertheless, PT. Lapindo was still held responsible for restoring the environment in the affected areas.

Prosecuting a provision on corporate environmental crime successfully is difficult. Canada,⁴⁶ the United States,⁴⁷ The Netherlands,⁴⁸ France,⁴⁹ and Germany are countries that do not have environmental crime provisions in their environmental laws. In Japan environmental crime⁵⁰ has never been declared by the courts because the prosecutors are unable to prove the presence of intention, an element essential in criminal law. In China, criminal sanction for environmental crimes is regulated by the 1979 Law on Environmental Protection, where section 32 declares that “polluters are liable to administrative, economic or criminal sanctions⁵¹ but there is no information whether those regulations are applicable in reality for corporate environmental crime.

The problem with corporate environmental crime is the focus on intention in connection to environmental pollution, in addition to the element of deterrence and the effectiveness of formal legal sanctions in limiting illegal corporate acts. Meanwhile, scholars have not provided a solution as to how intention can be proven or how deterrence can be more effective. Petermoster and Simpson⁵² stated that “corporate crime consists of illegal acts by corporations or their representatives that are undertaken to further the goals of the organization and violate civil, administrative and criminal statutes and encompasses a variety of behaviour.” Some of the acts categorized as corporate crimes are bribery, fraud, price-fixing, toxic dumping, insider trading, and crimes against employees, consumers, suppliers, buyers and competitors.⁵³ Suing corporate environmental violation using a

traditional deterrence model as applied to corporate crime has not been effective since in many environmental cases involving big corporations are not severe enough to affect the corporation’s behaviour.

Under the Indonesian legal system, the issue of corporate crime is not only regulated under the EMA but also the anti-corruption⁵⁴ and money laundering laws.⁵⁵ However, in reality the provisions that deal with corporate responsibility under the EMA⁵⁶ are not strong and respectable enough to bring the offenders to prison as compared to the other two laws mentioned above.⁵⁷ Meanwhile there are also other environmental violations that have never been brought to court, such as leak of a three-ton tank of monosodium glutamate of “Ajinomoto” which created a tremendous impact on the environment in 1998. In this case there was neither law enforcement nor an environmental recovery. The entire group of villagers was forcibly removed and their land compulsorily purchased. Then, in 2001 there was an oil and gas leak from the plant operated by Devon Canada and Petrochina in Suko district, Tuban East Java. The hydro sulphide content was quite high, resulting in the hospitalisation of 26 farmers. The incident sparked rage among the village community who went to investigate resulting in 14 people being shot by the Bojonegoro police. In 2003, an explosion at Petrowidada, an oil and gas company, razed several buildings and polluted a nearby river. Only two were sentenced, a security guard (*satpam*) and a technical officer. Similarly with PT. Lapindo, in 2006, the displacement of 50,000 people was seen as

a minor accident and not a corporate crime.⁵⁸

Many factors hamper law enforcement in Indonesia. As a developing country Indonesia has less stringent environmental standards than industrialized countries.⁵⁹ It is more profitable for investors since Indonesia does not require compliance to strict environmental standards. Investment regulations which provide incentives like tax holiday or grace period, BOT (Build, Operate and Transfer) and other facilities etc., are open for negotiation and would certainly attract many investors to Indonesia. Economic calculations can easily compute the financial rewards of non-compliance to current environmental laws and the administrators can easily be bribed to smoothen the bureaucratic chain and facilitate escape from penalties. The supremacy of law will seriously be in jeopardy if the administrators continued to treat industry as paramount and environmental degradation and pollution as the price the locals have to pay.⁶⁰

IS CORPORATE ENVIRONMENTAL CRIME A CRIME AGAINST HUMANITY?

Discussing environmental crimes from the human rights' perspective is something new in Indonesia, although the notion of incorporating environmental rights into human rights values has been acknowledged in The EMA 2009 No. 32 and The Law 1999 No. 39 on Human Rights. Political manifestation of the international community toward the human environment and development as mandated by The

Stockholm Declaration 1972 on Human Environment⁶¹ and The Rio Declaration on Environment and Development⁶² has been implemented into regional⁶³ and national laws. Among the 55 countries,⁶⁴ Indonesia has adopted environmental rights into her Environmental and Human Rights Laws⁶⁵ and also in the Second Amendment of The Constitution 1945. Thus, the notion of a good and healthy environment is constitutional rights and legal rights, respectively, which the State has prioritised to secure and protect their citizens. Placing environmental human rights values into a national constitution is a strong indicator of national *opiniojuris* and represents the highest level of national law operating as a *lexsuprema*.⁶⁶

As stated above, in Indonesia the right to a good and healthy environment has been guaranteed under the EMA 1982 No. 4 and EMA 1997 No. 23. However, this legal right has no further explanation either in the text or in the elucidation of the provision. It was just recently after the Reformation in 1998 that environmental rights was integrated into human rights law, such as point (a) of the Consideration of The EMA 2009 No. 32 which was implemented into Article 3 where the objectives of environmental management is, *inter alia*, to guarantee the fulfilment of the protection of rights towards the environment as a part of human rights. The environmental human rights in Article 9(3) of The Law No. 39 of 1999 on Human Rights⁶⁷ stated that "the right to a good and health environment is part of human rights, especially the right to life". Thus, in legal terms, a violation

to environmental rights is also a violation to human rights⁶⁸ and the offender may taken to Human Rights Court. Regrettably, environmental human rights violation does not come within the purview of the Human Rights Court as it only prosecutes gross human rights violation including genocide and crime against humanity.⁶⁹ This situation is similar to the European Human Rights Court prior to The Stockholm Declaration 1972. Many environmental cases submitted to this Court were rejected.⁷⁰ After the Stockholm Declaration, the Commission realized that there was correlation between environmental rights violation with human rights, especially the right to life.⁷¹ Human beings cannot live in a polluted environment and human survival depends on the quality of the environment.⁷²

Integrating environmental rights into human rights values is important, as Kesentini⁷³ declares in her report that "... human rights and the environment... [are] equally important to establish the legal framework for pursuing what have become the essential demands of this century, in order to take up the legitimate concerns of our generation, to preserve the interests of future generations and mutually to agree upon the components of a right to a healthy and flourishing environment." Mohammed Sahnoun⁷⁴ has acknowledged in his report about the linkage between human rights matters and the environment by fostering global awareness of complex, serious and multidimensional nature of environmental problems and attention is being focused more and more on environmental deterioration.

Other scholars, like Hill, Wolfson and Targ⁷⁵ and Appattu⁷⁶ opined that "marrying" environmental value to human rights is a slow emergence of the idea that humans have a basic right to a healthy environment. It will achieve a higher degree of relevance because the environment is everyone's backyard.⁷⁷ No one can escape the human consequence of environmental degradation and human society cannot function independently of the natural environment.⁷⁸ Other scholars, for instance Ruppel⁷⁹ reviewed environmental problems from the angle of the third-generation of human rights or solidarity rights and there is a close relationship between human rights violation to the impairment of environment.⁸⁰ George tta⁸¹ claimed that sustainable development could not be realized if the implementation of such development programs always impairs environmental rights. Chen and Dong⁸² discussed environmental rights from the perspective of development without impairing the environment called "eco-development" and concluded that environmental rights might become a safeguard and defend human rights and ultimately facilitate producing better conditions of life on earth by stretching and expanding the theory of traditional human rights.

A dilemmatic problem in the implementation of environmental human rights into the national law of developing countries is frequently the question of sacrificing the environment and human rights to overcome economic backwardness. The international community has responded

this trade-off with the third generation of human right which includes amongst others a healthy environment and right to development.⁸³ Regrettably, the developing countries respond to this by paying less attention to environmental standards than industrialized countries. Strict environmental laws are not often enforced in developing countries like Mexico, Brazil, the Philippines and Indonesia who have a long-standing reputation for being 'soft' in regulating environmental issues.⁸⁴ Many⁸⁵ argue that the real problem originates from the lack of motivation of administrators to enforce environmental law. In reality, in Indonesia many issues are problematic and interrelated; beginning from the ambiguous legal text formulated in the statutes and its multi-interpretation, lax attitude of legal enforcers, lack of apparatuses for law enforcement to the legal culture of the society.⁸⁶ They all form a tangled thread that need to be cut for a way out.

CONCLUSION

The environmental criminal provisions stipulated in The Indonesian Environmental Management Act (EMAs) cannot fully be implemented to punish the corporate whose activities have created pollution and environmental degradation. Many factors hamper law enforcement. As a developing country Indonesia has less stringent environmental standards than industrialized countries. Consequently, it is more profitable business making since administrators are not often forced to comply with the strict environmental standards.

The supremacy of law is in a quandary if the administrators continue to treat the industry as paramount and environmental degradation and pollution as the price the people of Indonesia have to pay.

Corporate environmental crimes should be viewed as human rights violation under the right to life. By extending the purview of the Human Rights Court to include environmental pollution and environmental degradation as an element of human rights, not only can this matter be addressed, it can also inculcate a healthier corporate attitude towards the environment and the citizens of earth.

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ENDNOTES

¹“PT” is the abbreviation of *Perseroan Terbatas* is legal person under Indonesian law which is equivalent to *Sdn.Bhd* in Malaysian legal system.

²There is no precise number as to how much land had been flooded but estimation shows from approximately 360 hectares to approximately 600 hectares. The mudflow is still continuing, and in 2008 at least 10 km square kilometers had been covered by the mud (See: Radar Sidoarjo on <http://mudflow-sidoarjo.110mb.com/index.htm>, March 12 2007in: Friends of the Earth International, “A Background paper prepared for Friends of the Earth International and Friends of the Earth Europe”, June 15, 2007.

³Mud Volcano In Java May Continue To Erupt For Months And Possibly Years. (2007)*Science Daily*, Jan 24.In abackground paper prepared for Friends of the Earth International and Friends of the Earth

- Europe, *Friends of the Earth International*, June 15, 2007.
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- ⁵ ANTV News, June 8, 2006; The *Surabaya Pagi* Post (June 7, 2006); The *Kompas* Post (June 8, 2006); Geo-science Laboratory in *Kompas* June 8, 2006; *Opini Metropolis Jawa Pos* (2 June, 2006); *Kepala Pusat Studi Bencana, Kompas* (8 June, 2006); *Surya Post* (10 June 2006).
- ⁶ The last remedy was to build some sort of containment "basin", looks like a "pond" where the mud expected to flow. At first this efforts seems fruited success. Because of the volume of mud getting increased everyday, then the container leaked aspecially during the raining season (*The Jakarta Post*, March 02 2007, March 19, 2007, <http://mudflow-sidoarjo>).
- ⁷ www.walhi.or.id
- ⁸ No. 284/Pdt.G/2007/PN.Jak. Sel.
- ⁹ Those investment laws are: The Law 1967 No. 1 on Foreign Investment (State Gazette of the State of The Republic of Indonesia 1967 No. 1, Additional to State Gazette No. 2828); The 1970 No. 11 on The Revision and Additional to The Law 1967 No. 1 on Foreign Investment (State Gazette of The State of The Republic of Indonesia 1970 No. 46, Additional to State Gazette No. 2943) and The Law No. 6 on Domestic Investment (State Gazette of The State of The Republic of Indonesia 1968 No. 33, Additional to The State Gazette No. 2853; The Law 1970 No. 12 on The Revision and Additional to The Law 1968 No. 6 on Domestic Investment (State Gazette of The State of The Republic of Indonesia 1970 No. 47, Additional to State Gazette of the State of the Republic of Indonesia No. 2944). The present investment law is The Law 2007 No. 27 on Investment (The State Gazette of The State of the Republic of Indonesia year 2007 No. 67).
- ¹⁰ Those five priorities development are: to develop a more democratic political system in the context of Indonesia's unitary state of; to realize the supremacy of law and clean government; to accelerate economic recovery and strengthen the found-ation of sustainable development and justice; to develop people's welfare and cultural resilience, and to improve regional development.
- ¹¹ The concept of good governance introduced by the donor countries in their aids for recipient country in 1980-1990s and is difficult to implement since high levels of poverty and weak governance making selectivity of development program priority difficult to implement (Ved P. Nanda, "The "Good Governance" Concept Revisited", University of Denver Sturm College of Law (<http://ann.sagepub.com/content/603/1/269.short>) (29 June 2012).
- ¹² "Environmental Crimes Go Unpunished in Bio-diverse Countries," Report Says, (2004) 42 (244)*Clean Water Rep.* In Tracy M. Schmidt, "Transnational Corporate Responsibility for International Environmental and Human Rights Violations: Will the United Nations "Norms" Provide the Required Means?" 36 *Cal. W. Int'l L.J.* 217.
- ¹³ National Coordination Meeting on Environmental Law Enforcement 2011 arranged at Mercure Hotel 3 Oct. 2011/RakornasPenegakanHukumLingkungan 2011((29 June 2012))
- ¹⁴ National Coordination Meeting on Environmental Law Enforcement 2011 arranged at Mercure Hotel 3 Oct. 2011/RakornasPenegakanHukumLingkungan 2011((29 June 2012)).
- ¹⁵ Basel Convention on the Control of Transboundary Movements of Hazardous Waste and Their Disposal. (Available at www.basel.int/.../Basel%20Convention/.../BaselConvention)
- ¹⁶ The United Nations Declaration on Human Environment 1972 (A/CONF. 48/14/Rev.1).

- ¹⁷ The Nagoya Protocol on Access to Genetic Resources and the Fair and Equitable Sharing of Benefits Arising From Their Utilization to the Convention on Biological Diversity. (Available at : www.cbd.int/abs/doc/protocol/nagoya-protocol-en.pdf)
- ¹⁸ <http://wwwnew.menlh.go.id> (Retrieved on 29 June 2012)
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- ²⁰ Muna djat Danusaputro, (1981). *Hukum Lingkungan Buku I: U M U M*, Penerbit Binacipta Bandung.
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- ²² The verdict No. 294/Pdt.G/2007/PN.Jak. Sel. (27th December, 2007).
- ²³ The Appeal Court accepted the appeal reported in No. 383/PDT/2008/PT.DKT and this strengthened the verdict made by the District Court of South Jakarta No. 284/Pdt.G/2007/PN.Jak.Sel, dated 27 December 2007. This means that the volcano mudflow in Sidoarjo was regarded as a natural disaster. There are two more legal recourse left for Walhi may use nowie. submitting the case to the Supreme Court and the legal review (Peninjauan Kembali/PK) of the Court's verdict.
- ²⁴ ANTV News, June 8, 2006; Executive Director of WALHI East Java as quoted by the Morning Surabaya Post, June 7, 2006; The Kompas Daily, June 8, 2006; The Opini Metropolis JawaPos, June 2, 2006; Kepala Pusat Studi Bencana, ITS, June 8, 2006; Surya Post, June 10, 2006; Ikatan Ahli Geologi Indonesia).
- ²⁵ The Volcano mudflow occurred during the application of The EMA 1997 No. 23 on Environmental Management before the promulgation of The EMA 2009 No. 32 on the Protection and the Management of the Environment.
- ²⁶ Uncertified translation.
- ²⁷ E. G. Cooch, D. B. Lank, R. F. Rockwell and F. Cooke, (1991). Long-Term Decline in Body Size in a Snow Goose Population: Evidence of environmental degradation?. *Journal of Animal Ecology*, 60, 483-496.
- ²⁸ T. D. William, E. G. Cooch, R.L. Jefferies, and F. Cooke, (1993). Environmental Degradation, food limitation, and reproductive output: Juvenile survival in lesser snow geese. *Journal of Animal Ecology*, 62, 766-777.
- ²⁹ The Buyat bay is small bay located on the south coast of Minahasa Peninsula island of Indonesia. PT. Newmont *Minahasa Raya*, the subsidiary company of Newmont Mining Corporation had used the bay as the tailing (mine waste) dumping ground for its gold mining activities from 1996. In 2004 local people in the area complained for several unusual health problems which further suspected Newmont's for breaching the mining waste regulation to have contaminated the area with hazardous materials.
- ³⁰ Walhi Lampung, 22th August 2000.
- ³¹ Komar Kantaatmadja, *Gantirugi Internasional Pencemaran Minyak di Laut*, Alumni Publisher, Bandung 1981, p. 58.
- ³² Komar Kantaatmadja, Alumni Publisher, Bandung 1981, p. 58.
- ³³ Robert L. Rabin, (1979) *Perspective on Tort Law*, Boston, p. 1.
- ³⁴ Komar Kantaatmadja, Alumni Publisher, 1982., 57-67.
- ³⁵ The State Gazette of the Republic of Indonesia 1982 No. 12.
- ³⁶ The State Gazette of the Republic of Indonesia 1997 No. 68, State Gazettes Additional No. 3699.
- ³⁷ The State Gazette of the Republic of Indonesia 2009 No. 140.

- ³⁸ KomarKantaatmadja, Alumni Publisher, Bandung 1981.
- ³⁹ 31 Torts and Ins. L.J. 73-88 (1995)
- ⁴⁰ *Textile technology digest*, vol. 28., 194.
- ⁴¹ Edmund Hatch Bennett, Russell Gray, Henry Walton Swift, Franklin Fiske Heard, Francis Lewis Wellman, Massachusetts. Supreme Judicial Court, *Massachusetts digest*: a digest of the reported decisions of the Supreme Judicial Court of the Commonwealth of Massachusetts from 1804 to 1879, with references to earlier cases, Volume 1: 48.
- ⁴² Charles Szyppzak, 211 *Understanding Law for Public Administration*, Jones and Bartlett Publisher, 182.
- ⁴³ Many American scholars saw the decision in *Rylands* was a poor one. It was not considered as trespass, since the damage is not direct, and it was not a nuisance either, since there was no continuous action (Bohlen, Francis H., "The Rule in *Rylands v. Fletcher*. Part I". (1911) 59 (5) *University of Pennsylvania Law Review and American Law Register*.
- ⁴⁴ Art 184 of Penal Proceeding Code (*Kitab Undang-Undang Hukum Acara Pidana*): Legal evidence may consist of statements of witnesses, expert testimony, letters, instructions and a description of the defendant. In the elucidation of Art 184 no information whether news paper clippings, TV news, internet sources may regarded as legal evidence under the Indonesian Penal Proceeding Code.
- ⁴⁵ 146 *University of Pennsylvania Law Review* 173 (1997)
- ⁴⁶ Canadian Environmental Protection Act (CEPA)
- ⁴⁷ National Environmental Protection Act (NEPA)
- ⁴⁸ Environmental Management Act, Text of the Environmental Management Act dated 1 May 2004 (Legislation Netherlands in: www.lexadin.nl).
- ⁴⁹ Environmental Code (Act No. 2002-276 of 27 February 2002) (www.legifrance.gouv.fr).
- ⁵⁰ The 1970 Law No. 142 on the Punishment of Crimes related to the Environmental Pollution which Adversely Affect the Health of Persons.
- ⁵¹ V. Cheng Yang, (1995) 44 "Punishing for Environmental Protection?-Enforcement Issues in China", *Int'l & Comp. L.Q.*, 671-682
- ⁵² Raymond Peternoster and Sally S. Simpson, "A Rational Choice Theory of Corporate Crime" in: Ronald V. Clarke and Marcus Felson (Eds), *Routine Activity and Rational Choice: Advance in Criminology Theory*, 5, 37.
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- ⁵⁵ The Law 210 No. 8 on The Prevention of and Combating Crimes for Money Laundry (The State Gazette of the Republic of Indonesia 2010 No. 122).
- ⁵⁶ For instance: Art 22 (The EMA 1982 No. 4); Art 45 and Art 46 (The EMA 1997 No. 23) and Art 97 (The EMA 2009 No. 32).
- ⁵⁷ The Law 1999 No. 31 on the Corruption Eradication amended by The Law 2001 No. 20 on The Revision of Law No. 31 of 1999 on the Corruption Eradication (The State Gazette of the Republic of Indonesia 2001 No. 134)., and The Law 210 No. 8 on The Prevention of and Combating Crimes for Money Laundry (The State Gazette of the Republic of Indonesia 2010 No. 122).
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- ⁵⁹ PushkarMaitra, Environmental Regulation, International Trade, and Transboundary Pollution, *International Economic, Finance and Trade*, Vol II (available at: www.eolss.net/Sample- Chapters/C13/E1-23-06-03.pdf)

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- ⁶¹ A/CONF. 48/14/Rev. 1 (1972)
- ⁶² A/CONF.151/26 (Vol. I)
- ⁶³ Art. 16 (1) African Charter of Human and People's Rights adopted 27 June 1981, OAU Doc. CAB/LEG/67/3 rev. 5, 21 I.L.M. 58 (1982), entered into force 21 October 1986) (www.africa-union.org; Art. 11 of the 1989 San Salvador Protocol to the American Convention on Human Rights in the Area of Economic, Social and Cultural Rights; The Protocol came into force in 1999 (P.R. Gandhi, *Blackstone's Statutes: International Human Rights Documents*, Oxford University Press, 2006).
- ⁶⁴ Art. 46 (Environment)(Belarusian Constitution, Adopted 1994) (); Chapter VI: Environment. Art. 225 (The 1988 Constitution of the Federative Republic of Brazil); Art.1 – The Constitutionalisation of the French Charter for the Environment: Constitutional and Environmental Implications”, (2008) 10 *Envtl.L. Rev.* 9; Art 37 (3) The Georgia Constitution, Adopted on 24 August 1995, and last amendment 27.12.06 states in Article 37 (3) (<http://www.parliament.ge>); Art 110 (b) of The Norwegian Constitution (<http://www.stortinget.no>); Art 72 (1) (2) (Healthy Living Environment) of The Slovenian Constitution adopted on 23 Dec. 1991 and amended on 14 July 1997, 25 July 2000, 7 March 2003, 15 June 2004, 20 June 2006. (); Sec 41.-(The 1994 Argentina Constitution) ([http://www.hrcr.org/chart/annotations &references/Argentina.html](http://www.hrcr.org/chart/annotations&references/Argentina.html)); Art 19 Para. 8.-(1980 Constitution of Chile); Art 50.Para. 2(Constitution of The Republic of Costa Rica, as amended by Article 1°, Law No. 7412, June 3, 1994.)(http://www.costaricalaw.com/constitutional_law/constitution_en.php); Art 27(Constitution of the Republic of Cuba, 1992) (http://www.cubanet.org/ref/dis/const_92_e.htm); Art 14. (Constitution of the Republic of Ecuador)(); Art 69 (Constitution of the Republic of El Salvador, 1983(as Amended to 2003) ()); Art 145(Constitution of the Republic of Honduras 1982 (Updated through the Decree 36 of May 4 2005) ()); Art. 60 (Nicaraguan Constitution of January 9 1987. (Retrieved: <http://janda.org/politxts/Major%20Democratic%20Documents/nicaragua.htm>) and Art. 7 (1) (Paraguay Constitution, adopted 20 June 1992) (http://www.servat.unibe.ch/icl/pa00000_.html)
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- ⁶⁶ Ole W. Pedersen, *European Environmental Human Rights and Environmental Rights: A Long Time Coming?* (2008) 21 *Geo.Int'l Env'tl. L.Rev.* 73.
- ⁶⁷ State Gazette 1999 No.165.
- ⁶⁸ S. Giorgetta, “The right to a healthy environment, human rights and sustainable development” (2002) 2 *International Environmental Agreements: Politics, Law and Economic.* 173–194.
- ⁶⁹ Art 7 (The Law 2000 No. 26) classified that gross breaches of human rights may include genocide crime and crime against humanity. Furthermore Art 9 explains the criterion of genocide crime and Art 9 is about the criterion of crime against humanity (State Gazette 2000 No. 208).
- ⁷⁰ Daniel García San José, 2005 *Environmental Protection and The European Convention on Human Rights*, Council of Europe Publishing, 7.
- ⁷¹ Daniel García San José, 7.
- ⁷² S. Sensi, ‘Human Rights and the Environment: The Perspective of the Human Rights Bodies.’ In UN Environment Programme, *Human Rights and the Environment*, Proceedings of a Geneva Environmental Network Roundtable (UNEP, 2004), at 6, (available at(<http://www.environmenthouse.ch/docspublications/reports/roundtables/Human%20Rights%20Env%20Report.Pdf>).

- ⁷³ See: FatmaZohraKesetini's report entitled "Review of Further Developments in the Fields of Human Rights and the Environment" submitted to the Forty-sixth session of the Commission on Human Rights, Sub-Commission on Prevention of Discrimination and Protection of Minorities (between year 1992 and 2001).
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- ⁸⁰ Rights in this category include self-determination, the right to peace, the right to ahealthy environment, and the right to inter-generational equity which include the right to development (Oliver C. Ruppel, 'Third-generation of human rights and the protection of the environment in Namibia' (<http://scholar.google.com.my/scholar>)).
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- ⁸³ The division of human rights generation was proposed by KarelVassak at the International Institute of Human Rights in Strasburg France in 1977. Notwithstanding the "Third Generation of Human rights" remains largely unofficial and covers extremely broad spectrum of rights.
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- ⁸⁵ Soekamto Soerjono, *Faktor-Faktor Yang Mempengaruhi Penegakan Hukum*, Penerbit CV. Rajawali, Jakarta, 1983.
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Mechanism and Government Initiatives Promoting Innovation and Commercialization of University Invention

**Wan Mohd Hirwani Wan Hussain^{1,2*}, Mohd Nizam Ab Rahman²,
Zinatul Ashiqin Zainol³ and Noor InayahYaakub⁴**

¹Graduate School of Business (GSB), Universiti Kebangsaan Malaysia, 43600 Bangi, Selangor, Malaysia

²Department of Mechanical and Materials Engineering, Faculty of Engineering and Built Environment, Universiti Kebangsaan Malaysia, 43600 Bangi, Selangor, Malaysia

³Faculty of Law, Universiti Kebangsaan Malaysia, 43600 Bangi, Selangor, Malaysia

⁴School of Management, Faculty of Economics and Management, Universiti Kebangsaan Malaysia, 43600 Bangi, Selangor, Malaysia

ABSTRACT

This paper reviews the mechanisms and the Malaysian government initiatives to support commercialization and technology transfer from universities. To be more precise, this study attempts to demarcate the role of the Malaysian government by examining the initiatives for promoting commercialization of university research. Commercialization is still new in the Malaysian environment and undoubtedly requires a lot of support from the government to transform the Malaysian universities as centres for generating revenue. Commercialization has a positive impact on economic development and facilitates the exchange of knowledge with industries as well as the entrepreneurs. The main objective of this paper is to study whether the Malaysian government is aware of and supports this process by diverting resources from research to commercialization. The policy implications and suggestions for further research are outlined in the conclusion to this paper.

Keywords: Government initiatives, technology transfer, commercialization of Malaysian university research, promoting university inventions

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E-mail addresses:

wmhwh@ukm.my (Wan Mohd Hirwani Wan Hussain),

mnizam@vlsi.eng.ukm.my (Mohd Nizam Ab Rahman),

shiqin@ukm.my (Zinatul Ashiqin Zainol),

inayah@ukm.my (Noor InayahYaakub)

* Corresponding author

INTRODUCTION

Most of us will remember the significant date, 12 December 1980, when the U.S senate passed the University and Small Business Patent Procedures Act, also known as the Bayh Dole Act 1980. This Act removed the university rules to “say their

right” concerning inventions created from federal funding. It had a dramatic impact in that the Act transformed the organizational structure of universities. Many earlier scholars were concerned about the critical role that the Act played in shifting the universities from being a manufacturing and producing base into a technology base (Shane 2004; Miller 2005; Kenny & Patton 2008; Aldridge & Audretsch 2011).

The enactment of Bayh Dole Act 1980 was an essential landmark for universities in the U.S to incorporate commercialization and technology transfer (technology diffusion) into their research functions. This led to a rapid rise in commercial knowledge transfer from university to industry, through mechanisms such as, partnership, licensing agreement and university start-ups. This specific Act removed the barriers the universities had in interacting with the industry. The United States has become very advanced in technology transfer and commercialization because of this Act, which has been in effect for more than 30 years. Malaysia could duplicate this Act and apply similar principles, just as other countries such as Germany, Japan, Canada, India and Singapore have done. The Bayh Dole Act 1980 not only removed the limitations of university interactions with the industry but also enabled the university to become an industry partner as the industry could utilise the expertise of the university.

In the context of intellectual property ownership in Malaysia, there are acts that promote the commercialization of university research, namely the Patents Act 1983,

Copyright Act 1987 and Industrial Designs Act 1996. These Acts provide protection for the inventions from research conducted in the universities, like the Bayh Dole Act 1980. This reflects the recognition of the contributions of inventors and their creativity.

According to Freeman and Hagedoorn (1994), science has become an alternative engine of economic growth, in addition to the classic triumvirate of land, labor and capital. The Silicon Valley and Route 128 in the U.S have often been mentioned as the most productive areas of high-tech ventures, where the abundant academic research capacity contributes towards improvements in the industrial system (Mowery & Ziedonis 2002; Shane 2002). A greater focus on exploiting research findings is evident from the managerial changes between academics with respect to university-industry collaborative projects (Van Looy *et al.*, 2006). Given a knowledge-based economy, academic research institutions are no longer just venues for education, research and public services. They play a very important role in regional economic development and recruitment creation (Chrisman *et al.*, 1995; Etzkowitz 2003).

Commercialization of university research in Malaysia is still new. Most of the literature so far has focussed on the developed economies (Wan Mohd Hirwani *et al.*, 2011; Ismail *et al.*, 2011). The developing countries, until quite recently, had attached little importance to the role of universities as a source of knowledge and innovation for firms (Hershberg *et al.*, 2007).

Policymakers increasingly view universities as engines of economic progress, via the commercialization of intellectual property through technology transfer (Siegel & Phan, 2005). Numerous research universities have now formulated formal mission statements on the role and importance of technology transfer (Markman *et al.*, 2005). The main commercial components of university technology transfer are licensing agreements, research joint ventures, and university-based start-ups.

Policy makers are initiating these reforms both through changes in the academic system and instruments pertaining to research finance (Benner & Sorlin, 2007; Slaughter & Leslie, 1997) and also by setting up physical structures to assist such activities (Mian, 1997; Guston, 1999; Hellstrom & Jacob, 2003; Kenny & Patton 2008; Alice, 2011). Regulations are made both top down through the government as well as its agencies, when other initiatives are bottom-up, coming from individuals and also entities within the universities (Goldfarb & Henrekson, 2002).

There are several research gaps found based on previous research investigations. First, there is still a paucity of researches undertaken concerning the commercialization of Malaysian university research (Yusof *et al.*, 2009; Wan Mohd Hirwani *et al.*, 2011; Ismail *et al.*, 2011). It is true that commercialization of university research is still in its infancy stage in Malaysia as compared to other countries. However the Malaysian government has

begun to emphasize that universities in Malaysia should focus on transforming their research and innovations into products that generate additional income for the university. Secondly, earlier studies have mainly investigated academic research commercialization in the U.S., Europe, and Japan, and thus have not highlighted the implications for universities in the emerging economies (Anokhin & Wincent, 2012; Azagra-Caro, 2011; Rothaermel *et al.*, 2007). They only looked at the university generating spin-off/start-up companies to showcase their academic entrepreneurship (Shane, 2004b) and did not dwell on other mechanisms such as licensing and patenting. For Malaysia, it is very important to establish a strong foundation for commercialization. Finally Wan Mohd Hirwani *et al.* (2011) and Ismail *et al.* (2012) argued about the challenges to commercialization from agricultural inventions. However, they did not focus on other types of inventions available in Malaysia. In order to bridge the mentioned gaps in the literature, this study analyses and focuses on the mechanisms that the government uses to promote the commercialization of university research in Malaysia. It verifies the relationship between university and government in supporting commercialization and technology transfer. This will provide a better understanding of the commercialization process and assist the Malaysian government in drafting the new mission for Research Universities by incorporating the commercialization element as their additional task.

COMMERCIALIZATION OF MALAYSIAN UNIVERSITY RESEARCH

Commercialization of university research in Malaysia, when compared to countries such as United States and United Kingdom, is still new and at its infancy stage (Wan Mohd Hirwani *et al.*, 2011). There are five research universities in Malaysia and they receive funding from the government to conduct research every year. The five research universities are:

- Universiti Sains Malaysia (USM),
- Universiti Kebangsaan Malaysia (UKM),
- Universiti Malaya (UM),
- Universiti Putra Malaysia (UPM),
- Universiti Teknologi Malaysia (UTM).

Through commercialization, these research universities help recover the costs incurred by the government and at the same time contribute towards the economic growth of Malaysia. Universities in Malaysia are currently transforming their mission and vision to align with the commercialization objective (Wan Mohd Hirwani *et al.*, 2011), given that university-based research has thus far been severely neglected. Since 2008, the Malaysian Government has been promoting academic research and commercialization, especially by research institutions and research centres by providing more funding. The phrase “university-industry knowledge transfer” is used to depict a wide range of relationships at different levels, as well as the many activities directed towards

exchange of knowledge and technology, involving both the universities and firms. This includes the setting up of start-up firms interested in the commercial exploitation of university inventions, collaborative research among firms and academic institutions, contract research and academic consulting commissioned by industry, the development and commercialization of intellectual property rights on the part of universities, and other activities, such as co-operation in graduate education, advanced training for enterprise staff, and exchange of researchers between firms and universities (Jacobsson *et al.*, 2013). In the perspective of universities, these are often referred to as the “third stream” or “third mission”, terms that emphasize the role of universities as promoters of economic development, besides their two traditional missions of teaching and research (Lawton-Smith 2007).

There are several gaps that encumber the commercialization of university research. A study by Farsi *et al.* (2011) showed that there are three constraints that hinder the process of commercialization of university research. These are a) lack of intellectual property rights, b) the lack of funding sources to develop more new technologies and c) limited interaction with the industry. Furthermore, a research by Leisyte (2011) and Jacobsson *et al.*, (2013) pointed out the constraints in terms of policy covering the mission and activities of universities in driving the commercialization of university research. Constraints in terms of incentives and rewards have been raised by Rasmussen (2006); Alice (2011); and Perkmann *et al.*,

(2013). The study by Siegel *et al.*, (2003) explained that incentives and rewards should not only be in the form of money, but could be extended in the form of stock holdings to the university researchers. However, the study by O'Shea *et al.*, (2005) pointed out that incentives and rewards are important not only for the researchers but also for the Office of Technology Transfer who are managing the technology.

Malaysia hopes to gain leverage from the universities to promote economic development, in its endeavour to become a high nation economy. If this initiative succeeds, it would contribute towards sustaining the economy, increase productivity, create international brand names and diversify from labour-intensive assembly operations (Yusuf 2008). The transformation of the universities in Malaysia towards greater interaction and commercialization with the industry started in the 1990s and gained momentum during the economic crisis in 2008. With the new policies in place, all universities in Malaysia have begun to interact, communicate and create relationships with the industry to assist in the commercialization process.

There are varied definitions for an "academic entrepreneur". It has often been defined as a person involved in establishing start-up companies relating to their technology (Lockett *et al.*, 2005; Shane, 2004; Stuart & Ding, 2006). According to the explanation by Etzkowitz and Leydesdorff (2000), Etzkowitz (2003), the transformation of universities are affected by the following:

1. Teaching: this was the traditional role of the university until the late 19th century.
2. Teaching and research: these are new roles added to the mission of the university as the centre for creating new knowledge.
3. Teaching, research and direct contribution to social and economic development: this is what is known as the Third Mission of the university. This is an important element for a sustainable university in the 20th century.

The study by Shane (2004) mentioned that the process of creating academic entrepreneurs in universities is difficult and it takes time. This was reaffirmed by Anokhin & Frishammar (2011) who stated that the process of transformation of university researchers into entrepreneurs is dependent on the experience acquired by the researchers as well as the extent of the interactions with the industry. University researchers are more likely to be involved in commercialization if they have a close relationship and contact with the industry. The research by Alice (2011) mentioned that academic entrepreneurs do not have the expertise in convincing the industry to invest in product innovation research. This is because the expertise to interact and identify opportunities is different and is acquired through experience (Boardman & Ponomariov, 2009). In addition, another constraint is the attitude of the researchers who conduct non-profit oriented research (Arvanitis *et al.*, 2011,) and are only concerned with purely the academic value,

as noted by D'Este & Perkmann (2011). Siegel *et al.* (2003) suggested that one of the ways to address this constraint is to build an industrial network with support from the university. Researchers should also move and think like an entrepreneur to ensure the successful commercialization of university research. The university must also support the academic entrepreneur by providing more research grants and incentive rewards that would enhance the commercialization process.

Over the years, universities have been pressured to transform from being ivory towers to manufacturing enterprises (Etzkowitz 1998, Etzkowitz 2003; Powers 2005). The crucial problem in linking university scientists with the industry is the tacit nature of their knowledge. The role of scientists is to enhance their research that is relevant to the private sector and effectively transfer their knowledge and findings (Dietz & Bozeman 2005). Scientists are evaluated based on the knowledge that they have generated. Hence, the research findings are limited to being published in journals or being patented (Agrawal & Henderson 2002). This logic is implicit in life cycle theories that maintain that junior researchers focus on building reputation in academia while later in their careers they capitalize on their expertise by reaching out to industry (Colombo & Piva 2012; Semrau & Werner 2012).

MECHANISM BY GOVERNMENT

In order to sustain and enhance the commercialization process and technology

transfer, the government has introduced several mechanisms. The main focus of the Malaysian government currently is to build an innovative and creative society. The Malaysian National Innovation Center (MyNIC) has been set up and it is expected to boost the innovative spirit among Malaysians. The purpose of this center is to enhance their knowledge about innovations which are vital for growth and development. The establishment of a National Innovation Centre (MyNIC) network of Centres of Excellence and Innovation (i-Coe), the Government has indicated that it aims to internalise innovation as a practice among the people.

The Malaysian Prime Minister Datuk Seri Najib Tun Razak, at a press conference after chairing a meeting of the National Innovation Council at the Putra World Trade Centre (PWTC), said that:

“Innovation is to be done that is comprehensive in the sense that it is not limited to science and technology.....It involves comprehensive innovations in areas covering governance, social, rural, village, industrial corporate, education, health care, transportation, social safety nets and branding”

During the same function, the Prime Minister's also mentioned that Quality Day was changed to National Innovation Day. This showed that Malaysia is serious in embedding innovation and science into

the society and creating awareness among the people. The Malaysian government has already engaged to become an intermediary between the universities and the industries to promote commercialization activities.

Establish Technology Transfer Office (TTO)

It is notable that now almost every university has established the Technology Transfer Office (TTO) to accelerate the technology transfers process. The TTO would be the best platform to assist researchers to engage with the industry. Many scholars have recognised the importance of having a TTO to promote commercialization and technology transfer (Arvanitis *et al.*, 2011; Ismail *et al.*, 2012; Perkmann & Salter, 2012). TTOs play an important role in managing the long process of knowledge transfer given their personnel skills and governance structure (O'Shea *et al.*, 2008, Swamidass & Vulasa, 2008; Woolgar, 2007). They often are the first place where invention disclosure occurs and the potential for commercialization is assessed. In addition, many TTOs provide seed money for further work on inventions, assistance in business planning, introduction to venture capitalists, assistance in recruiting start up teams, and providing incubator space (Alice 2011). However, there is an emerging consensus among researchers that most TTOs lack the necessary resources and competencies (Swamidass & Vulasa 2008). Besides problems associated with skill and budget shortages, TTO staff are pressured for time. As a result, they might succeed in patenting inventions but may have limited

resources for marketing them to potential licensees and investors (Swamidass & Vulasa, 2008; Wright *et al.*, 2008b).

The discoveries and innovations these researchers produce, later become the technologies which TTOs seek to commercialize. Technology Transfer Offices become aware of new discoveries and innovations either because the faculty are actively interested in commercialization or because the aforementioned Bayh-Dole Act has resulted in university policies that often require research faculty to disclose newly-discovered innovations to the TTO. In some cases, the research faculty are not particularly motivated to disclose their innovations, and if university policy does not require disclosure the technology is very likely to remain 'on the shelf' (Ahrweiler *et al.*, 2011). Once an innovation is disclosed, TTO staff members would commence an extensive review process to determine whether the innovation is worth the time, effort, and expense required to secure intellectual property (IP) protection. The outcome of this review process is either rejection or the submission of a formal application for intellectual property protection (Carlsson & Fridh, 2002). A rejection by the TTO does not necessarily mean that the innovation would never be commercialized; rather, the IP typically reverts back to the researcher and it becomes his or her responsibility to individually pursue IP protection or engage in commercialization. Since they must individually bear the costs and risks of pursuing IP protection and

commercialization activities at this juncture, the faculty members are usually quite reluctant to proceed on their own (O’Shea *et al.*, 2008).

Research Grant

There are many research grants that have been provided by the Malaysian government for research universities (Hock *et al.*, 2012). These research grants could be used to expand their research work from basic to applied research and also for developing prototypes to attract venture capital. To maximize economic growth potentials, academic institutions must seek new opportunities to reduce lag time in acquiring new knowledge (Ismail *et al.*, 2012). The development of optimal research practices and procedures at universities would not only facilitate the licensing of new technologies to commence start-ups but could also lead to the commercialization of new applications that improve living conditions and promote job creation.

Firms established from the research endeavours of our universities have

introduced important new drugs and devices to the market. Some have provided the society an access to new markets which were created as outcomes of new corporations such as Netscape and Google. Others have served as a catalyst for the semiconductor industry, for firms such as Cadence and Synoposes, and the clean-tech industry, for firms such as A123 Systems. Many of these enterprises are categorized as high growth firms and have become integral to economic development, generating a large number of new jobs each year.

Table 1 shows the type and number of research grants provided by the Malaysian government to support the innovation, technology and commercialization process. The total research funding amounts to more than USD 200 million and this is one of the measures under the Government Transformation Plan (GTP) initiated by the fifth Prime Minister of Malaysia. More than 1000 research findings have been identified as being eligible to enter the commercialization stage and these research grants would be used to fund

TABLE 1
List of Research Grants Provided by the Malaysian Government

Research Fund	Date of Approval	Amount
FRGS (Fundamental Research Grant Scheme)	2006	USD 98,635,538.70
ERGS (Exploratory Research Grant Scheme)	2011	USD 98,635,538.70
PRGS (Prototype Research Grant Scheme)		
LRGS (Long Term Research Grant Scheme)		
Incentive Research	2011	USD 13,480,190.29
Special Fund From Ministry of Higher Education	2011	USD 32,878,512.90
TOTAL		USD 243,629,780.60

Source: Ministry of Higher Education Malaysia (www.mohe.gov.my/)

that process. The Malaysian Government recognizes the importance of innovation in the development of the country and it is noteworthy that a similar approach is used by the universities in the United States and other European countries.

Rewards and Incentives

Establishing institutional structures and providing incentives to promote commercialization of research findings could bring benefits to a university as a whole. Industrial linkages offer additional incentives to attract and retain talented faculty members and students. Despite the time involved, entrepreneurial faculty members tend to have higher scholarly productivity than others. They often reinvest “profits” in lab equipment and engage additional postdoctoral researchers, enabling them to conduct further research and experiments (Blumenthal, 2003; Jackson & Audretsch, 2004; Poyago-Theotoky *et al.*, 2002). Normally, a firm is always willing to pay for a more valuable innovation, and so the TTO has a vested interest in declaring that it has a path-breaking discovery. If the university is better informed than the firm on the value of the innovation, it could use royalties to denote the value of the innovation (Macho-Stadler *et al.* 2007). Indeed, under fixed payment arrangements, the TTO receives its money upfront, independently of the firm's revenues, while under a variable payment agreement, the amount is dependent upon the firm's output. Hence, royalties link the TTO's profits to the value of the innovation, and thus, their

inclusion in the payments would signify the high-quality of the innovation.

However, there are risks involved. The traditional commitment of a university to the integrity of scientific research could come into conflict with the new financial interests of the profit oriented companies. The threat to integrity could emerge through various mechanisms of support for research from the industry. This could lead some faculty members to wittingly or unwittingly bias their findings in the firms' favour, and the relationships could hamper the openness of communication within the research environment (Blumenthal, 2003; Gassol, 2007; Link & Scott, 2003; Poyago-Theotoky *et al.*, 2002). The risks could undermine the public's faith in the university research enterprise and public funding.

Research shows that incentives are important in terms of explaining variations in relative performance and has a positive relationship with commercialization (Debackere & Veugelers, 2005; Woolgar, 2007; Wright *et al.*, 2008a). Additional incentives are required to attract faculty participation in commercializing important inventions, including royalties and equity. Although the vast majority of agreements (in the U.S.) include royalty payments, contracts with equity have been shown to be Pareto superior to those with royalties (Jensen and Thursby 2001, Thursby and Thursby 2004). The distribution of royalty rates between inventors and the university also could influence the inclination of the faculty to exploit academic inventions. It is clear that allowing the faculty to

retain a higher share would lead to more invention disclosures (Tang *et al.*, 2012; Link and Siegel, 2007; Ponomariov, 2008). Spin-offs started by enterprising faculty as well as graduates license university IP to commercialize inventions. These ventures are often assisted by incubators, venture capital funds or equity financing (to cover up front costs of start-up firms), and business support systems established by the university. These policies, together with the commercial orientation of university research and its intellectual eminence, determine why some institutions generate more new spin-offs than others (Shane 2004). Another important constraint concerns how commercial pursuits are rewarded in the promotion process, as patenting and consulting do not receive as much merit as publishing and research activities (Renault, 2006, Wright *et al.*, 2008). Moreover, the attitude of many faculty members against commercial involvement, lack of research focus on urgent industry needs, unbalanced distribution of benefits, and inadequate IP protection are among some of the main obstacles of an academic spill over (Liu & Jiang 2001).

Other mechanisms

i. Technology Licensing Agreement

Technology licensing agreements have proven to be an effective mechanism for the commercialization of university-held innovations (Agrawal, 2006; Thursby & Thursby, 2007). Technology licensing agreements facilitate commercialization of university innovations by transferring

the innovation knowledge to an external party in return for a fixed fee or continuing royalty payments. From the perspective of the university, technology licenses are often preferred because they increase speed to market, allow for optimization of multi-partner relationships, and minimize financial risks (Kim *et al.*, 2012; Zhao, 2004). In the case of Malaysia, a country bound by regulations derived from the British system, licensing has drawbacks, such as the licensing approach where the university innovations are often not well developed, the licensing fees could be difficult to value a priori, and there is substantial variability in the degree of involvement research faculty members (Thursby & Thursby, 2005). Indeed, research indicates that only about half of university license agreements have resulted in successful commercialization (Agrawal, 2006). This must be acknowledged by the university and it should provide a feasible arrangement to facilitate engagement with the industry.

ii. University Spin-off

University spin-offs constitute the entrepreneurial route to commercializing public research. They are initiated either directly by the researcher (or laboratory) that made the discovery or by the university's TTO. A spin-off agreement involves the TTO and the researcher as well as one external financier, who are either a venture capitalist (VC) or a business angel (BA). VCs are "formal" early-stage investors who create funds that pool and manage money. BAs are "informal" wealthy individuals

who invest their own funds in a small set of new business ventures. Given that spin-offs have a gestation period to become profitable and lack tangible assets, debt financing by banks is typically not an option. Spin-off contracts are more complex than licensing agreements. They allocate both cash flow rights and control rights, the latter of which might or might not be associated with cash flow rights, to the principal participants (i.e., the TTO, researcher and VC or BA) and possibly also to the manager who is hired to run the venture. It is customary to distinguish two types of shares, namely, financial shares, which are directly related to the capital invested, and founder shares, which compensate for the intellectual property, brought in by the researcher(s) and owned by the university's TTO.

The rather high level of scientific, financial and commercial uncertainty implies that each step in the venture could lead to the renegotiation of previous contracts and/or an increase in the financing of the spin-offs; new financial shares issued, and new partners included. Also, a successful spin-off must determine its exit strategy either through acquisition by an existing company or through an Initial Public Offering (IPO). Given the different objectives that the participants in such contracts usually have, each renegotiation generates conflict, since decisions that benefit one participant does not necessarily benefit the others.

CHALLENGES IN COMMERCIALIZATION OF UNIVERSITY INVENTIONS

An obstacle that prevents the faculty members from being involved with the industries is their academic freedom which allows them the flexibility to conduct research without any consideration for commercial gains (Tang *et al.*, 2012). The collaborations between the university and the industry would sustain if the researcher feels that the industry shows an interest in their inventions (Lee & Yang, 2000). Previous research shows that academic researchers' attitudes towards the coll ties with the industry sponsors are largely positive, especially when funding is indirectly related to their research, disclosure is agreed upfront, and ideas are freely publicized (Glaser & Bero 2005). As pointed out by Meyer (2005), most academic researchers in Germany regard obtaining additional funding for research and opportunities to learn from the industry as the main motives for engaging with industry. A qualitative study by Owen-Smith and Powell (2003) lends support to the view that most academics involved in commercialization of university research are attracted by monetary considerations. These authors highlighted that life sciences are more valuable because the patents on their own generate monetary rewards for the researchers which could enhance their income levels. However the situation is different in the physical sciences where it is less attractive because of lower monetary pay-offs and research is therefore pursued

primarily to develop relationships with fihe , gain access to equipment or exploit other research-related opportunities (Owen-Smith & Powell 2003).

IMPLICATIONS

As mentioned earlier , commercialization of university researches and innovations is of paramount importance, both practically and theoretically. The study by Chiesa and Piccaluga (2000) is of the view that the changes that occur due to scientific findings in the form of new applications, have benefitted the country, however the process is often hampered in terms of ownership of intellectual property. The study by Liu and Jiang (2001) concluded that there is a conflict between the needs of the market and the focus of many researchers. According to researchers, the industry does not require high technology but basic technology that could increase productivity of their company (Liu & Jiang 2001). This statement is also supported by Ismail *et al.* (2012) who state that it is important for both parties to understand and tolerate each other so that both could gain from making significant contributions to the country. Collaboration between industry and university researchers would strengthen relationships. This would enable the researchers to build and enhance their reputation and if they have a product for commercialization it will be easier for it to be accepted by the industry (Perkmann *et al.*, 2011; Hock *et al.*, 2012; Perkmann & Salter, 2012). The research by Bray and Lee (2000) proposed two commercialization strategies for university research, which

are : i) a traditional licensing strategy that includes an up-front license issue fee for the use of the technology and a royalty on sales and ii) an alternative strategy of taking equity in the company formed. Their research showed that the higher the percentage of shares in the company, the higher would be the returns for the university. However, their research analysis is based on a very limited number of cases and further studies are needed to draw conclusions on the relationship between commercialization strategy and income generation.

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CONCLUSION

In conclusion, we feel that there is a strong case to be made for the benefits of commercialization of research in universities, to various potential stakeholders. As discussed, those who choose to be directly involved in the process obtain several gains. Furthermore, there are also untold benefits to the communities, regions, and nations in which these entrepreneurial endeavours occur. Challenges do exist, however, and the process of academic entrepreneurship is not as efficient or as effective as it could be. It is hoped that this article provides a better understanding of the mechanisms that the government should place emphasis upon and the academic

entrepreneurship process, difficulties faced and recommendations to overcome them, as well as the potential benefits to be gained as academics and practitioners strive to develop improved models of academic entrepreneurship. University administrators have become more willing to engage in commercial pursuits and set up enterprises. Clearly, the government has a high stake in such pursuits, as it perceives the role of universities as beyond human resource training and basic research. In particular, investment priorities for elite institutions of higher education and critical policies for rewarding commercialization are largely decided by the central government. One of the criteria for assessing the performance of universities and their administrators is commercialization of research and the tangible contributions to local economies. These policy directions, together with the need for universities to diversify revenue sources and pursue economic gains, have jump started and sustained a growing level of research commercialization nationally.

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Internet: The Double-Edged Sword of Trafficking of Women in Malaysia

Olivia Tan Swee Leng^{1*}, Shereen Khan¹ and Rohani Abd Rahim²

¹*Graduate School of Management, Multimedia University, Jalan Multimedia, 63100 Cyberjaya, Selangor, Malaysia*

²*Faculty of Law, Universiti Kebangsaan Malaysia, 43600 Bangi, Selangor, Malaysia*

ABSTRACT

Trafficking in persons is a major concern for global nations. The technology, growth, and usage of information and communication technologies (ICTs) have been accompanied by an increase in exploitation and abuse of technology for criminal activities. With regards to cyberspace, the Internet is increasingly used as a tool and medium by transnational organized crime. Trafficking in women is an obvious form of organized crime that has been affected by the globalised revolution in ICT. This illegal trafficking is not exclusive to sexual exploitation with respect to women or child trafficking, but also covers indentured servitude and child labour. This new form of crime violates fundamental and basic human rights and freedom, and transcends national boundaries and territories to negatively impact on numerous countries across the world. It is estimated that over 900,000 people are being trafficked every year¹. This paper seeks to discuss, address and analyze the impact of Information Communication Technologies (ICTs) on trafficking in women for sexual exploitation. Such trafficking is a major criminal activity and a blatant evil that should be effectively tackled on all levels. An analysis of the existing legislative and regulatory framework and their efficiency in the Asian region to combat this form of cross-border organized crime was made and the difference between trafficking and smuggling as stated in the Anti-Trafficking of Persons Act 2007 in Malaysia was discussed. The methodology for this research is qualitative research based on case-study and secondary data collected from government agencies. The paper concludes by discussing the steps that should be taken to

protect human rights and minimize the risk of using ICTs in illegal criminal activities, especially with respect to trafficking in persons.

Keywords: Trafficking of women, Information Communication Technologies, Abuse of technology

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E-mail addresses:

oliviatan@mmu.edu.my (Olivia Tan Swee Leng),

Shereen.khan@mmu.edu.my (Shereen Khan),

rohani_rahim@yahoo.co.uk (Rohani Abd Rahim))

* Corresponding author

INTRODUCTION

Trafficking in persons is a major concern for the global nation². The growth and usage of information and communication technologies (ICTs) have been accompanied by an increase in exploitation and abuse of technology for criminal activities. With regards to cyberspace, the Internet is increasingly used as a tool and medium by transnational organized crime. Trafficking in persons is an obvious form of organized crime that has been affected by the global revolution in ICT. Internet access is borderless and therefore transnational crime is growing faster than before the ICTs era. Despite new techniques that are constantly being implemented and rules being adopted to combat and eliminate diverse forms of trafficking in persons, yet ICTs are also providing new means and tools that facilitate human trafficking, especially for sexual exploitation. The researcher studied the impact of these technologies on trafficking in the case of girls and women and also analysed the current state of legislation in this area whilst examining the role Malaysian laws could play in preventing the new technologies' potentially harmful effects.

This research aims to study the trafficking of women for the purposes of sexual exploitation especially in the human rights context; a comprehensive term encompassing child pornography, enforced prostitution and other forms of sexual exploitation in order to create awareness within the global community and also tighten the current enforcement process in Malaysia.

METHODOLOGY

Globalization³ is the key issue of higher usage in using the internet in the Asian region. ICTs is the means of daily communication to enhance economics, political and social links between the countries in the Asian region. The culprits involved in human trafficking are using this chance to organize their crimes within the region by making use of the ICTs to their advantage. Trafficking in persons is one of the oldest and most lucrative criminal activities after drug trafficking. There are many different definitions of trafficking in persons that have been suggested by scholars, domestic law, and international agreements⁴. The most influential definition, is the one offered by the United Nations protocol⁵ to prevent, suppress, and punish trafficking in persons especially women and children. The United Nations convention⁶ against transnational organized crime takes the term trafficking in human beings to mean :

“The recruitment, transportation, transfer, harbouring or receipt of persons, by means of the threat or use of force or other forms of coercion, of abduction, of fraud, of deception, of the abuse of power or of a position of vulnerability or of the giving or receiving of payments or benefits to achieve the consent of a person having control over another person, for the purpose of exploitation. Exploitation shall include, at a minimum, the exploitation of the

prostitution of others or other forms of sexual exploitation, forced labour or services, slavery or practices similar to slavery, servitude or the removal of organs”.⁷

Smuggling is not trafficking⁸. It is generally voluntary, whereby a person agrees to be transported, across the border. The relationship between the smuggler and the person being smuggled ends when the border is crossed. Smuggling fees are paid up front or perhaps usually upon arrival of the victims, whereas trafficking is not voluntary. Trafficked victims are lied to, tricked and may be forced into crossing a border. The relationship between the transporter and the victim continues well after they reach the destination. The trafficker keeps the victim's documents, threatens them or their family if they do disobey the traffickers. Traffickers impose large debts on the trafficked victims for 'transportation' and force the victims to work to pay off the debts. Smuggling can turn into trafficking when the smuggler uses threats of harm or force against the person smuggled or 'sells' the person and the transport debt to a trafficker⁹.

This research sets out to show the various ways in which victims are recruited via internet. Given the internet usage boom in Asia, the researcher anticipates possible future techniques. The researcher will specifically list down the means used to recruit victims of trafficking via internet; identify the legal, judicial, administrative and technical means used by various countries to combat the misuse of internet;

and make recommendations on legal, judicial, administrative and technical means of eliminating the use of internet to recruit victims of women trafficking.

Researchers conducted interviews with officers and secretaries of Non-Governmental Organizations in Malaysia. They gathered reports on computer crimes through Malaysia Communication and Multimedia Commission (MCMC) and the Human Rights Organization in Malaysia especially on statistics on women trafficked through the internet.

THE USAGE OF INTERNET IN THE WORLD (SHOWING COUNTRIES IN ASIA AS THE HIGHEST INTERNET USERS)¹⁰

Fig.1 shows that Asia (which clearly includes Malaysia) is the top internet user by geographic regions in Year 2011 followed by Europe and North America. This shows that ICTs usage has grown in Asia since the year 2000. The use of ICTs in human trafficking involves the usage of technologies and / or networks. As sophisticated as the technology has become and as fascinating as the science of artificial intelligence (AI) might be, we are not yet at the point where computers can by themselves engage in criminal activity. The machines are wonderfully compliant and totally amoral hence, trafficking in persons by the use of ICTs always involves at least one human being who becomes the master mind of the criminal activities and initiates the criminal act¹¹.

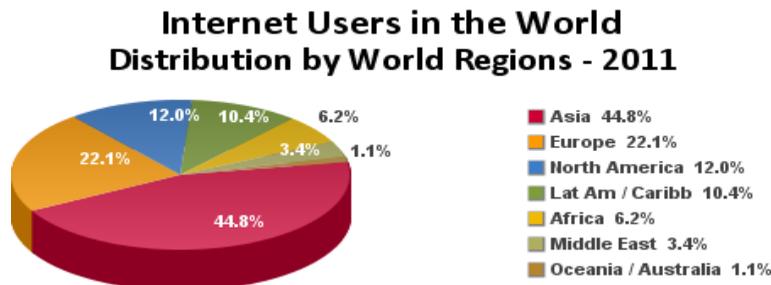
In Malaysia employment through several channels, formal and informal, seems to be the main issue. The internet

offers a wide variety of possible approaches to recruitment such as employment abroad through the use of search engines publishing tempting offers, all the way to spaces such as chat-rooms, spam mail and internet dating, where victims can be recruited. The use of internet to recruit victims is not a new tool of trafficking but simply a new weapon in the traffickers' armory. Categorizing the potential internet users in Malaysia, recently the Norton Cybercrime Report 2011¹² stated, although Malaysia was not in the list of countries studied in the report, national cyberspace police Cybersecurity Malaysia said the findings are representative of the Malaysian threat landscape¹³. Malaysian cyber threat landscape is no less alarming with over 10,000 cases reported every month up till August 2011. Last year, Cybersecurity Malaysia received over 8,000 reports about cybercrime via its cyber999 hotline and Cyber Early Warning System has also detected over 5,000,000 security threats up until August. The increasing amount of cyber threats here warrants a

further need for more stringent measures to prevent more Internet users from becoming cybercrime victims and to review and improve the current cybersecurity laws¹⁴.

THE TRAFFICKERS MINDSET AND THE VICTIMS IN ICTS

Traffickers can be freelancers or members of a criminal network. They recruit and search for potential victims through advertisements in local newspapers offering good jobs in cities, use fraudulent travel, modeling and matchmaking agencies to lure innocent young women into trafficking business. A trafficker may be a family friend or someone familiar within the community who is able to convince the families that their children will be safer and better taken care of in a new place¹⁵. Traffickers usually mislead parents into believing that their children will be taught a useful skill or trade but in actual fact the children end up enslaved in small shops, on farms, or in domestic servitude. Many traffickers depend on the use of a computer network to accomplish



Source: Internet World Stats - www.internetworldstats.com/stats.htm
Basis: 2,267,233,742 Internet users on December 31, 2011

Fig.1: Internet Users in the World Distribution by World Regions-2011

the criminal act. In such cases, technology is directly or indirectly used to commit this organized crime.

The victims include men, women and children, although most agree that women and children are more often the victims of trafficking. Traffickers prey on those vulnerable people who are very poor, who have disabilities, the very young or old, people who have low educational levels, or people who are ignorant. Women are lured by promises of employment as shopkeepers, maids, nannies, or waitresses but then find themselves forced into prostitution or become sex slaves upon arrival at their destination. Many victims are unaware that their travel documents will be confiscated, that they will have to pay an enormous debt, or that they will be subject to physical abuse if their earnings are unsatisfactory¹⁶. These victims do not know how to escape the abuse or where to seek help. The victims generally avoid enforcement authorities out of fear of being jailed or deported, especially if they have forged documents¹⁷. Traffickers often transport the victims from their home communities to other areas within their country or to foreign countries where the victim is often isolated, unable to speak the language and is unfamiliar with the culture. Most of the victims lose their support network of family and friends, thus making them more vulnerable to the traffickers' demands and abuse.

Amending the current existing laws takes time and is a slow and laborious process. In the meantime, human trafficking continues to escalate at an alarming rate.

Malaysia needs to intensify education and awareness efforts to educate users on Internet risks. Currently, Cybersecurity Malaysia is open to the idea of working with security solution providers like Symantec to come up with cybersecurity awareness programmes. Cybersecurity Malaysia already has a list of home made security tools such as DontPhishMe, DNSwatch and MyPHPiPs that protects users from cybercriminals which can be downloaded for free. It is also working on establishing a Cyber Clinic which will offer an extensive list of cybersecurity services to computer users.

THE ASIAN GOVERNMENTS' EFFORTS IN COMBATING TRAFFICKING OF HUMANS THROUGH INTERNET (LAW, JUDICIAL AND ADMINISTRATIVE EFFORTS)

Governments from other countries in Asia such as Malaysia, Singapore, Philippines, Thailand, and Brunei have enacted various legislations to prevent this heinous crime from spreading through the use of internet. In Malaysia for instance, the government has enacted the Computer Crime Act 1997 to combat misuse of computer technology. The Communications and Multimedia Act 1988 (CMA 1988) and also Malaysian Communication and Multimedia Commission Act 1998 serve to oversee and regulate telecommunications in Malaysia. Recently, the Malaysian government gazetted the Personal Data Protection Act 2010 to curb misuse of data to prevent criminal activities.

In 1993, Singapore passed the Computer Misuse Act (Chapter 50A of the Singapore Statutes), which it has amended numerous times. This Act addresses computer crimes and provides for stiff penalties for violation of the law. It has applied its existing Penal Code provisions for activities that are deemed cyber crime such as the release of a virus. This would fall under the jurisdiction of the Computer Misuse Act, whereas an economic crime such as fraud would fall under the the Penal Code. Singapore has created new law enforcement agencies with specially trained personnel to keep pace with the rapid advances in technology and the resulting proliferation of computer crimes. Singapore has given its police force additional powers, including extra-territorial jurisdiction to aid in their efforts at apprehending computer-based criminals.

As for Thailand, Computer-related Crimes Act 2007 was enacted to prevent unauthorized applications and access made to other people's computers; as well as alteration, deletion or destruction of the information of others. Impostors using others' identities to send slanderous messages or those who flood information on discussion forums are also subject to criminal penalties under the law. This was proposed and drafted by the National Electronics and Computer Technology Centre (Nectec) and enforced by the Information and Communications Technology Ministry. The Act also subjects those circulating pornographic material or libelous content through e-mails to hefty fines. The Act originated from anti-hacking efforts a few

years ago when Nectec began its fight against the practice and later studied online intrusions. Other online crimes have also been included in the law. The Act also requires Internet service providers (ISPs) to keep log files of bandwidth usage and Internet traffic and records of individual users for 90 days.

Table 1 showing the development and scope of ICT Legislations in the Asian region

FINDINGS

International Organization of Migration (IOM) stated that “ the majority of these victims come from Asia, with more than 225,000 arriving annually from Southeast Asia and more than 150,000 from South Asia. The former Soviet Union has become the largest new source of sex slaves with 100,000 trafficked each year from the New Independent States. Largely, more than 75,000 are trafficked from Eastern Europe; 100,000 from Latin America and the Caribbean; and over 50,000 from Africa.” The majority of victims are sent to cities, vacation or tourist areas, or military bases in Asia, the Middle East, Western Europe, and North America. The most common means by which sexual predators contact children over the Internet is through chat rooms, instant messages and email¹⁸.

Interviews that were conducted by researchers on the Human Rights Organization in Malaysia and NGOs¹⁹ reveal that there are no proper statistics for trafficking on women through internet except for statistics gathered by MCMC

TABLE 1
Scope and Development of ICT Legislations in some Asia regions

Issues	Laws	National Actions	International Actions
Harmful sites or contents	Penal law or legislation	China, HK, India, Japan, Malaysia, Philippines, Singapore	N.A
Hacking & Virus	E-Commerce Act	Philippines	NA
Data Protection & privacy	Personal data Law Privacy Law	HK, S.Korea, Malaysia, Singapore	OECD Guidelines on Trans-border Data Barriers & The Protection of Privacy
Security	Electronic Transactions Act Digital Signature Law Computer Crime Act Computer Misuse Act	Malaysia, Singapore, Thailand, Philippines, HK, China	
Spam	Spam Act		

and CyberSecurity Malaysia in respect of computer crimes such as credit card fraud, hacking, malware, phishing, etc. Some officers mentioned that they have no knowledge of trafficking of women through internet in Malaysia and are aware only of trafficking of humans in general.²⁰

In furtherance to this, a total of 15,218 cybercrimes were reported by CyberSecurity Malaysia last year -in sharp contrast to only 8,090 in 2010. CyberSecurity Malaysia is the government department in charge of monitoring and preventing online crime. The majority of cases were online fraud (5,328 cases); followed by intrusion or attempted intrusion (4,433 cases), and cyber harassment (459 cases). It is estimated that more than 17 million of the country's 28 million people use the Internet daily, with Malaysians spending an average of 20 hours online every week.²¹ Cybercrime in Malaysia rose by 88 percent in 2011²².

Cyber crime²³ has the following characteristics:-

- It is easily committed
- It is cheap for the criminal
- It is anonymous, since the criminal does not have to reveal his identity
- It is fast and leaves only digital traces
- It cannot be committed by just anyone, since it requires a thorough grasp of the technology involved
- The criminal does not have to leave his place, while the crime itself can produce consequences in various countries simultaneously and affect numerous victims
- It can be hard to locate. To cover their traces, criminals operate in various countries, making it hard for national police agencies to determine the crime committed.

In other words, the internet is an efficient tool in the hands of the perpetrators of all kinds of crime (especially organized crime like Human Trafficking). The two prevalent methods used by traffickers to recruit victims via the internet are advertisements for employment, marriage, dating agencies and chat-rooms.

In a random Google search, there were more than 100,000 suspect sites advertising marriage, escort services, dating, modeling services etc. Researchers can only have a high level of suspicion as there is no actual evidence that women offer sexual services or marriage online or are actually potential trafficked victims.

The common sites used by traffickers are:

- a. marriage agency sites (such as mail-order bribe agencies or dating clubs);
- b. escort services sites;
- c. dating clubs;
- d. employment sites eg:-²⁴
 - home helps
 - waitress/bartenders

- au pairs/carers
- models
- dancers/hostesses
- models
- people to work in the building trade/factories/agriculture
- people to take educational courses
- people to work in tourism
- sex workers (it should be noted that the fact of already being a prostitute does not exempt a woman from being trafficked)

RECOMMENDATIONS

The numbers are staggering in Asia. It is estimated that from one to two million women and children are trafficked each year. In the year 1991, at a conference of Southeast Asian women's organizations, it was estimated that 30 million women have been sold worldwide since the mid-70s. More than 100,000 women are shipped each year to Japan to serve in local bars and brothels. Thousands of young women and

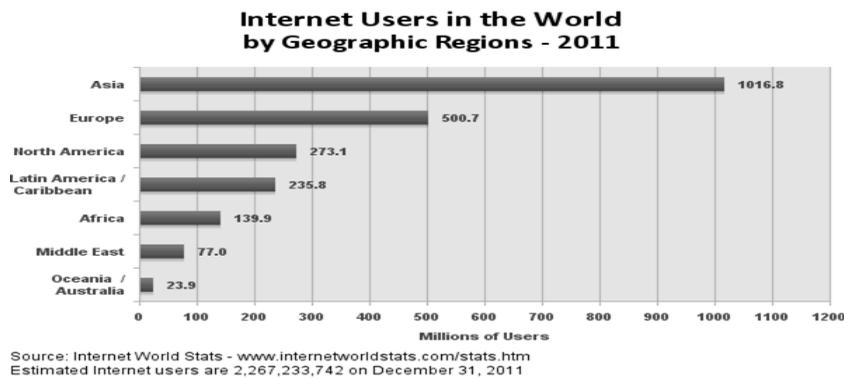


Fig.2: Internet Users in the World by Geographic Regions-2011

girls are sent from Nepal to India and from Burma to Thailand and Malaysia. These numbers mostly exclude the issue of internal trafficking for “domestic consumption.”²⁵

With heightened awareness that the crime of human trafficking is growing rapidly during this ICT era, the stakeholders of each country have a part to play in order to combat this heinous crime at national and international levels such as:-

- a. Raise awareness of the serious nature of abuse of internet usage for Trafficking of Humans. It must be stressed that links between the Internet and Trafficking can take several forms ie the victims may fall prey to traffickers via web sites and other internet services, trafficked victims may be traded or their services advertised to clients via internet and victims recruited in traditional ways may be forced to contact clients online.
- b. Revise, amend and enforce national and international laws specifying various substantive and procedural aspects pertaining to internet usage.
- c. Harmonize the different national laws to regulate and police the crime.
- d. Cooperation between and among the law enforcements of one’s own country as well as other countries concerned should be enhanced.
- e. Endeavour to establish an international tribunal to regulate the increase of trafficking in persons crimes through internet usage.

- f. Each stakeholder should be aware and be involved actively in preventing and eradicating the negative side of internet usage.

CONCLUSION

The trafficking of women is an ongoing international evil that spans national boundaries in a manner that renders this form of organized crime a global concern. Trafficking in women may take several forms including trafficking for forced labour, servitude, and organ removal. It is noted that trafficking for the purposes of sexual exploitation is a major criminal activity and a gross evil that should be effectively tackled on all levels. It has been seen that the major problems that facilitate trafficking are various unfavourable aspects of economic, educational, and social conditions in each country. Usually the source countries are mainly in the low income category and are developing and/or under developed States. Globalization of technology and the revolutionary advancement of internet usage have impacted on criminal activity, especially trafficking in persons for the purpose of sexual exploitation. Information technology communications, video digitizers, Internet applications and services, and software and file transfer protocols are amongst the methods utilized by traffickers to commit their crime activities.. The increasing usage of technology assisted criminal activity and trafficking warrants further attention from global nations who need to

enact the necessary legislative provisions and implement effective technological and enforcement tools that will reduce internet criminal activities²⁶. The governments from Malaysia and the Asian region should not take this matter lightly as technology is an ever growing tool and it is a double-edged sword.

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ENDNOTES

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Corporate Rehabilitation: Informal Corporate Rescue Mechanisms for Troubled Companies in the United Kingdom and Malaysia

Ruzita Azmi^{1*} and Adilah Abd Razak²

¹School of Law, UUM College of Law, Government and International Studies, Universiti Utara Malaysia, 06010 Kedah, Malaysia

²Faculty of Economics and Management, Universiti Putra Malaysia, 43400 Serdang, Selangor, Malaysia

ABSTRACT

Corporate insolvency law aims to provide instruments of corporate survival or rescue. The revival of companies on the brink of economic collapse may involve rescue procedures that go beyond the normal managerial responses to corporations in distress and they may operate through both informal mechanisms and formal legal procedures. Most importantly only viable companies and businesses deserve to be rescued. There are various types of rescue actions to turnaround corporate fortunes at a time of corporate crisis. This could be in the form of a broad range of restructuring activities. This article examines the informal rescue practices and mechanisms available to troubled companies in the UK and Malaysia. Some common rescue mechanisms that are discussed include sell-offs, management buy-out (MBO), debt for equity conversion, retrenchment, redundancy as well as ‘workout’ arrangements to restructure debts owed by companies to banks or creditors.

Keywords: Corporate rehabilitation, informal rescue mechanisms, restructuring, turnaround, workout

INTRODUCTION

Corporate rescue has been defined as “a major intervention necessary to avert eventual failure of the company,” (Belcher,

1999) and “the revival of companies on the brink of economic collapse and the salvage of economically viable units to restore production capacity, employment and the continued rewarding of capital and investment” (Omar, 1997). Rescue procedures involve going beyond the normal managerial responses to corporate troubles and they may operate through informal mechanisms as well as formal

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E-mail addresses:

zita@uum.edu.my (Ruzita Azmi),

adilah@upm.edu.my (Adilah Abd Razak)

* Corresponding author

legal processes (Finch, 2009). Central to the notion of rescue is the idea that drastic remedial action is taken at a time of corporate crisis (Belcher, 1997; Finch, 2009). Basically, all these views support the notion that rescues should not be confined to formal rescue procedures but be widened to cover informal rescue mechanisms.

As noted, troubled companies may resort to formal rescue mechanisms. Indeed, there are two types of corporate formal rescue procedures practised in both Malaysia and the UK to resolve a corporate debtor's financial problems namely Scheme of Arrangement (SOA) and Administrative Receivership (AR), while Company Voluntary Arrangement (CVA) and Administration are available only in the UK. Alongside those procedures corporate debtors can be rescued informally. However, when all informal rescue strategies have been exhausted, the ailing company should enter into the formal rescue process as a last resort (Finch, 2002).

It has been pointed out that formal proceedings can be pricey and lengthy, and can destabilise public faith in the company and lay an enormous administrative burden on the debtor (Neyens, 2002). Therefore, companies, when faced with financial problems, may choose to renegotiate their debt directly with their creditors, without recourse to the formal process (Franks and Sussman, 2000). Frank & Sussman (2000) discovered that there are elaborate rescue processes outside formal procedures. They claimed that about 75% of firms emerge from rescue and avoid formal

insolvency procedures altogether (after 7.5 months, on average). These firms are either turned around or repay their debt by finding alternative banking sources. The remaining 25% of cases enter some form of insolvency procedure, usually administrative receivership, or winding up. It is claimed that most rescues are achieved through informal action (Finch, 2009). According to Finch (2009) "informal actions do not demand any resort to statutory insolvency procedures but are contractually based and such actions are usually instituted by directors or creditors and may involve a turnaround professional or 'company doctor' to investigate the company's affairs and to make recommendations."

It should be noted that international bodies such as United Nations Commissions on International Trade Law (UNCITRAL), the World Bank and International Monetary Fund (IMF) have agreed that, besides formal rescue or insolvency procedures to resolve corporate debtors' financial difficulties, there should be informal mechanisms that allow debtors and creditors to resolve their differences in a consensual manner outside the formal procedure (UNCITRAL, 2001; World Bank, 2005; IMF, 1999). In addition, the International Insolvency Institute emphasized that the informal process is significant because formal rescue regimes are not always entirely suitable to the task of rescuing firms with financial problems (International Insolvency Institute, Law & Policy, 2000). Informal attempts at rescuing the company or its business may precede a formal rescue, and may be

done when the fortunes of the corporation could be informally turned around or the ailing company can informally work out the debts owed to their banks or creditors through negotiation or arrangement, without the company entering a formal rescue procedure.

Considering the importance of informal rescue to financially sick firms, this article examines informal rescue mechanisms in the UK and Malaysia. In order to analyse informal rescue actions and activities, the author collected information through primary and secondary data. Sources of data are judicial decisions, textbooks and articles from journals and law reviews. This paper examines the concept of informal turnaround and workout. It also explores some informal common mechanisms as possible components of corporate rescue. These include methods to turnaround the company or its business; to workout with creditors or banks the debts owed by the company to them; and also to negotiate the raising of extra finance or investment in order to rescue the ailing company or its business.

CONCEPT OF INFORMAL 'TURNAROUND' AND 'WORKOUT'

Informal turnaround is a “very general concept and encompasses various types of rescue activities,” (Belcher, 1997) and “such informal turnarounds are often achieved with the support of the company’s bankers and/or of a company doctor” (Walters and Armour, 2006). Meanwhile, informal workouts/arrangements may also cover

possible financing arrangements designed to obtain extra finance in order to stay in business or for the company’s survival.

It should be noted that International bodies like UNCITRAL, the World Bank and the IMF, having discussed the policy choices to be addressed by countries when designing an insolvency system, had focused on arrangement or negotiation as an alternative mechanism to formal procedures, yet gave little consideration to the notion of informal turnaround (UNCITRAL, 2005). Meanwhile, some commentators have defined a turnaround candidate as “a company or business entity faced with a period of crisis sufficiently serious to require a radical improvement in order to remain a significant participant in its major industry” (Zimmerman, 1991; Belcher, 1997).

Belcher (1997) and Zimmerman (1991) view turnaround as a process which involves reversal; meaning dramatic and sustained improvements in the company’s performance at the point of corporate crisis. They also maintain that companies normally revert to turnaround when their very existence is threatened. Other commentators like Goldston (1992) recognise that turnarounds can be classified as a marketing turnaround, financial turnaround or operations turnaround. This means specific types of turnaround may be required for a company depending on the evaluation of the company’s crisis.

A workout is described as financial rescue of a company in distress, which takes place outside the limits of insolvency law (Kent, 1997). According to Belcher a

workout is “the restructuring of the terms of a company’s debt contracts to remedy or avoid default achieved by private negotiations with its creditor outside formal bankruptcy or insolvency proceedings” (Belcher, 1997). It is fair to say that a workout includes arrangements or negotiations between the corporate debtor and its creditor/bankers outside the formal rescue process to obtain financial investments or rescheduling or restructuring of debts. A workout is normally arranged by the company’s leading banks, but it may also involve major shareholders, bondholders, clients and suppliers, who have a direct interest in the continued existence of the company (Kent, 1997).

It seems that the concept of ‘turnaround’ and ‘workout’ involves ‘restructuring’ of the company’s operations, structure, business, workforce or terms of company’s debt as the company responds to the corporate crisis. Also, some measures of rescue attempt or activity are presented to turnaround the company or its business when a workout takes place between the corporate debtor and its creditors or bankers. The following discussion examines the various types of rescue activities to turnaround the company or its business and to workout solutions with the company’s bankers and creditors in order for the company or its business to survive.

COMMON INFORMAL RESCUE MECHANISMS IN THE UK AND MALAYSIA.

As noted, directors, creditors or shareholders are able to take informal and formal actions in order to effect rescues for companies that

are financially distressed (Finch, 2009). It is important to note that various drastic remedial actions may have to be taken at a time of corporate crisis. Rescuing troubled companies may inevitably require the companies to be restructured. Such restructuring involves parts of the business being sold off to other companies or to managers in MBO. The companies may also undergo corporate reorganization or restructuring whereby the workforce is reduced through retrenchment; redundancy or Voluntary Redundancy (VR) or Voluntary Separation Scheme (VSS). The quest to turnaround the company in distress may include refinancing the corporate debts as well as capital reorganization via debt equity swap and to workout with creditors or banks the debts owed by the company to them. In the following sections some informal rescue actions and activities are presented.

Restructuring

It has been pointed out by Belcher (1997) that restructuring is one of the ways used by a company to respond to crisis. Restructuring comes in many forms including sell off, where elements of the business are closed or part of the business is sold to another company or even to managers in a MBO. Restructuring also involves downsizing where the workforce is reduced by means of retrenchment and redundancy, VR or VSS. The company in distress may engage in capital reorganisation by means of a debt-equity swap. It may also need to restructure its debts or financing arrangements and engage in a workout.

Sell-offs and MBO

Selling off parts of the business or closing down parts of the business are the most encountered form of restructuring. When a firm is experiencing financial crisis, closing down a part of the business that is a financial drain can save the rest, and a sell off can have positive effect if it raises much needed cash immediately (Belcher, 1997). Normally, in a sell-off situation, the company must first decide what type of core business it wants to participate in, and then decisions must be made on which part of the business to sell. Here, the core business must be a viable one and the business or assets to sell must be attractive enough to get interested buyers. After selling off the unwanted assets or business, the company resources can be pooled together to concentrate on the core business in order to improve productivity and competitiveness. In return for selling off the non-core business, the company can generate revenue, which can be used to pay off debts and reduce the company's borrowings. With only the core business to concentrate on, company overheads can be reduced to a minimum, and the company can be nurtured back to profitability. As for the non-core business that was sold off, there is a chance that the new owner would be able to rescue it (Belcher, 1997). Therefore, selling portions of the company, such as a division that is no longer rewarding or which has distracted management from its core business, can greatly improve the company's balance sheet.

Sell-offs can also be achieved in the form of hive down, leveraged buy-out and

MBO. In a hive down, the relevant assets are transferred to a newly set up subsidiary company by management for sell-offs. In a leveraged buy-out, the purchase of the business is heavily financed by bank loans (Belcher, 1997). MBO is a special form of sell-off and is defined as a sell-off where the existing management is the purchaser, and this is heavily funded by the bank to enable the purchaser to acquire an existing product line or business (Storey, 1996). According to Belcher (1997) the first stage in a MBO is for the management team to ask the consultant or a financial institution to act as intermediary and carry out an initial appraisal of the proposed deal. If the consultant gives a positive report on the initial appraisal, then informal discussions with the management of the parent company will be initiated (Belcher, 1997). Normally, this will take place before the company is involved in formal rescue. In the UK, if the company is under receivership or administration, a proposal could still be made and this would require less need of secrecy and consultation with intermediaries before the initial approach, as management at this stage would have little to lose. In a case where the initial approach is well received, details of the negotiations will follow. Within a formal rescue regime, the sell-off of part or the entire company becomes public knowledge. However, the negotiation process can be held secret from the public if it occurs outside a legal/formal rescue regime. The management team will need the strong backing of the bank to complete the purchase, and usually this will

work as a filter to discourage incompetent managers becoming purchasers (Belcher, 1997).

MBOs are usually heavily financed by the bank, which normally comes up with ninety percent of the financing with the remaining ten percent being put up by the purchaser. This means that the newly acquired company is quite often left with a high monthly repayment both for the principal amount and the interest in order to service the loan. Despite this, the performance of MBOs is usually very good, with a success rate of more than eighty percent (Belcher, 1997). In an MBO, the success formula is the quality and the innovation of the management team. In numerous circumstances of distress, management is a liability rather than an asset to the company. It is important to note that research comparing results of various studies like Slater (1984) and Belcher (1997) have found lack of financial or accounting control, poor or inadequate management as well as management or marketing problems to be a major contribution to the cause of corporate decline. According to Slater (1984) and Belcher (1997) in many instances, the solution to the problem of company distress is to change the current management so that the company can be turned into a corporate success.

Interestingly, the implications of MBO could be linked to the 'phoenix syndrome' (a shorthand expression), which was identified by the Review Committee on Insolvency and Practice also known as the Cork

Report (1982). The Cork Report referred to the 'phoenix syndrome' scenario where the director of an insolvent company sets up business again and trades with assets purchased at a discount from the liquidator of the old company, leaving behind a trail of unpaid creditors (Cork Report, 1982: Para 1813). Although the report's primary concern was to deal with the director of an insolvent company who starts a fresh company to take over the business of the failed company, it was of the opinion that it is necessary to deal with the director who transfers the trading activities to a new company shortly before in anticipation of the failure of the old (Cork Report, 1982: Para 1830). It should be noted that in the UK part of the regulation of the 'phoenix syndrome' is contained in ss. 216 and 217 of the Insolvency Act 1986.

In Malaysia, rescue may be attempted by selling off or closing down the parts of the business that are caught in financial problems. Restructuring in the form of sell off is also employed to show profit or to curtail deterioration of the company's profit. It was reported that BP plc, Europe's largest oil company, was selling off its petrol stations in 270 outlets in Malaysia for up to RM1 billion, and the decision had been made by BP on the grounds that returns from Malaysia were not good enough (Chia and Shiew, 2004). Similar to the UK, a MBO takes place when the management of a company buys over the company from the existing shareholders and is normally supported by the banking sector for greater

success (Yahya, 1995).

However, MBOs seem to have been a 'mixed bag of results.' Companies like Malaysian Resources Corporation Ltd. (MRCB) and its listed subsidiaries have undergone a MBO in an effort to show profit. Meanwhile companies with managers as owners have also been seen to have better chances for long-term survival (The Edge Daily Business, 2005). It is critical for MBOs to get the support of the banks and the relevant authorities to make it successful. There are two reasons why a MBO may occur, depending on whether the companies are profitable (The Edge Daily Business, 2005). Firstly, in addition to the more common reasons, a MBO rewards managers who have played important roles in running the business. Secondly, an MBO exercise is to allow the managers to freely run and hopefully turn around the business of a company that is not doing well. Notwithstanding that the company was run by the managers, generally the performance of these companies tends to decline or show inconsistent results after a MBO exercise has taken place, as the managers who may be experts at running the company, may not have much experience in making acquisitions. Furthermore, such MBO usually occur within a short time frame and need extensive and multiple sources of capital as well as legal, accounting and other professional support. This could end up being detrimental to the company over the long term (The Edge Daily Business, 2005).

Retrenchment, redundancy, VSS and “Last in, first out” (LIFO) principles

Retrenchment and redundancy are some of the forms of corporate restructuring. “Retrenchment” may happen not only during recession but could also be relevant when the economic situation is good” (Marsono and Jusoff, 2008). Retrenchment refers to activities that reduce the scope or scale of an organization’s operations. It has also been referred to as downsizing, resizing, cutbacks and rationalization. If these were necessary for the survival of a company, then it would constitute a rescue (Belcher, 1997). As described by Belcher (1997), the economic arguments for closure of a particular plant or site of operation may be strong and retrenchment may appear to be a relatively easy solution, yet retrenchment may have political costs which should be taken into account. Although retrenchment is needed to help rescue a company or its business, it may not be a popular choice with the workers, managers and the public mainly due to their resistance to change and for economic reasons. A successful retrenchment requires careful management to accommodate the political as well as economic problems and pressure. A high level of morale, motivation, and commitment within the company is also necessary to help make retrenchment a successful turnaround (Belcher, 1997).

In the UK, one example is the case of Ford motor company, which announced on 17 September 2004 that it was closing down the Brown’s Lane factory in Coventry and retrenching about one thousand and one

hundred workers. For Ford the justification of the closing down of this plant and the retrenchment was to cut down on Jaguar losses and to cut costs so that the company could be nurtured back to profitability by being more competitive (Pagnamenta, 2004). For the analyst, Jaguar losses could be due to mismanagement, stiff competition, and the weak dollar, which dampened sales in the US market. Jaguar produced 120,000 cars yearly, short of the 300,000 needed to achieve an economy of scales. The production plant closure and retrenchment was supposed to save the company eighty millions pounds yearly. However, this generated a lot of ill feeling amongst the workers toward the parent company, Ford of the US, which promised to keep all three UK production plants afloat since buying it in 1990. The workers in the meantime promised to take whatever action was necessary in order to keep their jobs and this included protests and pickets (Pagnamenta, 2004). In 2007 it was reported that the Jaguar workers' union had given its backing to the Tata Motors' bid to buy Jaguar from the US giant Ford because union members believed its industrial background would be a good fit. Moreover, Tata Motors also promised that it would continue to keep open all three UK factories which jointly employ more than 13,000 workers (Cunliffe, 2007).

According to Honeyball (2006), one of the reasons why redundancy may happen is because a workplace is closing down or fewer employees are needed for a particular kind of work. In the UK, there are statutory controls on redundancy under the ambit

of the Employment Rights Act 1996. This provides that an eligible employee may claim a redundancy payment and such payment is designed to tide an employee over the period of uncertainty and hardship after redundancy (Honeyball, 2006).

It is pointed out that in Malaysia, redundancy and retrenchment are some of the forms of corporate reorganization and it has been referred to as "alteration in the structure of the company or business ... for the primary purpose of sustaining the continuity of the company or the business itself on a going-concern basis" (Segaran, 2000). Redundancy as pointed out by Segaran (2000) occurs where the company concerned is faced with redundant employees due to either a surplus of labour or the reduction of workload for specific positions after the reorganization, and under such circumstances, the retention of the services of the redundant employees would not be economically sound for the company if it were to continue to exist as a profitable ongoing concern. It is likely in this situation that redundancy will be considered as one of the rescue mechanisms where companies will try to cut costs by reducing their workforce in order to stay in business or for the survival of the company.

According to Marsono and Jusoff (2008) redundancy can occur for a number of reasons such as a downturn in production, sales or economy; the introduction of technology; business relocation; a business merger or a business is sold; or restructuring of a company. It is claimed that the law permits termination of service for operational

reasons under the umbrella of redundancy (Marsono and Jusoff, 2008).

In the case of *Bal Plantations Sdn Bhd v. Sabah Plantation Industry Employees' Union* (1984) the court held that the term 'retrenchment' connotes, by its ordinary acceptance, that the business itself is being continued but that a portion of the labour force is discharged as surplus. In another case *Georgetown Pharmacy (M) Sdn Bhd v. National Union of Commercial Workers* (1992) the Industrial Court confined the usage of the term 'retrenchment' to mean a discharge of surplus labour. Accordingly, retrenchment means the termination of a contract of service for reasons of redundancy.

Interestingly, it is well established in Malaysia's Industrial Law that if an employer is a company, it has the right to restructure its business in such a manner, as it believes fit for economic efficiency. In this respect, the company may downsize its workforce by means of redundancy and retrenchment (Segaran, 2000). This principle was upheld in *Maser Sdn Bhd v. Yeoh Oon Wah* (1990) where it was decided that it is for the management to decide the strength of its staff which it thinks necessary for efficiency in its undertaking and the court cannot dictate to the employer the number of persons to be employed in order to run its business profitably. Furthermore, it was held in Maser's case (1990) that the employer has the right to restructure the enterprise and to terminate the service of employees who are redundant. An employer who carries out a retrenchment exercise must be motivated by sound reasons and conviction that such an

exercise is indeed desirable and that it will enable the employer to run the business more efficiently in the long term.

In a case of *Plusnet Communication Sdn Bhd & Ors v Leong Lai Peng* (2005) the court was of the opinion that a redundancy situation did exist as a result of reorganization and downsizing carried out by the company to minimize losses. It has been pointed out by Marsono and Jusoff (2008) that the court will look at several matters when the issue of retrenchment is referred to them. Amongst others these include whether retrenchment was justified; whether the employer is in a position to give the true grounds for the retrenchment and whether the retrenchment is made *bonafide*. The court in *TWI Training and Certification (SE Asia) Sdn Bhd v Jose Sebastian* (1998) has ruled that as long as the measures taken by the employer are genuine commercial and economic considerations, it has the managerial prerogative to decide in the best interest of its management to identify its own area of weakness and then proceed to discharge its own surplus. It has been emphasized that retrenchment must be a *bona fide* exercise and the employer should not abuse such prerogative (Segaran, 2000). It has been decided in *Kumpulan Perubatan (Johor) Sdn Bhd v Mohd Razi Haron* (2000), that massive retrenchment made by the employer was a genuine measure and not done for any ulterior motive to victimize the employees. The Industrial Court also found no evidence that the employer had acted with *mala fide* in the retrenchment process.

In *Gurbux Singh Prabha Singh v. J White & Co (M) Sdn Bhd* (1981) it was held

that the employer should, when selecting employees to be retrenched, not only act reasonably, but also observe any customary arrangement or code of conduct. The code of conduct referred to in this case is the Code of Conduct for Industrial Harmony 1975 (Code 1975). This code was endorsed in February 1975 by the Malayan Council for Employer Organisations (representing employers) and the Malaysian Trades Union Congress (representing employees) and was witnessed by the Minister of Human Resources. The purpose of the Code is to promote sound industrial relations practice in Malaysia and to lay down principles and guidelines to employers and employees on the practice of industrial relations for achieving greater industrial harmony (Segaran, 2000). Section 30(5A) of the Industrial Relations Act 1967 provides :

“In making an award, the Court may take into consideration any agreement or code relating to employment practices between organizations representative of employers and workmen respectively where such agreement or code has been approved by the Minister.”

In *Kesatuan Pekerja-Pekerja Perusahaan Logam v. KL George Kent (M) Bhd* (1991), the Malaysian High Court upheld that the Industrial Court is bound to consider the provisions of the Code of Conduct for Industrial Harmony while deciding on disputes relating to

retrenchment. In this case, there was a provision in a collective agreement between the employer and employees that they agreed to observe the provisions of the Code. One of the provisions in the Code provides that the retrenched employees should be given priority for engagement or re-engagement. However, the Industrial Court in its decision did not consider this provision. On appeal the High Court reversed the Industrial Court’s decision and held that the latter has made a jurisdictional error when it failed to consider the relevant clause in the collective agreement. The employer was bound to follow the provision of the Code, which provided that the retrenched employees should be given priority of engagement or re-engagement rather than bringing in new employees.

It is important to note that the Industrial Court recognized the principles of Code 1975 and this has generally been accepted as good industrial relations practice in undertaking a retrenchment exercise (Segaran, 2000). In *Rocon Equipment Sdn Bhd & Anor v Zainuddin Muhammad Salleh* (2005), the Industrial Court stressed that although there is ample justification for redundancy, the retrenchment is to be done in line with the accepted standards of retrenchment’s procedure. Code 1975 suggests that one of the appropriate measures to be taken by an employer under retrenchment is to introduce VSS before imposing the redundancy and preferably for such Scheme to be combined with reasonable monetary benefits (Clause 22 (a) Code of Conduct 1975). It should also be noted that in the Malaysian context,

companies could employ VSS as one of the avenues to reduce costs in the long run. Employers are told to give as early a warning as practicable and consult the employees and their union representatives. The employer must also spread the retrenchment over a longer period and also retire workers who are beyond their normal retiring age (Clause 22(a) Code of Conduct, 1975). Furthermore, with effect from 1998, all employers are required by virtue of s. 63 A of the Employment Act 1955 to submit a report on retrenchment to the nearest Labour Department of the impending retrenchment exercise at least one month before each retrenchment is carried out.

The principle of “Last in, first out” (*LIFO*) or “first come, last go” or “last come, first go” is recognized and applied by the Malaysian Courts (Ahmad Mir and Ahmad Kamar, 2003). *LIFO* means the junior employee would have to leave employment before the senior could be directed to leave (Ramasamy, 2002). According to Marsono and Jusoff (2008) such an arrangement has advantages to employees as it reduces the possibility that the management may make selections in terminating employees on the basis of favouritism. In the case of *Aluminium Company of Malaysia Bhd v Jaspal Singh* (1978), the employee was retrenched by the company on the grounds of redundancy, which was challenged on the ground that there was no such redundancy. In this case the Industrial Court ruled that the principles of *LIFO* have to be followed by the employer in the case of retrenchment. The Court found that the claimant’s job

was still in existence after his retrenchment and the employer had failed to consider that the claimant was the first who joined the company for the post compared to the other superintendents. As a result, the court held that the retrenchment was wrongly exercised. The Court also said that the question of comparative seniority of an employee for applying the principle of *LIFO* has to be determined with reference to the employee working in the same category. It is important to note that the principle of *LIFO* is only applied where other things are equal (Ahmad Mir and Ahmad Kamal, 2012). Ahmad Mir and Ahmad Kamal (2003) have pointed out that the principle of *LIFO* restricts employer’s common law right to decide which of the employees should be retrenched. Indeed, the employer can *bona fide* retain employees possessing special qualification in the interest of the business without following the principle of *LIFO*. However, the reason for departing from the rule must be stated in the order of termination (Ahmad Mir and Ahmad Kamal, 2003).

Marsono and Jusoff (2008) argued that the principle of *LIFO* is flexible and the Code is merely a moral guideline between the employer and employees and no penalty can be imposed against the employers for their failure to follow its provisions. Nevertheless, in the case of *Mamut Copper Mining Bhd v Chau Fook Kong & Others* (1997) and in *Weeluk Cooperation (Sarawak) Sdn Bhd v Wee Siak Luan* (1998) the courts emphasized in *Mamut’s* case that the employers are

expected not only to follow the *LIFO* principle but also other principles provided for by the Code. However, in the latter case the court held that a retrenchment is only justified if it is made in line with the accepted industrial relations standards, practices and procedures.

Accordingly, for the survival of the company or its business, a company has the right to downsize its workforce via redundancy or retrenchment, yet it must comply with the Code and *LIFO* before opting for a retrenchment exercise. It is fair to say that it has always been the company's prerogative to reorganize its business for the sake of the company or business survival. The courts will always respect the company's decision as they are not 'men of business'. Indeed the courts acknowledged the importance of making commercial decisions on the part of the company as an employer. Furthermore, the company as an employer has the prerogative power especially in matters relating to an improvement of its business (Marsono and Jusoff, 2008). However in doing so, the company must follow the law. Despite the prerogative power to organize and arrange its businesses including determining whether or not to retrench the employees, the company's purpose of carrying out a retrenchment exercise must be for genuine reasons as well as be free from *mala fide* or unfair labour practices. If there is no ample justification for redundancy, it shall be deemed that the termination was without just cause or excuse as decided by Federal Court in the case of *Goon Kwee Phoy v J*

& P Coats (M) Bhd (1981). Accordingly, in case of a breach of an employment contract or unfair dismissal by a company or an employer, legal action could be brought against them.

Debt for Equity Conversion/Swap

Another form of rescue activity available to ailing companies in the UK and Malaysia that may informally turn the company affairs around is debt-equity conversions. This can be defined as 'capital reorganizations in which creditors (usually, but not exclusively, lenders) exchange or convert a proportion of a company's indebtedness for one or more classes of its share capital' (Chatterji and Hedges, 2001: p.246). It is claimed that debt-equity transactions can provide an effective and efficient means of allowing troubled companies to continue operations and of avoiding formal insolvency procedures (Finch, 2009). Such transactions might be attractive for the creditors as well as companies. For companies these transactions may reduce their financial risk by improving their balance sheet structure whilst relieving cash flow and working capital difficulties. When a company plans for equity swap transaction, it is usually in a state where it is unable to meet its debt servicing burden and its business operations are seriously constrained, either by lack of operating or investment cash. Therefore, by substantially reducing its debt-servicing obligation a swap transaction provides a robust financial foundation for its turnaround (Chatterji and Hedges, 2001).

Debt-Equity conversion can also bring back strategic shareholders confidence in the company since debt swap transaction increases the company's financial strength (Finch, 2009). Through the transaction, the financial profile and gearing of the company will improve as debts and competitive disadvantages are eliminated. Consequently, the company has a brighter opportunity to get new credit line from creditors, to attract new business as well as to restore the confidence of its current customers. From the creditor's point of view, a debt/equity conversion is attractive because it would give them a chance to earn a higher return on their investment than the return available on liquidation (Finch, 2009). This is especially true in a situation where banks have given loans without collateral to larger quoted groups that have borrowed from many banks. The rate of recovery is very low in an insolvency process and as such debt/equity conversion can be more desirable than resorting to a formal insolvency procedure (Finch, 2009). In a prestigious project, a debt to equity conversion is a good public relations exercise for the creditors' companies because the public will see the creditors as being dedicated to the industry and devoted to its customers during their financial dilemma (Finch, 2009). In 1996 in the UK, the Department of Trade and Industry stressed the important contribution that debt/equity swap can make in allowing troubled companies to reorganise their affairs (DTI, 1996; Finch, 2009).

Apart from all the advantages mentioned, debt to equity conversion also faces a few

difficulties and drawbacks. Finch (2009) emphasises that in debt to equity conversion schemes, creditors will lose their priority (unless they are secured or preferential creditors) if the company was to liquidate due to their new status as shareholders, and they will only receive their payment after all the creditors have been paid. Another drawback of this scheme is that they tend to be considerably more complicated than conventional debt refinancing and rescheduling and involve many parties with conflicting interests and complex legal and regulatory issues which make it time consuming and expensive to complete a successful scheme (Chatterji and Hedges, 2001). In addition, extra shareholders bring considerable on-going legal and regulatory commitment, and banks do not normally have the administrative infrastructure to deal with shareholdings even though some of the commitment can be assigned to a lead or agent bank (Chatterji and Hedges, 2001). The Banks' situation as lender and shareholder can result in possible conflicts of interest, as there can be pressure to continue giving money to a company in which an institution is a shareholder, even though such lending does not meet the minimum credit requirement (Chatterji and Hedges, 2001).

Rescheduling and Extra Finance or Fund

Companies in distress can negotiate to restructure the terms of a company's debt and such agreement may operate informally and contractually (as well as within a formal process by means of SOA practised in

both UK and Malaysia; or CVA between the corporate debtor and its creditors or bankers which is practiced only in the UK). Rescheduling is “a contractual arrangement entered into by a debtor company or companies with all or some of their banks or creditors” (Lickorish, 1990: 53). Debt rescheduling permits the company to stay alive for the time being by reducing its debt servicing obligations in terms of reduced capital repayments and /or interest charges, besides which there is no direct injection of finance (Belcher, 1997).

Rescheduling the company’s debt may ease immediate problems faced by a troubled company, in particular where the company’s credit is supplied by a small number of banks and the company’s financial problems are short term in nature (Finch, 2009). Finch (2002) argued that rescheduling may catch the attention of the banks since such informality evades the adverse publicity involved in precipitating the liquidation of a company. According to her, rescheduling allows securities to be adjusted and may be appropriate where a few banks are involved, and the company’s financial problems can be overcome by changing the progressive interest or principal repayment (Finch, 2002). In addition, where creditors in a diversity of jurisdictions are involved with a company, it may be faster and cheaper to react to problems by negotiating new contracts rather than by resorting to formal proceedings (Finch, 2002). One of the main problems of rescheduling is that when many banks are involved and some banks feel uncommitted to the company involved, there is a lack of close relationship with the

company, and thus an absence of loyalty to the company (Finch, 2002).

When companies are faced with financial crisis, they can resort to their banks or other banks to provide additional finance if their individual managements are capable, and have a core business that is viable with good planning. These factors may give confidence to the banks to lend the company extra finance. It is fair to say that by offering extra finance at times of crisis the banks can and do rescue small companies. This is also referred to as ‘bank rescues’ (Belcher, 1997). Perhaps such ‘bank rescues’ are more straightforward in a case where the banks are already the lenders to the company and should know the company better to make a good evaluation of the company’s survival before getting involved with arrangements for any additional finance to the company. With faster reimbursement of the additional finance a company can react at an early stage to help solve its financial difficulty. For most companies such a problem may only be short term in nature, thus, quick additional financial help from the banks is enough. Apart from bank rescue another alternative available to a company facing financial crisis is to initiate formal rescue procedures. However, the bank, as a secured lender also has an option to initiate action for repayment of the facility or to put the company under liquidation process or appoint a receiver or an administrator (only applies in the UK). In this situation, the company is at the mercy of the banks.

In Malaysia, workouts or financing arrangements cover extra finance from banks and rescheduling which is similar to

practice in the UK.. Practically companies which are facing financial distress in Malaysia can negotiate with their bankers/creditors to reschedule their borrowing. Normally, if they have a viable proposal the banks/creditors would agree to reschedule their borrowing. This can be done by reducing their monthly repayments and thus prolonging the repayment period. Indeed, the central bank of Malaysia, Bank Negara, encourages banks to work closely with their clients (Central Bank of Malaysia, 1999). It is possible for companies facing financial difficulties to request that their bank give extra finance or funds to help them alleviate the problem (Central Bank of Malaysia, 1999). Again, the banks would normally look at the viability of the business in which the companies are engaged, and if the businesses were viable, this would improve the chances of the companies getting additional finance from the respective bank (Central Bank of Malaysia, 1999).

Informal workout: London Approach (LA) and Corporate Debt Restructuring Committee (CDRC)

The concept of informal workouts in the UK includes the 'London Approach' (LA) of which the Bank of England (BOE) is the patron. This approach has been copied and developed in some other countries including Malaysia; yet such an approach needs to be tailored to fit local circumstances. In Malaysia the establishment of the CDRC in 1998 with guidance and headship from the CBOM was inspired by the BOE supervision in the corporate workout

(Azmi and Abd Razak, 2011). The lack of an orderly arbitration to workout debtor-creditor problems without resorting to legal proceedings in rescuing financially troubled companies in both jurisdictions, was the main reason why the central banks in both countries published a set of non-binding guidelines via the LA and the CDRC. Accordingly, both the LA and CDRC provide incentives for corporate borrowers and their creditors/banks to negotiate a corporate workout outside the confines of the formal rescue process. The LA under the patronage of the BOE came into force in the UK thirty five years prior to the creation of the CDRC in Malaysia and indeed was the inspiring scheme behind the creation of the latter.

As noted, the CDRC's framework was a reproduction of the LA that has been tailored to fit into the specific conditions in Malaysia with some modification. The key features and framework of both mechanisms are similar. For instance, banks/creditors are supportive and sharing of information among the participants in the workout and losses are carried out in a fair manner (Kent, 1996; Rajandram, 1999). Indeed, their frameworks are comparable including a 'standstill'/moratorium' period among the creditors towards the debtors company where no enforcement actions are taken against the latter, as well as an investigation of the company's financial standing to determine the viability of the company's business. Such moratorium is informal rather than formal like the one available under formal rescue procedures within the

SOA (only Malaysia has a moratorium in its Scheme), administration and CVA with moratorium (applicable only for the UK). However, both informal and formal moratorium come within the collective rescue regime that holds back individual debt enforcement among creditors enabling it to prevent the damaging 'race to collect' among creditors that results in the gradual 'take to pieces' of the corporate assets.

Ironically, one of the weaknesses of the LA and CDRC lies with the informal moratorium, while another disadvantage of both workout frameworks is the need for unanimity of support from relevant creditors; if a single creditor refuses to agree to a proposed negotiation, this could result in a failed workout. Moreover a requirement for unanimity risks slowing down the workout process, and therefore they may be practicable when the creditors consist of a small group of banks rather than when large groups of banks and non-banks are involved. In the UK, the BOE in the past has suggested the possibility of majority voting as a solution for the need of unanimity, and unless such recommendation is implemented, it will remain the main disadvantage of a corporate workout. Nonetheless, such workout has the inherent fragility of being dependent upon a high degree of co-operation amongst a different range of parties, and it may be no exaggeration to say that the failure of such co-operation may result in the initiation of the liquidation process, which in many cases will lead to the downfall or demise of the company (Brown, 1996; Bird, 1996).

Under the frameworks of the LA and CDRC, if the company or its business is viable the banks may consider providing financial support for the troubled company that includes, amongst others, further lending of new money, which may help to overcome their financial problem. Yet such additional cash flow is normally given priority (by agreement) as the price for the former consent as well as reflecting the additional risk accruing to them, and this appears to portray that the banks/secured creditors fare better at the expense of other creditors as well as shareholders (Buljevich, 2005; Koh, 2003).

The differences between the LA and CDRC are illustrated in their choice of adviser; the LA, being more specific, will appoint a team of accountants to investigate the company's finances, whereas under the CDRC, such a similar task would be conducted by an independent financial advisor (consultant), which might include an accountant. Moreover, unlike the LA, the viability of the business was not the only criterion for a company to be eligible under the CDRC; the debtors should have had borrowings from at least two creditors amounting to a minimum aggregate borrowing of RM30 million. The LA can employ any suitable method for restructuring depending on circumstances, as it is up to those involved to agree whereas the restructuring method under the CDRC as reported included debt to equity conversion, debts/interest waiver, cash payment, debt rescheduling, redeemable instruments, convertible redeemable instruments and

convertible irredeemable instrument (Rajandram, 1999; CBOM, 2007). Similar to the role of the BOE under the LA, wherein the central bank acts as a peacemaker, the CBOM worked closely with the CDRC on the basis of the mediation concept in order to facilitate and steer negotiations between banks and corporate debtors. If the BOE plays the leading role of the mediator in the corporate workout based on the LA's structure, the same role was played by the CBOM through the Steering Committee (SC) headed by the Governor of the CBOM (Azmi and Abd Razak, 2011).

It is important to note that there are some problems as well as challenges for a non-statutory corporate workout under the framework of the LA and CDRC, like the issue of 'new money,' debt trading or credit derivative, (even though such issues probably arose with less attention within the CDRC). The arrangement via LA and CDRC is informal, has no binding legal status and can be called off by either party at any time. Notwithstanding that, the arrangement offers flexibility where no changes in power are required but the company may get a fresh injection of funds while creditors may strengthen their positions. Even though, CDRC announced its closure in 2002, it was restored in July 2009. CDRC was revived as part of pre-emptive measures against any large increase in nonperforming loans in the Malaysian banking system during the current global recession (Azmi and Abd Razak, 2011). CDRC remains as an informal corporate rescue workout even after it was revived in 2009. However, CDRC

is not for every company with financial difficulties. The applicant company, as part of the requirements, must have a potentially viable business and only those company that have aggregate indebtedness of RM30 million or more with at least two financial creditors are covered under CDRC (Azmi and Abd Razak, 2011).

CONCLUSION

A company can be rehabilitated without resort to the formal insolvency system if its financial distress is detected earlier and it can be resolved quickly through an informal rescue that offers many advantages to both creditors and debtors. What is important is for the company to have a viable business and the turnaround professional or 'company doctor' who can advise on the best alternative to take in order to rescue the company earlier, thereby increasing the chances of success. Informal rescue processes generally involve voluntary negotiations between the debtor and some or all of its creditors. Often these types of negotiations are developed through the banking and commercial sectors and typically provide for some form of restructuring of the companies in distress. Informal rescue offers a number of potential gains as it is faster and cheaper than formal rescue and offers a lot of confidentiality, thus protecting the goodwill and standing of the company. There is always flexibility in the informal rescue negotiation, where the terms and conditions of the rescue can be changed during negotiation, while formal rescue process would not have the same degree of flexibility. Despite all the

good points that informal rescue offers, it also suffers from weaknesses. The first weakness is the requirement of unanimity (like in the case of workout/arrangement with the lenders) where the agreement of all parties whose privileges are affected will generally be required if the rescue is to succeed. The second weakness is that there is lack of formal moratorium. Therefore, creditors who oppose the process have the right to disrupt the informal rescues by initiating formal insolvency procedures, including liquidation. This risk therefore makes an informal rescue a fragile device dependent on the cooperation of all parties. Nevertheless, it can be seen that there are always material advantages for both creditors and debtors in the speedy completion of informal rescue.

The above discussion on informal corporate rehabilitation reveals that there is a broad range of rescue activities or mechanism available to ailing companies and creditors to figure out if the company or its business is viable and deserves to be rescued. It can be seen that ailing companies may be “reorganised (where, for example, managerial reforms are instituted), restructured (where, perhaps, closures of elements of the business are involved), refinanced (as where new capital is injected or debts are rescheduled), downsized (where operations may be cut-back, workforces reduced or activities rationalised) or subjected to sell-offs (where parts of the business are sold to other firms or even to managers in management buyouts” (Finch, 2009; p.244). The discussion on

types of rescues activities is definitely not comprehensive. However, rescue measures like sell-offs, MBO, retrenchments and debt equity conversion are some of the common rescue measures that are available in both Malaysia and the United Kingdom.

Such rescue measures could all occur outside formal rescue regimes and for some troubled companies this could be part of a formal proposal within a formal rescue procedure. For instance, a MBO can take place under receivership or debt for equity conversion within a SOA or CVA (only in UK). Meanwhile in large-scale informal workout or arrangements for companies with banks or creditors, unless unanimity of support of the affected creditors is obtained, the workout would fail. Arguably, the participants have the option to organise the workout within a formal rescue regime like the SOA that can proceed with majority voting and without unanimity, but binds both dissenters and the apathetic. Formal and informal rescue procedures are related, partly because formal rescue procedures provide the baseline for negotiations among stakeholders seeking to achieve an informal rescue (Walter and Armour, 2006). In this sense, in the UK context it is claimed that the Enterprise Act 2002 affects the terms on which the various interested parties bargain in the shadow of the law and may therefore influence their behaviour prior to the commencement of a formal rescue procedure (Walter and Armour, 2006). While in Malaysia, it is pointed out that the informal rescue or workout co-exists with formal rescue proceedings and for informal

workouts to be effective, there must be mechanisms in place within the existing legal infrastructure to transform the informal agreements into legally effective solutions (Kit Lee, 2001). Meanwhile, international organisations like World Bank recognise that informal workouts are negotiated in the 'shadow of the law' and an environment that includes clear laws and procedures is necessary to encourage participants to restore an enterprise to financial stability (World Bank, 2005). Formal rescue procedures do indeed form the backdrop to these workouts/arrangements and if informal rescue (turnaround or workouts) fails, the company goes into formal rescue procedures.

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Exercising the Principle of Free, Prior and Informed Consent (FPIC) in Land Development: An Appraisal with Special Reference to the Orang Asli in Peninsular Malaysia

Rohaida Nordin* and Mohd Syahril Ibrahim

Faculty of Law, Universiti Kebangsaan Malaysia, 43600 Bangi, Selangor, Malaysia

ABSTRACT

Contemporarily, the rights of indigenous peoples are considered to include the right to free, prior and informed consent (FPIC), perceived as mandating consultations and negotiations between indigenous peoples and interested parties, followed by approval from the indigenous communities affected prior to the beginning of initiatives, whether social, political or developmental in nature. The current article considers the situation of the Orang Asli in Malaysia against the growing support for FPIC within international, regional and domestic legal regimes. This paper will be structured as follows: firstly, the exercise of the right to FPIC is defined in the context of the rights of indigenous peoples. Secondly, existing international, regional and domestic legal frameworks that promote FPIC for indigenous peoples are examined. Thirdly, the approach taken by the Malaysian government towards the Orang Asli in relation to FPIC and development projects is surveyed. Lastly, recommendations are made in light of the challenges faced by interested parties when indigenous peoples desire to exercise the right to FPIC.

Keywords: Free, prior and informed consent, indigenous peoples, Orang Asli, land development

INTRODUCTION

Consent, as the basis for relations between States and indigenous peoples, was observed as early as 1975 by the International

Court of Justice (ICJ) in its advisory opinion in the *Western Sahara* case. In that case, the ICJ stated that entry into the territory of indigenous peoples required the freely informed consent of that peoples as evidenced by an agreement. Around the world, large-scale infrastructure and extractive industries' projects are being developed at a fast pace. These projects are driven by an ever-increasing demand for

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E-mail addresses:

rohaidanordin@ukm.my (Rohaida Nordin),

tresz_addin04@yahoo.com (Mohd Syahril Ibrahim)

* Corresponding author

natural resources, which includes logging for timber, mining for minerals and oil, and damming rivers for hydro-electric power production. Such development projects, however, can lead to massive changes in the lives of people, as they affect the nature of their livelihoods which revolve around the environment in and around the project area. However, if developed sustainably, these projects can bring about benefits for local residents, avoiding negative environmental and social effects. In most cases, such projects lead to violations of human rights, as the development often takes place without any real consideration for the rights and interests of the indigenous peoples and the environments in which they live.

Indigenous peoples have fought for recognition of their right to give or withhold consent for project development by their national governments, the international community and private companies. This right relates directly to the right for indigenous peoples to control their own future and the future of their people. The right to free, prior and informed consent (FPIC) has been stated as the right “to give or withhold their free, prior and informed consent to actions that affect their lands, territories and natural resource” (Tamang, 2004). This right is often violated when there are large-scale development projects, such as mineral resource, timber resource, agricultural or infrastructural development. Often, indigenous peoples and other community members are left out of the planning and decision-making process in these projects. The outcome can be devastating: indigenous peoples and

other project-affected communities risk a permanent loss of their livelihoods and cultures, as lands can be damaged or taken without their consent. Resettlement is often forced upon communities while inadequate compensation is offered (Errico, 2006).

The principle of FPIC is recognized to be deeply related to the human rights approach to development which turns subjects, including indigenous peoples, from passive recipients to right-holders and active participants in development programmes.¹ A human rights approach to development has the human being at its main focus, and gives attention to the manner in which development occurs, not simply on the outcome of the project.² The United Nations Development Program (UNDP) meaningfully relies on the FPIC of indigenous peoples when incorporating their perspectives in development planning (UNDP, 2005). Additionally, such a connection has also been highlighted by the United Nations (UN) Committee on the Elimination of Racial Discrimination. The issue of FPIC can be addressed as a combination of a right to property and the right to self-determination. In practice, FPIC

¹ The International Workshop on Methodologies regarding FPIC and IP was convened in accordance with Economic and Social Council decision 2004/287 of 22 July 2004, following a recommendation of the Permanent Forum on Indigenous Issues at its third session and was held from 17 to 19 January 2005.

² As spelt out in the paper *Engaging indigenous peoples in governance processes: International legal and policy frameworks for engagement* by the UN Forum on Indigenous Issues.

is premised upon the notion that indigenous peoples have the right to determine what use should be made of their lands, territories and resources (Rohaida & Matthew, 2012). The principle of FPIC of indigenous peoples in relation to policies, programmes, projects and procedures affecting their rights and welfare has been widely discussed by inter-governmental organizations and international bodies, and has been the subject of provisions in conventions and international human rights instruments, and is being increasingly recognized in the laws of States (MacKay, 2004).

In Malaysia, the Aboriginal Peoples Act 1954 (APA 1954) acts as the main law for the Orang Asli groups; however, it contains no specific provisions regarding the concept of FPIC to the Orang Asli when development projects affect their land. There is no exclusive right given to the Orang Asli, as they only have rights of occupancy despite having inhabited a particular place for many years. This allows various groups to take advantage of the situation, since the provision does not require the consent of the Orang Asli, unlike the provisions regarding FPIC enshrined in international instruments.

For the purpose of this research, the theoretical analysis will be employed, by looking into the existing legal instruments pertaining to the concept of FPIC to indigenous peoples. This paper will also examine a case study in Malaysia regarding the position of the Orang Asli in order to gain a better understanding of the principle of FPIC to them. This paper will be structured as follows: firstly, the exercise of the right

to FPIC is defined in the context of the rights of indigenous peoples; secondly, existing international, regional and domestic legal frameworks that promote FPIC for indigenous peoples are examined; thirdly, the approach taken by the Malaysian government towards the Orang Asli in relation to FPIC and development projects is surveyed; lastly, recommendations are made in light of the challenges faced by interested parties when indigenous peoples desire to exercise the right to FPIC.

THE CONCEPT OF FREE, PRIOR AND INFORMED CONSENT (FPIC)

FPIC is vital to upholding the human rights of indigenous peoples and local communities (Cacas, 2004). In accordance with FPIC, individuals and communities should be informed in appropriate, accessible language about projects that might take place on their land. The principle also seeks to guarantee that indigenous communities are given the opportunity to give, withhold or negotiate land use and related issues. When it has been determined that FPIC should be implemented, an approach for the implementation must be pursued. Such an approach begins with the identification of the specific characteristics of FPIC. These include the following:

Free: Decision-making and information-gathering by potentially affected people(s)/communities must in no way be limited by coercion, threat, manipulation, or unequal bargaining power. Consent must be entirely voluntary (Goodland, 2004; MacKay, 2004). It also connotes the absence of coercion

and outside pressure, including monetary inducements (unless they are mutually agreed to as part of a settlement process), and “divide and conquer” tactics. It includes the absence of any threats or implied retaliation if the results of the decision are to say “no”.

Prior: To be meaningful, consent must be sought after sufficiently, in advance of any decisions by the State or third parties, or any commencement of activities by the project proponent that will affect people(s)/communities and their lands, territories, and resources. ‘Prior’ means having sufficient time to allow for information-gathering and full discussion, including translations into traditional languages, before a project starts. It must take place without time pressure or constraints. A plan or project must not begin before this process is fully completed and an agreement is reached.

Informed: Disclosure of information concerning the nature, purpose, expected impacts, risks, and benefits of the proposed development must be made fully and accurately, in a form that is both accessible and understandable to the affected people(s)/communities with an understanding of how they specifically will benefit, and how these benefits compare to projected impacts and potential worst-case scenarios (and alternatives). Furthermore, potentially affected people(s)/communities must be fully informed of their own rights and understand the legal processes guiding the implementation of the project. Being informed is having all the relevant information available reflecting all views and positions. This includes the input

of traditional elders, spiritual leaders, subsistence practitioners and traditional knowledge holders, with adequate time and resources to consider impartial and balanced information about potential risks and benefits.

Consent: Consent does not necessarily mean that every member of the affected people(s)/communities must agree, but rather that consent will be determined pursuant to customary law and practice, or in some other way agreed upon by the community. The affected people(s)/communities need to specify which person/entity will represent them, and the project proponents must respect the representative(s) chosen by the community as the only legitimate provider(s) of consent. For many persons, the term “consent” connotes that the consent must be un-coerced and entirely voluntary; for these persons, the term “free” is redundant.

Methodologies on free, prior and informed consent should consider, as their basic objective, the improvement of the living conditions of indigenous peoples and that FPIC necessarily extends to all matters that relate to the life of indigenous peoples. The principle of FPIC encompasses not only a procedure to be elaborated, but also a right associated with indigenous peoples’ right to self-determination, treaties and indigenous peoples’ rights to lands, territories and natural resources (Perrault, 2006). Procedures concerning FPIC should recognize indigenous customary law where this is relevant, and address the issue of who represents the indigenous peoples. This principle is an evolutionary process

that could lead to co-management and decision-making by indigenous peoples on programmes and projects affecting them. FPIC is particularly relevant for the prevention of conflict and for peace-building (Motoc, 2004).

The definition of FPIC for local communities varies by context, and is generally described as a consultative process whereby potentially affected communities engage in an open and informed dialogue with individuals interested in pursuing activities in the area(s) occupied or traditionally used by the affected community. Discussions should occur prior to, and continue throughout, the time the activity is conducted, and communities should have the right to withhold consent at decision-making points during the project cycle. At no time should consent be coerced.

The implementation of the principle of the FPIC presents a number of practical problems. For example, the term “free”, “prior” and “informed consent” practically seems to be difficult to understand, not to mention how is consent given, and who gives the consent in a diverse community. In implementing FPIC, how do we ensure a balance between the State, the general public interest, and affected community interests, particularly in the distribution of benefits? Another issue is related to the person who is put in charge in providing information and impact assessments on projects that affect indigenous communities. Another related problem is the methods used to reach the indigenous peoples in obtaining information that affect their rights as a whole. Lastly, if

their rights to give or withhold FPIC are neglected, what form of redress should be available to indigenous peoples? Thus, it could potentially create more problems and challenges in ensuring that the indigenous peoples can freely exercise the principle of FPIC (Bulan, 2010).

By determining each meaning of FPIC holistically, its implementation can be more effective, and thus, give a clear argument that the indigenous peoples’ right to FPIC is vital, as it affects their communities at large. In the next section, the paper will briefly explain the concept of FPIC and its relationship with sustainable development concepts.

FPIC AND SUSTAINABLE DEVELOPMENT

Sustainable development is a complex and ever-expanding concept, incorporating social, cultural, economic, political and environmental issues – though essentially, sustainable development is a political concept. It promotes a strategy for development that seeks to marry environmental protection with economic and social development. Sustainable development has consistently recognized the importance of indigenous peoples and their rights as provided in Agenda 21³.

³ Section 3 of Agenda 21 provides for arrangements to be made to strengthen the active participation of indigenous peoples and their communities in the national formulation of policies, laws and programmes relating to resources management and other development processes that may affect them and their initiation of proposals for such policies and programmes.

On this basis, sustainable development policy approaches relevant to indigenous peoples should include two main features. Firstly, recognition and respect for legal measures aimed at the equal protection of indigenous rights and interests. Such legal measures may include legislation aimed at the recognition of land rights and the protection of cultural heritage as well as of indigenous knowledge systems through intellectual property law. In the event that such legislation fails to provide equal protection, a sustainable development approach should incorporate wider measures of protection to address this failure. It is noteworthy that international law standards are not only relevant to nation-States. There is a growing expectation that regional governments, administrative bodies and even corporations have a role in achieving human rights standards.

The second feature of a sustainable development approach relevant to indigenous peoples should be the incorporation of self-determination. Critically, self-determination is not an outcome, it is a process. This process is aimed at handing control of the economic, social, political and cultural development of indigenous peoples. While this may seem like a monumental task, it begins with respect for and incorporation of traditional decision making processes, the active participation of indigenous peoples in decisions which affect their rights and interests, and the opportunity to provide or withhold their informed consent for such decisions. Thus, should the development projects affect indigenous peoples, it must

be ensured that the rights of the indigenous peoples are protected and preserved.

LEGAL FRAMEWORK OF INDIGENOUS PEOPLES' RIGHT TO FPIC

This section aims to analyze the existing legal frameworks that govern the indigenous peoples' right to FPIC. Thus, the scope of the discussion will focus on the three (3) levels of legal frameworks. Firstly, the discussion will look into the international legal framework such as the provision in UNDRIP and ILO 169. Next, the provision from regional legal frameworks such as The Inter-American Commission on Human Rights (IACHR) and The Inter-American Development Bank's (IADB) 1990 will be examined. Lastly, the discussion will focus on the national legal frameworks that govern indigenous peoples' right to FPIC. It should be noted that since judicial recognition regarding the right of the Orang Asli to FPIC in land development is yet to be recognized, the international treaties such as UNDRIP and regional frameworks are the unfailing sources, of which the spirit of the law is embraced and applied by Malaysia constitution, as they are well-served to encounter the issues surrounding indigenous peoples particularly relating to the right to FPIC. These frameworks are important yardsticks to measure whether they are practical and compatible to be used within the Malaysian context of the Orang Asli right of FPIC.

International Legal Framework. Under international law, FPIC is one of the

basic rights enjoyed by indigenous peoples who have established distinct cultures, settlements and civilizations in countries across the world, long before the formation of present nation-States. It recognizes two basic facts: the first, that indigenous peoples have always had and still have rights over their lands, territories and resources; and the second, that indigenous peoples have the right to determine their own direction, priorities and processes of development and lifestyles.

The application of FPIC in relation to indigenous peoples, is formally and explicitly recognized in international law in various declarations and conventions, including the UN Declaration on the Rights of Indigenous Peoples (UNDRIP); ILO Convention No. 169 on Indigenous and Tribal Peoples 1989 (ILO 169); and the Convention on Biological Diversity (CBD) (Rohaida, 2010).

i. The United Nations Declaration on the Rights of Indigenous Peoples (UNDRIP).

The UNDRIP is a universal instrument adopted by the UN General Assembly on 13th September, 2007. In his comments to the UN Permanent Forum on Indigenous Issues, Permanent Forum member, Smith (2009) stated that the Declaration is formulated as a principle of law and, as such, is part of binding international law and a source of international law which, according to the Statue of the International Court of Justice Article 38, should be applied by the Court (Rubis, 2010). The provisions of the

UNDRIP explicitly affirm the right to FPIC and States' obligations to obtain it in many of its provisions, including:

Article 10 affirms that indigenous peoples shall not be forcibly removed or relocated from their lands or territories without their FPIC;

Articles 19 affirms that States must obtain the FPIC of indigenous peoples before adopting and implementing legislative or administrative measures which may affect them;

Article 29 affirms that indigenous peoples must give their FPIC before hazardous materials are stored or disposed of on their lands;

Article 32 affirms that States must obtain FPIC prior to the approval of any development projects affecting indigenous peoples' lands and resources, "particularly in connection with the development, utilization or exploitation of mineral, water or other resources".

Other provisions in the UNDRIP do not make reference to FPIC explicitly, but instead include language that has been interpreted as requiring FPIC, such as in Article 26 which explicitly addresses the right of indigenous peoples to natural resources. The pertinent language includes:

“[i]ndigenous peoples have the rights to the lands, territories and resources which they have traditionally owned, occupied or otherwise used or acquired,” and “[i]ndigenous peoples have the right to own, use, develop and control the lands, territories and resources that they possess by reason of traditional ownership or other traditional occupation or use ... States shall give legal recognition and protection to these lands, territories and resources.”

It is interesting to note that in American law, the language recognizing the right to property in the American Convention on Human Rights and the American Declaration of the Rights and Duties of Man has been interpreted as requiring that the State to ensure that prior informed consent is obtained from indigenous peoples and other local communities with significant ties to natural resources before carrying out any activity that may adversely impact their ability to enjoy these resources. Articles 25 and 31 of the Declaration on the Rights of Indigenous Peoples also address the relationship of indigenous peoples to natural resources. Article 25 states, “[i]ndigenous peoples have the right to maintain and strengthen their distinctive spiritual relationship with their traditionally owned or otherwise occupied and used lands, territories, waters and coastal seas and other resources and to uphold their responsibilities to future generations in this regard.” Thus, it can be said that Article 26 requires the

State to obtain prior informed consent from the indigenous peoples before any activities are conducted.

To what extent does the Declaration embrace an absolute right to FPIC? Although Articles 10 and 29 clearly prohibit action without consent, and contain no language qualifying the right to FPIC, the language utilized in Article 46 can be interpreted as providing opportunities for State action in the public interest under very limited conditions. Article 46 states that the exercise of the rights set forth in this Declaration shall be subject only to such limitations as are determined by law, in accordance with human rights obligations. Any such limitation shall be *non-discriminatory and strictly necessary* solely for the purpose of *securing due recognition and respect* for the rights and freedoms of others, and for *meeting the just and most compelling* requirements of a democratic society.

ii. *International Labor Organization Convention No.169 on Indigenous and Tribal Peoples (ILO 169).*

The ILO 169 emphasizes on the shift to improve the living conditions of indigenous peoples worldwide after the amendment of the ILO 107⁴ in the conceptual approach

⁴ Indigenous and Tribal Populations Convention, 1957 (No. 107) of the International Labour Organization (ILO) is an international instrument adopted to protect Indigenous populations from oppression and discrimination. The convention was drafted in the wake of rising concern about human rights following World War II. It is legally binding in the countries that have ratified it, but has since been amended in many countries by ILO Convention 169.

to indigenous and tribal peoples towards one based on respect for their specific identity and their right to participate in the decision-making process in all questions and programmes directly affecting them; that is to say, to participate in decision making for the determination of their own futures.

The Convention has 32 operative articles and is based on two fundamental concepts: consultation and participation. It is premised on the belief that indigenous and tribal peoples should have the right to be consulted when legislative and administrative measures which may affect them are being considered; that they should have the right to participate at all levels of decision making concerning them; and that they should have the right to decide their own development priorities. Consultation refers to the process and/or procedure by which indigenous peoples participate in decision making by States on issues which impact and affect their lives. Thus, it is clear that the right of 'consultation' referred to in ILO 169 is not the same as FPIC. The latter sets a standard for "effective participation in decision making", while the former provides for a right to be informed and heard on any particular issue, but not necessarily a right to consent to State action before it is undertaken. For example, compare ILO 169 Article 6 with UNDRIP Article 19. Article 19 sets forth clearly that the purpose of State consultation and cooperation with indigenous peoples is "*in order to obtain their free, prior, and informed consent...*" Having said that, the author believes the right to consultation

complements FPIC, therefore promoting the right to participate for indigenous peoples in decision making processes. Similar to Article 18 and 19 of UNDRIP, Article 6 (1) (a) of ILO 169 requires the government to consult the peoples concerned, through their representative institutions, whenever consideration is being given to legislative or administrative measures that may affect them directly. Thus, before adopting any legal or administrative measures that might affect indigenous peoples directly, the government must have open, frank and meaningful discussions with the people concerned. Article 6(2) requires that consultation be undertaken "*in good faith ... in a form appropriate to the circumstances, with the objective of achieving agreement or consent.*" This does not require consent, but does require that it be the objective of consultations. This is often overlooked when examining complaints filed by indigenous peoples under the provisions of ILO 169 (ILO 169, A.24), but it is an important requirement of the Convention that establishes, at a minimum, a moral obligation to seek and obtain consent (ILO 169, A.24).

Unlike the UNDRIP, the indigenous peoples' right to consultation in ILO 169 extends even to decisions about natural resources that remain under State ownership. Consultation is required to ascertain whether and to what degree their interests would be prejudiced before undertaking or permitting any developmental programmes for the exploration and exploitation of such resources pertaining to their land (ILO 169,

A.15(2)). Similar to the UNDRIP, ILO 169 also provides that relocation of indigenous peoples shall take place only with the FPIC (ILO 169, A.16 (2)).

iii. Convention on Biological Diversity (1992).

The Convention on Biological Diversity (CBD) was inspired by the world community's growing commitment to sustainable development. It represents a dramatic step forward in the conservation of biological diversity, the sustainable use of its components, and the fair and equitable sharing of benefits arising from the use of genetic resources. This clearly protects the rights of the affected groups, including the indigenous and local communities. Article 8(j) for example, requires that the traditional knowledge of indigenous and local communities may only be used with their "approval", which has subsequently been interpreted to mean with their prior informed consent, or FPIC. Thus, the convention promotes the rights for affected groups including the indigenous people to give approval when the actions would affect them (Rohaida *et al.*, 2012).

iv. Other International Instruments.

Other international instruments have been utilized to bolster the rights of indigenous peoples at the domestic level. For example, in 2001, the UN Committee on Economic, Social and Cultural Rights deliberated on the issue pertaining to traditional land in Columbia, and noted, "with regret that the traditional lands of indigenous peoples

have been reduced or occupied, without their consent, by timber, mining and oil companies, at the expense of the exercise of their culture and the equilibrium of the ecosystem." It then recommended that the State "ensure the participation of indigenous peoples in decisions affecting their lives. The Committee particularly urges the State party to the ICESCR to consult and seek the consent of the indigenous peoples concerned ..."

REGIONAL LEGAL FRAMEWORKS

The indigenous peoples' rights to FPIC as enshrined in international legal frameworks such as UNDRIP and ILO 169 is followed by the regional level in their principle related to FPIC itself. It can be seen in the following discussions.

i. The Inter-American Commission on Human Rights (IACHR).

The Inter-American Commission on Human Rights (IACHR) has developed considerable jurisprudence on FPIC. In 1999, finding that Nicaragua had violated, among others, the right to property by granting logging concessions on indigenous lands in Nicaragua, the Commission held that the State "is actively responsible for violations of the right to property ... by granting a concession ... without the consent of the Awas Tingni indigenous community." (IACHR, 1999).

The same approach was used in 2002 in the *Mary and Carrie Dann Case*, where the IACHR found that Inter-American human rights law requires "special measures to

ensure recognition of the particular and collective interest that indigenous peoples have in the occupation and use of their traditional lands and resources and their right not to be deprived of this interest except with fully informed consent, under conditions of equality, and with fair compensation.” The Commission concludes that the United States in its treatment of the Danns and their land rights had violated Articles II (right to equality before the law), XVIII (right to a fair trial), and XXIII (right to property) of the American Declaration on the Rights and Duties of Man. The IACHR also in their conclusion stated that any determination of indigenous peoples’ interests in land must be based upon a process of fully informed and mutual consent on the part of the indigenous community as a whole. This is to include: 1) members must be fully and accurately informed, and 2) members must have an effective opportunity to participate as individuals and as collectives.

ii. The Inter-American Development Bank’s (IADB) 1990.

The Inter-American Development Bank’s (IADB) 1990 Strategies and Procedures on Socio-Cultural Issues as Related to the Environment provides that: “[i]n general the IADB will not support projects affecting tribal lands and territories, unless the tribal society is in agreement”. The IADB is presently formulating a binding operational policy on indigenous peoples, and preliminary strategy papers on this policy include FPIC (IADB, 2004). Thus, FPIC is already included in the IADB’s

policy on Involuntary Resettlement as stated in Section IV.

NATIONAL LEGAL FRAMEWORKS

The Philippines, Malaysia, Australia, Venezuela, and Peru have national legislations on the FPIC of indigenous peoples for all activities affecting their lands and territories.

i. Indigenous Peoples Rights Act (1997).

In the Philippines, the *Indigenous Peoples Rights Act* (1997) recognizes the right of FPIC of indigenous peoples for all activities affecting their lands and territories including:

- a. Exploration, development and use of natural resources;
- b. Research-bio prospecting;
- c. Displacement and relocation;
- d. Archaeological explorations;
- e. Policies affecting indigenous peoples such Executive order 263 (Community Based Forest Management);
- f. Entry of Military.

The significance of the IPRA of the Philippines is primarily in the policy and rights framework that it establishes for the recognition of territorial, land and resource rights of indigenous peoples and the requirement for FPIC for all developments affecting them. This clearly defines their rights - not as individual rights, but collective rights, with attendant rights to self-governance and self-directed

development. Aside from being an important strategy for peace and security, FPIC is really but “best development practice” and “best governance practice” - in short, sustainable development in practice. Since the World Bank principles were adopted into its policies, it gives a good guideline for the Philippines as well as other countries that have adopted this “best” development and governance practice.

ii. *Australian National Legal Framework.*

In five states of Australia, consent has been obtained through statutory indigenous-controlled Land Councils in the mining area for more than 30 years. These consent procedures were reviewed by the National Institute of Economic and Industry Research in 1999, which found that they had been successful in safeguarding aboriginal control over aboriginal land and have also provided a process of negotiation by which an increasing proportion of aboriginal land in the territory had been made available for mineral exploration. Consent is obtained through statutory, indigenous-controlled Land Councils, which may not consent to a mining license unless: they are satisfied that the traditional Aboriginal owners of the land in question understand the nature of the activity and any terms or conditions and, as a group, and satisfied that the terms and conditions prove reasonable, and they agree on the terms and conditions with the miner. Similar numbers cases could also be found for mining on Aboriginal lands in Canada, where indigenous peoples have negotiated agreements giving their consent.

iii. *Malaysian Charter on Human Rights.*

In the preamble of the Malaysian Charter on Human Rights, it is clearly stated that recognition and respect of the right to political, social, cultural and economic self-determination of all peoples are fundamental to the protection of dignity and equality; and to justice, peace and freedom in our country. The relevant provisions are:

Article 4 – Development. *The right to holistic development is a basic human right. In order to attain socially equitable and environmentally sustainable development, there must be respect for civil and political rights as well as social, cultural and economic self-determination of all people. The peoples’ participation in the development process is essential to ensure that development is socially just and culturally appropriate.*

Article 7 – Environment. *All peoples and nations have a right to participate in decisions regarding local, regional, and global environmental issues such as nuclear arsenals, storage, transportation, and dumping of toxic wastes, pollution, and location of hazardous industries.*

It is suggested from the above provisions that all peoples, include the Orang Asli have a right to take part in decision making that may affect their lives. Indirectly, the concept of FPIC is stipulated in this Charter that

needs to be well observed by all interest groups.

In West Malaysia, Sarawak State passed the Sarawak Biodiversity Centre Ordinance 1977, and then the 1998 Sarawak Biodiversity (Access, Collection and Research) Regulations. The Sarawak Council is responsible for regulating access, collection, research, protection, utilization, and export of the State's biological resources. In 2004, the Sabah State of Malaysia in its "Framework for Incorporating Indigenous Communities within the Rules Accompanying the Sabah Biodiversity Enactment 2000" created a system rule that ensures indigenous peoples "shall all times and in perpetuity, be legitimate creators, users and custodians of traditional knowledge, and shall collectively benefit from the use of such knowledge."

From the preceding it can be seen that FPIC is an established feature of international human rights norms and development policies pertaining to indigenous peoples. Indigenous peoples' right to FPIC is clearly recognized under a range of universal and regional human rights instruments as well as in domestic law. As the principle of FPIC is well recognized internationally, the discussion will focus on the application of the right of FPIC for the Orang Asli in Malaysia, and to analyze whether or not the right to FPIC is recognized in the next section.

FPIC IN THE MALAYSIAN CONTEXT REGARDING THE ORANG ASLI

Malaysia consists of two landmasses separated by the South China Sea. The first, Peninsular Malaysia, is located between Thailand to the north and Singapore to the south. The second landmass consists of the states of Sabah and Sarawak on Borneo, the world's third largest island. The Malaysian governmental system is based upon a constitutional monarchy and a three-tier governance system comprised of the local, state and federal governments. The nation was formed as a federation in 1963 with Malaya, Singapore, Sarawak and Sabah joining together as Malaysia. Singapore later withdrew from this federation in 1965. The indigenous peoples of Malaysia, collectively known as Orang Asal, comprise the Orang Asli groups of Peninsular Malaysia as well as natives of Sabah and Sarawak. For the purposes of this article, the author will focus on the Orang Asli in Peninsular Malaysia only.

As discussed in the previous section, the UNDRIP contains extensive provisions for the recognition and protection of indigenous lands, territories and resources, including the principle that indigenous peoples shall have the right of consultation, participation and FPIC in matters affecting their lands, territories and resources.

Malaysia voted in favor of the UNDRIP, both at the Human Rights Council and at the General Assembly with no reservations (Yogeswaran, 2008; Yogeswaran, 2011). Although the UNDRIP is stated to be non-

binding, Malaysia's vote in favor of the UNDRIP creates a moral obligation and genuine expectation for it to pursue the standards contained in the UNDRIP in the spirit of partnership and mutual respect (UNDRIP, para 24; Yogeswaran, 2011). With its strong support for the passage of the UNDRIP from the UN Human Rights Council to the General Assembly, Malaysia has a special obligation to show that the principles and articles of UNDRIP are upheld within the State. While Malaysia is one of the nations that have agreed to the principles of the UNDRIP, Malaysia has only signed and ratified the Convention on Elimination of Discrimination against Women (CEDAW) and the Convention on the Rights of the Child (CRC), opting not to ratify other instruments including the International Covenant on Civil and Political Rights or the International Covenant on Economic, Social and Cultural Rights. The ILO 169 places special emphasis on the principles of consultation and participation, but Malaysia is not a signatory, nor has the government ratified the ICCPR. On the other hand, Malaysia has been more progressive in endorsing environmental treaties, amongst them the Convention on Biological Diversity (CBD), which provides several articles, most notably Article 8(j) for the protection of indigenous peoples' resources. In part fulfillment of its obligations under the CBD, the Malaysian Government has established a committee concerned with access, benefit-sharing and traditional knowledge, with three government agencies led by the Conservation and Environmental

Management Division.

For a long time, the advocates at international consultations on indigenous issues have consisted of representatives of NGOs working among indigenous peoples, who may or may not be indigenous peoples themselves working alongside government officials. PACOS Trust, COAC (Centre for Orang Asli Concerns) and SAM (Sahabat Alam Malaysia) are among the examples that have been the voice of the minority indigenous peoples at many international forums for many years, and have performed tremendous work in creating awareness of the plight of Malaysia's indigenous peoples. In recent years, in response to international developments, there has been an increase in multi-stakeholder consultations linked to both government and non-governmental institutions involving issues affecting indigenous peoples. This has created an avenue for indigenous peoples' leaders, through their cultural associations, to join the consultations as representatives of their own communities. The real respect and contribution for indigenous voices in policy implementations remains to be seen.

Having said that, international law also recognizes the right of States to act in the public interest under certain conditions. However, no official interpretation of international law existsto describe specifically *how* the rights to FPIC of indigenous peoples and other local communities relate legally, or to the rights of States to manage natural resources in the public interest in practice.

Be that as it may, the implementation of the indigenous peoples' right to FPIC in Peninsular Malaysia is slightly different (Noor Ashikin Hamid *et al.*, 2011). It has and needs to be seen in the wider perspective of the circumstances which involve this community. 'Orang Asli' is the homogenous term given to all eighteen (18) non-Malay indigenous groups on the Malay Peninsula, which total around 180,000 people. Orang Asli land rights are governed by the Aboriginal People's Act of 1954 (APA 1954). Under this Act, the State may declare an area customarily and currently inhabited by the Orang Asli to be an "aboriginal area." The Orang Asli have exclusive rights of occupancy of this customary land and use of its natural resources, but have no rights of ownership (APA, S8 (1)). They cannot sell, lease, or grant this land without permission from the Commissioner of Aboriginal Affairs (APA, S9), a post which has never been held by an Orang Asli. The government may take the land at any time, and must only pay compensation for the value of the crops and dwelling on the land, not the land itself (APA, S.12).

It is important in this section to look into the evolution of the Orang Asli rights to land and natural resources, especially to the right of FPIC. The APA 1954 contains no specific provision concerning FPIC. As discussed before, there is no exclusive right given to the Orang Asli, as they only have the right of occupancy, despite having inhabited a particular place for many years. For example, Section 6(3) and Section 7(3) of the APA give complete power

to the State to revoke, wholly or partly, the declaration of Aboriginal Area and Aboriginal Reserves without FPIC. If the land is acquired by the State and affects the Orang Asli, compensation can be given by virtue of Section 11. However, in Section 12, it is stated that compensation made by the State is not obligatory. The State has discretionary power whether or not to grant the compensation to the affected Orang Asli. It is clearly stated that the provision does not require the consent of the Orang Asli, unlike the provisions regarding FPIC enshrined in international instruments (Yogeswaran, 2008).

In a 1998 case, *Kerajaan Negeri Johor & Anor v Adong bin Kuwau & Ors*, 52 Orang Asli claimed right over the land which was alienated to the Johor Corporation. The high court ruled that the Orang Asli is entitled to compensation only for what is over the land, and not for the value of land itself. Nevertheless, in a 2002 case, *Sagong bin Tasi v. Selangor State Government*, the Malaysian High Court declared that the Orang Asli have a proprietary interest in their customary lands, including the right to use and derive profit from the land. The Court further declared that Orang Asli land fell under the Land Acquisition Act 1960, which governs all land acquisitions in Malaysia, and that the government taking of the land required compensation in the same manner as imposed upon non-Orang Asli land. The Court of Appeal affirmed the decision.

It can be said that the land right given to the Orang Asli is only to the right of

occupancy, and not of ownership, as the land is subjected to specific provisions within the Land Acquisition Act, 1960. Thus, the Orang Asli cannot exercise the concept of FPIC as originally, they do not have the right of ownership on the land. This is a sad situation as it seemingly contradicts the principles that serve as the foundation for the recognition of FPIC within the text of international instruments. While Malaysia voted in favor of the UNDRIP, the implementation of the soft law instrument is merely persuasive in nature, and not legally binding. However, the Malaysian government has a moral obligation to comply with the international instruments and it must move forward in the area of indigenous rights, by meeting international standards if it wishes to gain the respect of the international community.

Many civil society groups, including the Malaysian Bar Association, have strongly supported the Orang Asli rights. The Bar Association issued a press release urging the government to “formally recognize, protect and guarantee [Orang Asli] rights to all their ancestral lands,” and to withdraw any proposed legislation that would limit these rights. Commentators such as Ragnath Kesavan, as a former president of Malaysian Bar Council (2009-2011) also insist for the government to uphold its commitments under the UNDRIP, which states that indigenous peoples have “the right to the lands, territories and resources which they have traditionally owned, occupied or otherwise used or acquired” (UNDRIP, A.26(1)).

CHALLENGES AND RECOMMENDATIONS

This section deals with the challenges in implementing the principle of FPIC to indigenous peoples. It may vary from the government’s involvement as well as the durations of the negotiation process. This section also will provide recommendations in promoting the indigenous rights to FPIC that need to be observed by the relevant bodies.

Claiming the right to FPIC can be a challenging task, as FPIC is an ongoing process and negotiations can take a number of years. Project-affected communities may have to demand their participation in negotiations, or in the case of indigenous peoples, that their right to FPIC is respected. These rights are often not automatically recognized (Satterthwaite & Hurwitz, 2005). Some governments, companies and financiers have made progress towards respecting this right and have policies and commitments which are applied when developing a project. However, for many developers, FPIC is still something many fail to respect, implement or fully understand. Also, there may be national laws in a country which changes the manner in which FPIC can be claimed. It is important for project-affected communities to obtain advice on the local laws of their country.

The Malaysian Federal Constitution (FC) has a unique provision for preferential treatment and positive discrimination in favor of Malays, natives and the Orang Asli (FC, A.153 (8) (b)). The policy is based upon the premise that the Orang

Asli is historically disadvantaged, and it is aimed towards correcting the social and economic imbalance. This should enable States to promote more minority indigenous peoples into positions in the civil service or organizations dedicated to looking after the interests of the Orang Asli.⁵ There is a tremendous challenge for governments to hear and to really listen to indigenous voices, and to take their perspectives into account in formulating policies and in entering into any binding agreements which might adversely affect indigenous rights to avoid further marginalization of the poor.

Ensuring access to information is another crucial duty of the government. There must be continuous, wider dissemination of information and an adequate period should be given to ensure that informed decisions are made. Unfortunately, the usual scenario in almost all cases of development is, little information is available to the public. In the Murum Report, for instance, the Malaysian Human Right Commission (SUHAKAM) recommends that information be made public from the time plans are mooted, rather than making them available after they are finalized, to give affected people ample time to highlight their concerns.

In Malaysia, the government can recognize the Orang Asli's land rights via the introduction of specific legislation that would regulate such matters. The

⁵ For instance, in the JHEOA, Department for the Welfare of Aboriginal People, the high level administrative officers who determine the policies are mainly Malays. The few Orang Asli personnel are only in the lower rung of the administrative ladder.

drafting of this legislation should consider indigenous issues holistically, and with regards to the rights of indigenous people contained in the UNDRIP. The Declaration protects *inter alia*, which is the collective rights of indigenous peoples; the right to self-determination; the right to FPIC when making decisions that affect indigenous peoples; the right to determine their own priorities; and the right to the protection of the indigenous culture, values and identities. The experiences of other common law jurisdictions, such as Australia, Canada and New Zealand, should be considered in the drafting of a statute recognizing the rights of the Orang Asli in Peninsular Malaysia (Yogeswaran, 2007).

Furthermore, the government should consult and involve the Orang Asli representatives in its process of acquiring indigenous land. Even though the State Authority under the provision of Land Acquisition Act 1960 has the power to take possession of any private land, it does not allow the authority to violate other rights in relation to private property. Fair compensation must be made to the affected Orang Asli. The State should carry out consultations and negotiations with indigenous peoples whenever it seeks to acquire indigenous land, in a manner similar to the policy of mutual respect taken by Canadian State authority in dealing with indigenous land. The 1997 decision of the Canadian Supreme Court in the *Calder (1997)* case stressed the importance of consultation, negotiation and adequate compensation as preconditions of acquiring indigenous land.

Another example is the Waitangi Tribunal in New Zealand, whereby the New Zealand government interpreted the Waitangi Treaty as establishing a partnership between the Maoris and the State, requiring the holding of adequate consultations between State authority and Maori community before any land acquisition is made (Cheah, 2004). Moreover, this concept was also emphasized in the UNDRIP whereby it confers *inter alia* the right to the Orang Asli to participate in decision making in matters which would affect their rights, through representatives chosen by themselves (UNDRIP, A.18), and hopes that the State shall consult and cooperate in good faith with the Orang Asli in order to obtain their FPIC before adopting and implementing any legislative or administrative measures that may affect them.

Another suggestion is to apply the UNDRIP. A direct application of the Declaration as a binding instrument on the Malaysian courts may be difficult. However, the persuasive authority of the Declaration on the Malaysian courts cannot be denied, given the special position of the Orang Asli and their lands under the Federal Constitution and Malaysia's strong support for the declaration of the United Nations. Therefore, the Malaysian courts may rely on the provisions of the Declaration in giving effect to the constitutional protection afforded to the Orang Asli in any land rights claim. The government's vote in favor of this Declaration can be seen as an expression of willingness to discard of the many outdated Orang Asli laws and policies, and to replace

them with the ones that are in line with the Declaration (Yogeswaran, 2008).

Indigenous peoples are recognized as possessing rights to FPIC and generally, the following steps can be suggested to bring activities in Malaysia into compliance with international standards in this regard:

- Indigenous peoples should insist that any consultation processes, including that of sharing information, includes the right to say "no".
- Indigenous peoples need to continually strengthen and renew their knowledge of customs and traditions, as these not only contain the principles of access to their lands and territories, but also in order to reaffirm their collective identity as indigenous peoples.
- Indigenous peoples should be prepared to engage private and independent financial and legal advisors who can safeguard their interests, and to insist upon this as part of the obligations of the prospective investor.

With hopes that the indigenous rights to FPIC would be well observed by the community at large and the specific interest groups, mutual compromise between parties in reaching agreements especially when the rights of the indigenous peoples are at stake is important.

CONCLUSION

Today, indigenous peoples in many parts of the world are in the process of trying to renegotiate their relations with States and

with new private sector operators seeking access to the resources on their lands. They are asserting their right to FPIC as expressed through their representative institutions in dealing with the many interested parties. They are seeking support from international human rights bodies to find new ways of being recognized by international and national laws and systems of decision making without losing their autonomy and values (Colchester & Mackay, 2004).

In fact, without the sort of substantive participation that FPIC mandates, the tenure security of rural communities will remain at the mercy of decisions made by others. It is well documented that such insecurity perpetuates poverty. In contrast, with the bargaining power that FPIC provisions bring them, indigenous communities can demand direct compensation for damages or a continuing share of the profits of resource extraction. They can even require the backers of development to invest part of the profits from these ventures to meet community needs. In this respect, FPIC is a tool for greater equity and a natural pathway towards co-management roles for local communities in large development projects.

Even though Malaysia has a unique system for the governance of the Orang Asli, it should not impede the State from acting in accordance with moral obligations arising from international instruments, especially with regards to the exercise of the right to FPIC by the Orang Asli. To date, countries like the Philippines (Congress of the Philippines, 1997) and Australia (Commonwealth of Australia,

1976) have enacted laws requiring that FPIC be obtained by the government for projects within the ancestral domains of indigenous peoples. The right to FPIC must be respected by all parties, as it is in line with the principle of human rights and the sustainable development of indigenous peoples.

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***Shariah* Arbitration in Islamic Finance Transaction: An Urgent Need for Muslim Arbitrators**

Hakimah Yaacob

*International Shari'ah Research Academy for Islamic Finance (ISRA), Lorong Universiti A,
59100 Kuala Lumpur, Malaysia*

ABSTRACT

Muslim Arbitrators are needed to settle the dispute in Islamic Finance. The process Model in *Shariah* Arbitration may differ from the *tahkim* and conventional arbitration which is based totally on the UNCITRAL Arbitration Model and Rules. However, to be in line with internationality of the principles enunciated in UNCITRAL, there is no requirement under the it stating that an arbitrator should not be or must be a Muslim . Based on this comprehension, this paper attempts to propose that the appointment of an arbitrator in Islamic finance should be a Muslim. The paper ends with conclusion and some recommendations for future embarkation on the issue.

Keywords: *Shariah* arbitration, Islamic finance, arbitrator, appointment, muslim

INTRODUCTION

Dispute in Islamic finance may be resolved in many ways under the Alternative Dispute Resolution. One of the ways is Arbitration. Arbitration¹ was approved by the Holy Qur'Én and referred to in a number of verses as an acceptable dispute resolution mechanism. For example, the Holy Qur'Én states: "If you fear a breach between the two of them, appoint (two) arbiters, one

from his family, and the other from hers; if they wish for peace, Allah will cause their reconciliation, for Allah has full knowledge and is acquainted with all things."² Another Qur'anic verse states "Allah commands you to render back trusts to those to whom they are due; and when you judge between people, that you judge with justice. How excellent is the teaching which He gives you! For Allah is He Who hears and sees all things."³

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E-mail address:

hakimah@isra.my (Hakimah Yaacob)

The law governing International Trade at cross border transaction: The United Nations Commission on International Trade Law (UNCITRAL)

The United Nations Commission on International Trade Law (UNCITRAL), was established by the United Nations General Assembly by its resolution 2205 (XXI) of 17 December 1966. It plays an important role in developing the framework in pursuing its mandate to further the progressive harmonization and modernization of the law of international trade. This is done by preparing and promoting the use and adoption of legislative and non-legislative instruments in a number of key areas of commercial law⁴. Those areas include as follows;

1. Dispute resolution,
2. International contract practices,
3. Transport,
4. Insolvency,
5. Electronic commerce,
6. International payments,
7. Secured transactions,
8. Procurement (The combined activities of acquiring services or goods, including ordering, arranging payment, obtaining transportation, inspection, storage, and disposal)
9. Sale of goods

These nine instruments are negotiated through an international process involving a variety of participants, including member States of UNCITRAL

(which represent different legal traditions and levels of economic development), non-member States, intergovernmental organizations, and non-governmental organizations. Thus, these texts are widely acceptable as offering solutions appropriate to different legal traditions and to countries in different stages of economic development. In the years since its establishment, UNCITRAL has been recognized as the core legal body of the United Nations system in the field of international trade law. With regards to item no 1 in dispute resolution, there have been 146 countries ratifying the convention.⁵ Malaysia became the signatory to this convention in 1958. Despite articles in the UNCITRAL Arbitration Rule clearly stating that the appointment of an arbitrator must lie within the consent of parties in disputes,⁶ this paper attempts to prove that, according to *Shariah*, it is required for the disputants to appoint a Muslim to arbitrate in matters involving Muslims .

Arbitration and Arbitrator Definition

Arbitration is the referral of a dispute to one or more impartial persons for a final and binding determination.⁷Its essential characteristics include privacy and confidentiality, and it is designed for quick, practical, and economically efficient settlements. The disputing parties can exercise additional control over the arbitration process by adding specific provisions to their contracts' arbitration clauses or, when a dispute arises, through

the modification of certain aspects of the arbitration rules to suit a particular dispute.

Stipulations may be made regarding confidentiality of proprietary information used - evidence, locale, number of arbitrators, and issues subject to arbitration. The parties may also provide for expedited arbitration procedures, including the time limit for rendering an award, if they anticipate a need for hearings to be scheduled on short notice.

There are three essential elements of arbitration:

- (a) The existence of a dispute between the parties
- (b) An agreement between them to refer it to arbitration⁸
- (c) Both parties agreeing to be bound by the decision of the arbitration

Disputes under arbitration are resolved by an award made by an independent tribunal (third party or parties, the arbitrator or arbitrators). The tribunal is either agreed on by the parties or nominated by a further independent body, e.g., a court or a professional institution such as the Chartered Institute of Arbitrators. According to *Stephenson Arbitration Practice in Construction Disputes* (1998), Lord Justice Raymond provided a definition of an “arbitrator” some 250 years ago that is still considered valid today:

An arbitrator is a private extraordinary judge between party and party, chosen by their mutual consent to determine controversies

between them. And arbitrators are so called because they have an arbitrary power: for if they observe the submission and keep within due bounds, their sentences are definite from which there lies no appeal.

Arbitrator Appointment

- (a) The appointment of the arbitrator is made possible in one of the following ways;
 - (i) Arbitrator agreement or clause – An arbitrator may be specifically named in the arbitration clause of the contract between the parties. This is, however, a very rare occurrence.
 - (ii) Appointment by the parties to the dispute – It is common for contracts to have arbitration clauses providing for the parties to nominate and agree on the identity of the arbitrator upon occurrence of a dispute.
 - (iii) Appointment by an institutional body – In the event that parties cannot agree on the identity of the arbitrator to be appointed pursuant to the arbitrator clause in the contract, then a common contractual “fallback” measure is for a neutral third party to make the appointment for the parties. Generally, arbitration clauses in contracts provide for the president of a professional body or trade association to appoint the arbitrator, e.g., the President Centre for Arbitration.

Section 13(4) of the Arbitration Act 2005 provides that the Director of the KLRCA shall be the default appointing party should parties fail to agree on the arbitrator.

(b) There is also a provision in the Arbitration Act 2005 for the High Court to appoint arbitrators. Section 13(7) provides for appointment by the court when the Director of the KLRCA is unable to act or fails to act within 30 days of the request of parties. Section 13(8) of the Arbitration Act 2005 provides that the High Court shall have due regard for the following matters in appointing an arbitrator:

- (i) Any qualifications required of the arbitrator by the agreement of the parties
- (ii) Other considerations that are likely to secure the appointment of an independent and impartial arbitrator
- (iii) In the case of international arbitration, the advisability of appointing an arbitrator of a nationality other than those of the parties

Parties in an arbitration proceeding are free to determine the number of arbitrators who would constitute the arbitral tribunal (Section 12 of the Arbitration Act 2005). The default position under the Act is that the arbitral tribunal in an international arbitration would be made up of three arbitrators whilst a sole arbitrator would make up the arbitral tribunal in a domestic arbitration.

(c) Parties in an arbitration proceeding are also free to determine whether any person should be precluded from acting as an arbitrator by reason of nationality pursuant to Section 13(1) of the Act. It is to be noted that the default position under the Act is that the nationality of the arbitrator is irrelevant.

(d) An arbitrator is not required to have any special qualification save that which the parties have contractually agreed upon. The arbitrator need not necessarily be legally trained.

(e) Where the parties have agreed that the arbitrator is to possess special qualifications, such as being an engineer, an architect, quantity surveyor or accountant, the award of an arbitrator without the said special qualifications will be void unless the party challenging the award is stopped from doing so.

(f) An arbitrator would be well advised to consider the following matters before accepting appointment as an arbitrator:

- (i) Check arbitration agreement/clause, whether referral of disputes is to be made to arbitration and not to mediation or expert determination;
- (ii) Whether the arbitration clause stipulates that an arbitrator is to have certain special qualifications in order to be able to act in that capacity and, if so, whether this requirement has been met;

- (iii) Whether an issue of conflict of interest may arise pertaining to the identity of the parties; for example, a family or a business relationship with the arbitrator;
- (iv) Whether the arbitrator will be able to deal with the arbitration with due dispatch; i.e., does the arbitrator have the time to devote to the arbitration?
- (v) In the event of appointment by a third party, such as the President of PAM,⁹ whether the parties to the arbitral reference have been properly informed in writing of the arbitrator's appointment.

Arbitrator Powers

The primary sources of an arbitrator's powers lie as follows:

- (a) Agreement of the parties:
- As contained in the arbitration agreement/clause
 - As contained in the document of appointment of arbitrator
 - Ad-hoc agreement of the parties to confer certain powers upon the arbitrator before or during the course of the arbitral reference
- (b) The Act
- (c) Institutional rules
- (d) Case law

Parties to an arbitration agreement can generally confer upon the arbitrator whatever powers they wish to in respect

of the conduct of the reference, subject to certain legal limitations, which are as follows:

- (a) The parties cannot give arbitrators powers; the exercise of which would be contrary to public policy. An example would be terms of an arbitration agreement which seek to give the arbitrator powers to enforce an illegal contract;
- (b) The parties cannot give arbitrators powers to be exercised against persons who are not parties to the arbitration agreement. Accordingly, it is beyond the powers of an arbitrator to compel the attendance of third parties at arbitration hearings or to require third parties to produce documents;
- (c) The parties cannot confer upon the arbitrator powers "which only a judge can use" such as those affecting the life and liberty of a person.

As such, parties to an arbitration agreement are free to confer powers within the limits of the law upon an arbitral tribunal. Any power granted which is over and above those allowed by law would be invalid.

The Act provides for the arbitral tribunal to have certain powers such as the competence to rule on its own jurisdiction by way of Section 18 of the Act. However, it must be noted that the majority of the powers of the arbitral tribunal enumerated in the Act are default provisions which would apply in the absence of the parties' agreement to the contrary.

As such, parties are entitled to decide at the point of contracting or, alternatively, prior to commencement of the arbitral proceedings, whether they are content to allow the default provisions to apply. If not, they must specifically provide for an alternative.

THE SHARĒŃAH DEFINITION OF ARBITRATION

The ×anafĒ School defines arbitration as the process of choosing a person to settle a dispute. The MĒlikĒ School refers to it as the process of choosing a person to settle a dispute between two or more parties. Both parties are required to agree on the decision made by both of them.

The ×anbalĒ School defines it as choosing a party to settle disputes with the decision of the arbitration being binding upon them.¹⁰ It is proposed that arbitration is a mechanism to settle dispute by appointing a person agreed to by both parties to decide a case on their behalf, with the decision being binding upon them.

For the conventional system, arbitration is a settlement outside a court. This is covered under the concept of litigation in court. Hence the system falls within Alternative Dispute Resolution, better known as ADR, where no interference from the court is involved.

However, jurists differ on the nature of arbitration in the SharĒŃah, whether it is *wakĒlah* (agency) or litigation. Some scholars of the ShĒfiŃĒ School as well as the ×anbalĒ and MĒlikĒ Schools consider arbitration as a form of litigation. The

×anbalĒs added that the award is binding upon all parties. However, some MĒlikĒs consider it to be *wakĒlah* (agency), with the arbitrator appointed as a *wakĒl* to settle the dispute for the disputants.

Verse 35 of SĒrah al-NisĒ' confirms that arbitration must be used to resolve dispute between married couples before a divorce is granted; it outlines the need for two arbitrators (one from each side). Al-RĒzĒ,¹¹ in his *TafsĒr*, states that the two appointed arbitrators, as mentioned in the verse, must have the noble intention to make peace between the two. In one *ĪadĒth*, Prophet Muhammad (peace be upon him) said, "Whoever judges between two disputing parties who accept him an arbiter, but does not do justice between them, Allah will curse him."¹²

According to ImĒm al-ShĒfiŃĒ, each arbitrator appointed must be Muslim and responsible (*mukallaf*), which requires being of sound mind. The person must also be just and capable of carrying out the task assigned to him. A male shall judge between both female and male in family disputes. The school requires the person to have the ability to convince the disputants.

According to the ×anbalĒ School, the arbitrator must be competent in matters relating to marital disputes and be expert in *fiqh*.¹³

The ×anafĒ School requires arbitrators to be trustworthy, influential and impressive in their speech; acceptable and able to handle the process justly; and their aim should be to make peace between the married couple. The arbitrator can be more of an agent or

wak'el and not necessarily a judge. A woman can also be appointed as an arbitrator.

The M'lik School states that an arbitrator must be a Muslim male who has reached the age of maturity ; this school does not permit a female or a non-Muslim arbitrator. For obvious reasons, disputes between married Muslim couples would require another Muslim to be an arbitrator. The arbitrator should be a *faq'eh* or someone knowledgeable in the area that he is arbitrating in order to decide correctly and should be a just (*N'adil*) person.

The Singapore Administration of Muslim Law Act 1966 has provided the qualifications of the *Ikam* as follows:

- a. Islam
- b. *Mukallaf*
- c. Just
- d. Have knowledge of the rules of the Shar'ah, especially in marriage and divorce
- e. Know his duties as *Ikam*
- f. It is preferred to appoint the relatives of the parties who have the qualifications required under the Islamic law

According to the *Mejelle*, the concept of arbitration can be used to settle disputes in a way that resembles conciliation. Article 1850 of the *Mejelle* states that 'legally appointed arbitrators may validly reconcile the parties if the latter have conferred on them that power'.

Therefore, if each of the parties has given powers to an arbitrator to reconcile them and the arbitrators terminate the

case by a settlement, the parties may not reject such an arrangement. The technique proposed by Article 1850 enables each party to appoint its own arbitrator and the two arbitrators appointed are then authorised to settle the dispute by means of conciliation or *hull'*.

The reason the arbitrators should be from among the married couple's relatives is because they would know the circumstances of the couple's case better than outsiders would.¹⁴This is the reason that an arbitrator needs to be knowledgeable in Islamic finance and must be a Muslim. For disputes relating to commercial, Accounting and Auditing Organization for Islamic Financial Institutions (AAIOFI) Standards No 32 state the needs for arbitration. The standard observes *Shariah* standards in their rules and procedures. The standards make it binding in the following cases;

- i. When it is stipulated as a condition in the contract
- ii. When the two parties agree on seeking arbitration on disputes and pledge to observe the verdicts

The standards clearly state that an arbitrator should be a Muslim in principle. However, the standards allow Non-Muslims to be arbitrators as long as the decision is a valid arbitration decision that conforms to the rules of *Shariah*. This standard is silent on the award written that conform to *Shariah* norms.

It is submitted that, the award or decision in arbitration must be written in reference to Al-Quran and Al-Sunnah. In absence

of any authority in these two sources, the parties must refer to other methods of deriving *hukm* such as *ijtihad*, *qiyas*, *sad al-zara'*, Islamic legal maxim, etc. Failure to understand the concept of *usulfiqh*, Arabic Language, or Methodology of Hadith may lead to manipulation of Shariah sources and diverse interpretation of text.

The main reason a Muslim is needed to be an arbitrator is in award writing. Islamic Finance disputes combines commercial (*muamalat*) and derivation of *hukm*. During deliberation of *hukm* or decision in giving an award, an arbitrator must look into all the Islamic Legal Sources such as Al-Quran, Al-Hadith and other derivation of *Hukm* methodologies.

A simple example like Scott's Schedule is a tool provided for in the Act that is useful when dealing with multiple issues of facts and law found in the Statement¹⁵. The Scott Schedule is essentially a document that splits up the parties' stands on the various matters raised in the Statements. This would assist the parties to have an overview of the matters at hand. It is a tabular presentation of the key issues involved in the dispute, setting forth the claimant's and respondent's positions and the reasons therefore. It is sometimes referred to as the "Official

Referee Schedule" but is more commonly referred to by the name of its inventor, a former Official Referee (predecessor to Circuit Judge) in England. It is commonly used in construction and property disputes, but can be useful in any complex arbitration matter.¹⁶

The objectives of using the Scott's Schedule are as follows;

- i. To reduce the time and cost involved in the arbitration hearing and decision phases.
- ii. To assist the arbitrators to identify issues that are agreed upon by the parties in order to focus on the remaining issues that are crucial to the dispute.
- iii. To eliminate the need to constantly refer to vast volumes of pleadings.
- iv. To assist the arbitrators in focussing on the disputed issues that relate to the most significant monetary amounts claimed.
- v. To provide a convenient tool to ensure that all important issues are addressed in the evidence-taking and decision-making processes.
- vi. To increase the possibility of the parties reaching a settlement on at least some portion of the issues.

TABLE 1
Example of a Scott's Schedule

Item	Item of Change Work Claimed	Claimant's case: basis for entitlement	Claimant's valuation	Respondent's case: Agree, Deny and Why?	Respondent's Valuation

- vii. To force each party to identify areas in which they agree, or have no basis to disagree, with the other party.
- viii. To allow parties to identify any items on which the difference in their positions is less than the cost to litigate them.¹⁷

For Islamic finance, it is submitted that Scott Schedule needs to be supported with Table 2.

The usage of Scott’s Schedule is important when drawing up the awards. It is essential for the arbitrator to understand and know the *Shariah* because it involves derivation of *Hukm* in the awards.

In brief, the differences between *talkÊm* and conventional arbitration are illustrated in Table 3.

LESSONS FROM THE PREVIOUS ARBITRATION CASES:

Non recognition of Shariah Laws

In major international arbitrations, most of the cases replace SharÊÑah law in terms of its practical application. As such, the attitude of the non-Muslim arbitrators seems to be far removed from the *pactasuntservanda* rule.¹⁸

In the case of *Petroleum Development (Trucial Coasts) Limited v Syaikh of Abu*

Dhabi,¹⁹ the arbitrator, Lord Asquith rejected Islamic law, as applied in Abu Dhabi, as being insufficiently competent to regulate a modern commercial instrument.

The same outcome occurred in the case of *Ruler of Qatar v International Marine Oil Company Limited*²⁰ when the arbitrator declined to apply the Concession Agreement according to the SharÊÑah law. The SharÊÑah law of Qatar was clearly Islamic law following the ×anbalÊ School, but the arbitrator still held it to be inappropriate to govern a modern oil concession. In formulating such a view, he opined that SharÊÑah law does not contain any principles which would be sufficient to interpret the modern contract. He further mentioned that both experts (Prof Milliot and Prof Anderson) were in agreement that if Islamic laws were to be applied in the contract, it would be open to grave criticisms of invalidity.

In the famous case of *Aramco Arbitration, Saudi Arabia v Arabian American Oil Company*, the arbitrators, Prof G Sauser Hall (Referee), Sir Saba Habachy KBE (Arbitrator appointed by Aramco) and Muhammad Hassan (Arbitrator appointed by Saudi Arabia), held that the proper law of the concessions contract was the law

TABLE 2
Example of a Scott’s Schedule

Valuation	Issues	Validity –based Al-Quran/Hadith/ qiyas/ uruf , etc	Argument of School/ mazhab/SAC	Remarks
Respondent’s valuation				
Claimant’s valuation				

of Saudi Arabia, which they found to be Muslim law as taught by the *ẖanbalî* school.

However, whilst adhering fully to the rule of *pactasuntservanda*,²¹ which they correctly found to be fully recognised under Islamic law, they nonetheless held that the regime of oil concessions had remained embryonic in Islamic law. Consequently, they found it necessary to fill in the gaps in the law of Saudi Arabia by resorting to global customs and practices in the oil business and industry, global case law and pure jurisprudence. The Anderson-Coulson article suggested that the lacunae in the *Sharîḥ* in relation to modern commercial contracts might be best dealt with by treating such contracts as *sui generis*.²²

The New York Convention of 1958 on the enforcement of foreign arbitration awards had gone a long way to deal with cross-border enforcement of arbitral awards, and most countries under which the arbitration of Islamic finance disputes are carried out are signatories. The Convention requires that signatory states recognise and enforce arbitral awards made under the governing law of other nations.²³

Qualifications of Muhakkam is similar to a judge

Malaysia was in turmoil with regards to the cases being heard in civil court. The civil judges were claimed to have no expertise in Islamic finance cases and therefore the law failed to develop. However, this has been resolved by virtue of the amendment made in 2009.²⁴ Despite the amendment, there are still arguments

on the issues of unconstitutionality and inherent jurisdiction of the court.²⁵ In order to avoid future disputes, it is submitted that the qualification of an arbitrator is to be of a similar requirement as required in appointment as a *Shariah* judge. A minimum qualification is required, which is to be at least knowledgeable in *Shariah* in order to judge a case with fairness and justice. Being knowledgeable in *Shariah* alone without mastering finance/banking and arbitration would not render the person knowledgeable in the matter he arbitrates.

Jurisdiction of an Arbitrator

The jurisdiction of an arbitrator lies in the agreement. It refers to the limits within which the powers of an arbitrator may be exercised. Having a jurisdiction in respect of a particular case, means the arbitrator has the authority to hear and decide on that case. In contrast, the powers of an arbitrator refer to the acts that he is properly able and entitled to perform by law in his capacity as arbitrator. An arbitrator may or may not exercise all powers that he has. The powers of an arbitrator can only be exercised provided that he has the jurisdiction to do so. Powers are therefore subject to the jurisdiction of the arbitrator. The jurisdiction of an arbitrator is derived from the agreement between the parties to the arbitral reference. In the Court of Appeal decision of *Bauer (M) SdnBhd v. Daewoo Corp*,²⁶ on p. 561, Gopal Sri Ram JCA stated:

“To begin with, it is important to recognize that the foundation of

an arbitrator's jurisdiction is the agreement entered into between the disputants. Absent such an agreement, there is no jurisdiction. And as a general rule, mere participation in proceedings before the arbitrator does not cure any jurisdictional defect...."

Award Writing with inputs from Al-Quran and Al-Hadith

In respect of an arbitrator's authority to rule in his own jurisdiction, the position under the old Malaysian Act 1952 was that an arbitrator does not have the power to do so. The position is now different under the new Act as Section 18 provides that the arbitral tribunal may rule its own jurisdiction, including any objections with respect to the existence or validity of the arbitration agreement. It is advisable for the arbitrator to ensure that his appointment as an arbitrator is in order to ensure that the arbitral process proceeds unimpeded. Furthermore, the arbitrator must know the limitations of his power and jurisdiction in order to avoid overstepping the boundaries and risking an application to challenge any award issued. In this regard, the knowledge in *Shariah* is important to write an award that is *Shariah* compliant with the invocation of hadith and Al-Quran as the authority. [This could be done by the Muslim member of the tribunal. In an Islamic finance/banking dispute involving a non-Muslim, the non-Muslim party may wish to appoint a fellow non-Muslim who is knowledgeable of Islamic finance as a member of the arbitrating tribunal]

SHARĒÑAH QUALIFICATIONS OF THE ARBITRATOR

Religion

According to the ×anbalĒ School, non-Muslims are only allowed to settle disputes concerning their own personal law. According to the MÉlikĒs, ×anbalĒs and ShĒfiÑĒs, a non-Muslim is not allowed to be appointed as an arbitrator in Muslim territory. This even applies to arbitration among non-Muslims. This would appear to contradict Verse 5:47: "Let the People of the Gospel judge by what Allah has revealed therein." The above mentioned scholars consider this verse to be abrogated by 5:48: "So judge between them by what Allah has revealed, and follow not their desires away from the truth which has come to you."

Knowledgable in SharĒÑah

An arbitrator must be a person who sufficiently understands the SharĒÑah, especially the Qur'Ēn, Sunnah, and *ijmĒÑ* and *qiyĒs*. A judgment without reference to any of these will be considered as null and void. Some MÉlikĒs, ×anbalĒs and ShĒfiÑĒs even require an arbitrator to be a *mujtahid* who is able to exercise *ijtihĒd*. Ibn Taymiyyah of the ×anbalĒ School argued that arbitrators need only be specialists in matters falling within their expertise. However, the MÉlikĒ School allows a non-specialist to arbitrate provided they refer to the expertise in that particular area; the award given must be based on the testimony given by the expert consulted. Failure to do so may result in the voiding of the award.

Gender

Al-MÉwardÊ, a ShÉfiÑÊ jurist, holds the view that the power to arbitrate lies only with men. The ×anafÊ School, however, permits women to arbitrate all cases except crimes.

Maturity and Prudence

All the four major jurisprudential schools agreed that an arbitrator must have the ability to understand, analyse and solve complicated problems. In other word, he must be an expert in the dispute. ImÊM MÉlik stressed the necessity of an arbitrator possessing the qualities of ÑadÉlah (justice) and *rushd* (prudence). ÑadÉlah requires an arbitrator to be more vigilant and includes behaviour and religiosity. Impartiality is also a must that needs to be observed.

From the above discussion, and within the context of Islamic finance today, it is submitted that the arbitrator must have the following criteria;

- (a) Muslim. (All schools agree that the *Íakam* who arbitrates Muslim matters should be a Muslim). Regardless whether the litigants are Non Muslims, if the matters are within the expertise of a Muslim, a Non Muslim is not allowed to become the arbitrator. This may implicate bad perception in deriving *hukm* from the primary sources like Al-Quran or Al-Sunnah.
- (b) Female or male. (The arbitrator can be viewed as an agent to settle a dispute rather than a judge to decide a case.

Either female or male can be appointed as an arbitrator based on their respective qualifications).

- (c) Knowledgeable and expert in the matters disputed. (Islamic finance has three branches: Islamic banking, *takÉful* and Islamic capital markets; disputes may vary, and experts from each area are required.)
- (d) Knowledgeable on how to conduct arbitration procedures. (Able to conduct arbitration as practiced in the market according to the process model adopted by the Arbitration Act 2005 and in line with SharÊÑah).
- (e) Knowledgeable in the SharÊÑah (as required by MÉlikÊ School; the arbitrator should be a *faqÊh* in order to decide correctly and give an effective award).
- (f) Neutral and having a good intention to settle the dispute impartially.
- (g) Able to carry out the task and make peace between the parties.

Verse 2:235 of the Holy Qur'Ên imposes a duty on any person who judges a case and apportions blame between parties to do so fairly and justly. The verse authorises those who judge to make decisions that are binding. It could also be interpreted as imposing *ÍulÍ* between conflicting parties. Either way, the main aim of arbitration is to ensure that disputes between Muslims are resolved amicably and justly. The word *Íakam* refers, in its strict sense, to a person who is authorised for a specific mission.

In this sense, Islamic law commands an arbitrator to try to reconcile the parties first before deciding upon their dispute. Muslim parties place themselves entirely in the hands of a person whom they know, respect, and believe to be capable of helping them out of the deadlock.

CONCLUSION AND RECOMMENDATIONS

From the above discussion, the quality of an arbitrator is of fundamental importance to ensure the success of the process, be it mediation or arbitration. The most important points are that the mediator or the *Áakam* should be someone who is impartial, responsible and capable of carrying out the task. He or she is also expected to be knowledgeable in the area of the dispute. Thus this paper recommends as follows;

- i. Training for *Shariah* scholars in Islamic finance to become the arbitrator is pivotal. The training can be conducted by Kuala Lumpur Regional Centre or International setting Body collaboration with Islamic Finance.
- ii. The appointment of *Shariah* scholar as an arbitrator to hear disputes in Islamic finance is important. This is due to the fact that the appointment is similar to a *qadhi* who decide the cases in court.
- iii. Recognize the process Model in *Shariah* Arbitration differs from the conventional arbitration process model.
- iv. The standard drafting in arbitration relating dispute in Islamic finance is important to ensure there are specific

clauses countered with no element of *gharar* or interest imposition to any of the parties.

- v. The appointment of a Muslim arbitrator is important since the award writing in conventional arbitration is different from *caward* writing in conventional arbitration.
- vi. The confidence among the disputants will reach certain recognition and of value when it comes to disputes involving matters and issues of *Shariah*.

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ENDNOTES

- ¹ *Shariah* arbitration and *Tahkim* are used interchangeably in this paper.
- ² SĒrah al-NisĒ' (The Women), Verse 35.
- ³ SĒrah al-NisĒ' (The Women), Verse 58.
- ⁴ See the report of the Committee on Conferences (Official Records of the General Assembly, Thirty-fourth Session, Supplement No. 32 (A/34/32), para. 32 (e) (iii)). Prior to the relocation of the UNCITRAL secretariat from New York to Vienna, sessions of the Commission alternated between New York and Geneva (see General Assembly resolution 2205 (XXI), sect. II, para. 6, reproduced in UNCITRAL Yearbook, vol. I: 1968-1970, part one, chap. II, sect. E; General Assembly resolution 31/140, sect. I, para. 4 (c) and General Assembly resolution 40/243, part one, para. 4 (c).
- ⁵ For details refer to www.un.com
- ⁶ Refer to UN Convention on Arbitration, Art 5.
- ⁷ The arbitrators, judges and ombudsman (*al-muġtasib*) are also known as the adjudicators. Adjudication involves an independent third party considering the claims of both sides and making a decision. The adjudicator is usually an expert in the subject matter in dispute. Adjudicators are not bound by the rules of litigation or arbitration. Their decisions are often interim ones; i.e., they can be finalised using arbitration or another process. Adjudication decisions are usually binding on both parties by prior agreement. In relation to construction contracts, adjudication is a statutory procedure by which any party to the contract has a right to have a dispute decided by an adjudicator, normally used to ensure payment. It is intended to be quicker and more cost-effective than litigation or arbitration. Adjudication is also sometimes used to describe a non-specific alternative dispute resolution process in which a third party makes a decision as to the best way to resolve the dispute. In this sense, ombudsmen, arbitrators and judges are all types of adjudicators (online, available at http://www.infolaw.co.uk/partners/alternative_dispute_resolution.htm).
- ⁸ Refer to *Scott v Avery*. Clause states that the right for parties to litigate is denied until the matter in dispute has been considered by arbitrators and both parties agree to be bound by the decision of the arbitrators. Retrieved from <http://www.feg.com.au/Glossary.htm#NR4>
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- ¹³ Al-BuĪĒtĒ, *KashshĒf al-QinĒĒĒn Matan al-IqnĒĒ*, vol. 5, p. 211.
- ¹⁴ Al-QurĪubĒ, *al-JĒmiĒ li-ĀĪĒm al-Qur'Ēn*, (Cairo: DĒr al-KitĒb al-ĒArabĒ, 1967), vol. 5, p. 175.
- ¹⁵ Scott De Gray, "Use of Scott Schedule to Expedite the Quantum Issues", International Arbitration Conference: Managing Risk in a High-Growth, High-Risk Market, A conference for In-House Counsel and Executives Involved in International Arbitration, Wednesday, September 10, 2008.
- ¹⁶ In the case of *GMTC v Yuasa Warwick* (1994) 73BLR 102, the U.K. Court of Appeal allowed the appeal because the judge had struck out parts of the plaintiff's claim for his inability to provide such details in the form of a Scott Schedule. It held that no judge was entitled to require

- a party to establish causation and loss by a particular method, and advised parties to object at the outset if they are required to plead a case in a way which does not represent the way they wish to put the case. Where experts give evidence, it may be prudent for the expert for each side to give evidence on each item in the Schedule, rather than for the claimant's expert to give evidence on all items and the respondent's expert to give evidence on all items after the close of the Claimant's case. This will enable the arbitrator to decide each issue when both conflicting views are fresh in his mind. Scott De Gray, "Use of Scott Schedule to Expedite the Quantum Issues", International Arbitration Conference: Managing Risk in a High-Growth, High-Risk Market, A conference for In-House Counsel and Executives Involved in International Arbitration, Wednesday, September 10, 2008. For detail refer to the speech by WM Ballantyne, The SharĒÑah; a speech to the IBA Conference in Cairo on Arab Comparative and Commercial Law; 15-18 February 1987, Brill, *Arab Quarterly Law*, vol. 2, no. 1, p. 12-28.
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- ¹⁹ [1951] ILR Case No 37; (1951) 1 ICLQ.
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- ²⁴ Refer to Section 56 and Sec 57 of the Central Bank of Malaysia Act 2009
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From State Islamic Religious Schools to Syariah and Legal Studies: Human Resource in the Islamic Sector and Academic Entrepreneurship in Malaysian Higher Education Institutions

Nizamuddin Alias¹ and Nurhafilah Musa^{2*}

¹*Department of Social Studies and Citizenship, Universiti Pendidikan Sultan Idris, 35900 Tanjong Malim, Perak, Malaysia*

²*Faculty of Law, Universiti Kebangsaan Malaysia, 43600 Bangi, Selangor, Malaysia*

ABSTRACT

The present paper examines the importance of policy in enabling human resources, following the completion of university-level education, to be involved in the Islamic sector and academic entrepreneurship in *syariah* and legal studies in Malaysia. This paper argues that the human resources in the Islamic sector in Malaysia and academic entrepreneurship in *syariah* and legal studies are dependent on students from Islamic religious schools. Islamic religious secondary schools are usually administered either by the federal government, state governments or private institutions. According to the constitutional division of powers, education is a federal matter. Therefore, any educational institutions fall under the responsibility of the federal government, irrespective of the means of their establishment. However, state-administered Islamic religious secondary schools are considered to fall outside the purview of the federal government due to the fact that such institutions are administered by the state governments. This perceived conflict between state and federal authority in reading the Malaysian Constitution has resulted in the state Islamic religious secondary schools being virtually ignored by the federal government. This paper demonstrates the effects of the neglect of the Malaysian federal government regarding state Islamic religious secondary schools in relation to human resources in the Islamic sector and academic entrepreneurship at Malaysian higher education institutions, especially in the area of *syariah* and legal studies. The current scenario in the Malaysian

Muslim society will be taken into account in portraying the current need for students and graduates of Islamic studies to fulfill vacancies in the job market. The paper concludes with some suggestions to improve the development and management of human

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E-mail addresses:

nizamuddin@fsk.upsi.edu.my (Nizamuddin Alias),

hafilah@ukm.my (Nurhafilah Musa)

* Corresponding author

resources in the Islamic sector and academic entrepreneurship in the area of *syariah* and legal studies in Malaysia.

Keywords: Academic entrepreneurship, human resource, legal studies, state Islamic religious schools, syariah

INTRODUCTION

Academic entrepreneurship has only been recently discussed in Malaysia. Issues concerning how the social sciences, including law and *syariah*, can contribute to the development of academic entrepreneurship in Malaysia are seldom discussed. Law and *syariah* are two distinct branches of knowledge that do not produce tangible results in a fashion similar to science and technology. Nevertheless, solutions produced by social scientists, Islamic jurists, legal practitioners and legal scholars make significant contribution to the development of the Malaysian society.

Human resources are obviously an important element in academic entrepreneurship. The orientation of human resource towards academic entrepreneurship is not accomplished overnight, but is a process closely related to the national education policy and the expectations of society. This paper highlights the importance of developing human resources in the Islamic sector and academic entrepreneurship, especially in relation to *syariah* and legal studies during education in secondary schools and higher education institutions.

Of particular interest in the present study is the fact that the contribution of

state Islamic religious schools to human resources in the Islamic sector and academic entrepreneurship in *syariah* and legal studies is rarely recognized. State Islamic religious secondary schools are schools administered by state governments, either under the auspices of the education department of a state Islamic religious agency; or a state Islamic education foundation. Due to the fact that Islamic religious schools are considered Islamic institutions under the administration of the state governments, the Malaysian federal government deems such institutions to fall outside the purview of its responsibilities with regards to education institutions. These schools do not have adequate financial assistance, and have less qualified or trained teachers as well as proper educational facilities. The lack of attention from the federal government towards these secondary schools motivates the present study, as the situation has been ongoing for the past few decades, and has - directly and indirectly - affected the quality of talents in the Malaysian human resources with regards to the Islamic sector and academic entrepreneurship in Malaysia, particularly in relation to *syariah* and legal studies.

The present paper demonstrates that the lack of attention given to students who had studied in state Islamic religious secondary schools affects their position in the job market requiring Islamic knowledge background and academic entrepreneurship in *syariah* and legal studies. This paper begins with a preliminary discussion on academic entrepreneurship in Malaysia from an Islamic perspective. The constitutional

position of state Islamic religious secondary schools in the Malaysian legal framework and education system will be discussed in the next section. After that, a brief discussion will be provided on human resources in the Islamic sector in Malaysia, and academic entrepreneurship in *syariah* and legal studies that can be found in Malaysian universities. After that, the current situation in the Malaysian Muslim society will be assessed in relation to the role of students who graduate from state Islamic religious schools. This paper concludes with preliminary suggestions on how the current situation may be improved, especially with regards to the demands of human resource in the Islamic sector in Malaysia, and academic entrepreneurship in *syariah* and legal studies at Malaysian universities.

ACADEMIC ENTREPRENEURSHIP IN MALAYSIA

According to MoharYusof and Kamal Kishore Jain (2010), three differing views appear to exist regarding academic entrepreneurship: Firstly, the view that academic entrepreneurship is in conflict with the traditional view of the university, and thus, it normally and conveniently occurs outside the university, and beyond the traditional role of academia due to the conflict and tension created (Louis *et al.*, 1989; Klofsten & Jones-Evans, 2000; Laukkanen, 2003). Secondly, the view that academic entrepreneurship is focused on the creation of new business ventures created from university intellectual property, which would include the commercialization

of research, technology transfer and university spin-off activities (Chrisman *et al.*, 1995; O'Shea *et al.*, 2004). Thirdly, an integrative view based on a corporate entrepreneurship perspective, where academic entrepreneurship encompasses organizational creation and innovation and strategic renewal which occur both inside and outside the university (Brennan *et al.*, 2005; Brennan & McGowan, 2006).

Klofsten and Jones-Evans (2000) identified eight specific types of academic entrepreneurial activities, which can be distinguished by the amount of external contact with the respective industries: consultations, contract research, large scale science projects, external teaching, testing, patenting/licensing, spin-offs and sales. Out of these eight entrepreneurial activities, academic entrepreneurship in *syariah* and legal studies consist of consultations, contract research, external teaching and the sales of books, modules or software.

Academic entrepreneurship is a new phenomenon in Malaysia and considerable focus has been placed upon research and technology commercialization (MoharYusof *et al.*). Greater emphasis on the development of science and technology can be found in several Malaysian government documents, such as the Third Outline Perspective Plan (2001-2010); Knowledge-Based Economy Master Plan 2002, Ninth Malaysia Plan (2006-2010) and the Tenth Malaysia Plan (2011-2015). One of the important decisions made by the Malaysian government regarding research commercialization in higher

education was the designation of four public universities as research universities, namely, the University of Malaya, the Science University of Malaysia, the National University of Malaysia and the University Putra Malaysia (Ninth Malaysian Plan 2006-2010). The Ninth Malaysia Plan has allocated RM5.3 billion for science, technology and innovation initiatives to strengthen the national innovation system. In addition, considerable emphasis is placed upon biotechnology, advanced materials, manufacturing, information and communication technology, and nanotechnology to generate 300 science and technology-based companies through public-funded research and development, and 50 companies with global partnerships. The aforementioned facts clearly demonstrate that the Malaysian government is placing greater emphasis on the development of science and technology as compared to other areas of education, such as the arts, social sciences, law, economics and Islamic studies.

ACADEMIC ENTREPRENEURSHIP IN ISLAM

Academic entrepreneurship is rarely discussed in the social sciences and Islamic studies. Discussions on academic entrepreneurship are usually focused on its origin, development and implementation in various universities around the world. This may be due to the fact that research in these areas does not produce tangible materials that can generate income for academic institutions, with the exception of books.

Research in the social sciences and Islamic studies is usually geared towards addressing certain questions or problems faced by the society.

In order to discuss academic entrepreneurship in *syariah* and legal studies, the discussion must necessarily include a survey of academic entrepreneurship from an Islamic perspective. The philosophy and purpose of Islamic studies differ from what academic entrepreneurship is all about. The main premise of academic entrepreneurship is that, since a considerable amount of scientific research takes place in universities, these universities can be catalysts for entrepreneurial activities and agents for generating revenue (Wood, 2012).

In contrast, Islamic studies emphasize that man is to serve God and to be His vicegerent on earth. Al-Attas (1991) defines education as the progressive instilling of *adab* in individuals, namely “the recognition and acknowledgement of the proper places of things in the order of creation, such that it leads to the recognition and acknowledgement of the proper place of God in the order of being and existence”. In accordance with the premise of Islamic studies, the primary goal of education is to lead humanity to recognize and acknowledge its Creator, or to acquire a deeper faith (Al Attas, 1991). In short, education in Islam is viewed as a means to know God. Stemming from this principle, the Malaysian Ministry of Education describes Islamic education as a continuous effort to deliver knowledge, skills and practice of Islam based on the al-Quran and al-Sunnah in developing

attitudes, skills, personalities, and views of life as a servant of God who is responsible to develop oneself, society, the environment and country to achieve happiness in this world and hereafter' (Mohd.Yusuf, 2002).

This paper adopts the view that if the purpose of seeking knowledge and conducting research is purely for financial gain, then that intention is contrary to the purpose of seeking knowledge in accordance with Islamic principles. If financial gain is an incidental fruit in the process of seeking knowledge or dissemination of knowledge, then the activity can be considered permissible from the Islamic perspective. The challenge is to create a balance between seeking knowledge for the sake of Allah, and seeking knowledge for financial gain - which is one of the outcomes of academic entrepreneurship in higher education institutions.

THE POSITION OF STATE ISLAMIC RELIGIOUS SECONDARY SCHOOLS IN THE MALAYSIAN LEGAL FRAMEWORK AND MALAYSIAN EDUCATION SYSTEM

The present paper argues that the development of human resources for the Islamic sector and academic entrepreneurship in *syariah* and legal studies must begin in school, because this is where the foundation for Arabic language and the exposure for legal text is built. The contribution of state Islamic religious schools to the development of human resources in these two sectors is rarely highlighted. Although these schools are administered by state governments, the question arises as to which

level of government is actually responsible for graduates of these schools. In order to answer this question, reference will be made to the Federal Constitution, relevant state legislation and federal legislation.

Federal Constitution

In order to determine the legal position of state Islamic religious school in the Malaysian education system, the first reference must be made to the Federal Constitution. Since Malaysia is a federation, the division of powers between the federal government and state governments can be found in the Ninth Schedule of the Federal Constitution. Item 13 of the Federal List in the Ninth Schedule of the Federal Constitution provides that legislative power over education rests in the hands of the Federal government. Item 13(a) defines 'education' as including: elementary, secondary, and university education; vocational and technical education; training of teachers; registration and control of teachers; managers and schools; promotion of special studies and research; scientific and literary societies.

By virtue of this provision, this paper argues that the federal government is responsible to legislate, administer and finance educational institutions, including educational institutions administered by state governments. Whether the educational institutions are established by the federal government or the state government or private individuals or companies, this should not affect the way the responsibility is dispensed. Currently, state Islamic religious

secondary schools are considered state Islamic institutions and, therefore, are entirely under the responsibility of the state government. These schools implement the national curriculum while providing additional Islamic religious subjects simultaneously. However, the fact that the national curriculum is being implemented in these schools does not guarantee financial assistance from the Malaysian Ministry of Education. This is an unfortunate situation for state Islamic religious schools in Malaysia.

Article 12(2) of the Federal Constitution provides that both the Federal government and State governments can establish and maintain Islamic institutions of education:

“Every religious group has the right to establish and maintain institutions for the education of children in its own religion, and there shall be no discrimination on the ground only of religion in any law relating to such institutions or in the administration of any such law; but it shall be lawful for the Federation or a State to establish or maintain or assist in establishing or maintaining Islamic institutions or provide or assist in providing instruction in the religion of Islam and incur such expenditure as may be necessary for the purpose.”

Education institutions are considered part of state jurisdiction in the administration of Islamic matters based on Item 1, State List in the Ninth Schedule of the Federal

Constitution which states,

“...Wakafs and the definition and regulation of charitable and religious trusts, the appointment of trustees and the incorporation of persons in respect of Islamic religious and charitable endowments, institutions, trusts, charities and charitable institutions operating wholly within the State;..”

The word ‘institutions’ in the aforementioned provision includes educational institutions. Reading these two constitutional provisions together, one may come to the conclusion that state Islamic religious secondary schools are the responsibility of the state government. However, Item 1 of the State List in the Ninth Schedule of the Federal Constitution, which enumerates subject matters under state administration, does not prohibit cooperation between the federal government and the state in the administration of Islamic matters, including state Islamic religious schools.

State Legislation

Pursuant to the abovementioned provisions, states have legislated enactments regarding the establishment and management of such educational institutions. One example is the Control of Islamic Religious Schools (Kedah) Enactment 1988 which defines Islamic religious schools as:-

“Any Islamic schools within the state including mosques, suraus,

Islamic centres, pondok and tadika, of which twenty students have been registered to learn or be taught any subjects including Islamic Religion, except Islamic Religious schools under the purview of Ministry of Education”.

Section 3 of the Enactment provides that the Kedah Islamic Religious Council with the leave of the Ruler may appoint a Registrar of Religious Schools. Section 4 of the Enactment further provides that the Registrar shall oversee the administration of the schools accordingly.

Federal Legislation

All schools are subject to federal laws which were subject to the Education Act 1961, prior to the enactment of the Education Act 1996. The new act has been promulgated in view of the changes that have taken place in the field of education and the country's transformation since.

One of the main features of the Education Act 1996 is the emphasis upon equal opportunities given to children in developing their potentials. The Act defines the national education system as being comprised of primary, secondary, post-secondary and higher education. The Minister of Education is given the power to establish education institutions and to oversee their operations, management and maintenance.

The 1996 Education Act categorizes educational institutions into government educational institutions, government-

aided educational institutions, and private educational institutions. Unfortunately, the Act does not make reference to educational institutions under the state government, and whether or not such institutions are entitled to financial aid from the federal government. Section 52 of the Education Act 1996 provides that:-

“.. Financial assistance by way of grant may be given out of moneys provided by Parliament to an Islamic educational institution which is not maintained by the Minister under this Act or by the Government of a State...”

This provision clearly states that the federal government may assist Islamic educational institutions, even if they are not under the purview of the Ministry of Education. However, to be eligible for such aid, the Minister may impose any conditions that he deems fit.

From another perspective, in any federation, in order to determine whether legislation is within the purview of one legislature or another, the pith and substance of the legislation in question will be looked into. The pith and substance principle envisaged that ‘the legislation as a whole will be examined to ascertain its true nature and character in order to determine which legislature is responsible’ (Jain, 2003). The present paper contends that, by applying the pith and substance rule, since education is a federal matter, whether the institution is a religious one or not does not negate the

fact that it is an education institution under federal jurisdiction.

HUMAN RESOURCE IN THE ISLAMIC SECTOR AND ACADEMIC ENTREPRENEURSHIP IN SYARIAH AND LEGAL STUDIES IN MALAYSIAN HIGHER EDUCATION INSTITUTIONS

Human resource in the Islamic sector refers to firstly, human resource in the federal and state agencies involved in the administration of Islamic matters; secondly, human resource in commercial sectors such as manufacturing *halal*-compliant products including food and pharmaceutical, as well as establishing *syariah*-compliant services including Islamic banking, finance and *takaful*; and thirdly, professionals such as *syariah* court lawyers.

There are three Islamic religious departments at the federal level, and four Islamic religious agencies at the state level. The federal agencies are the Department of Islamic Development (JAKIM), the Department of Islamic Judiciary (JKSM) and the Department of Wakaf, Zakat and Haj (JAWHAR). All the states in Malaysia have at least four agencies to administer Islamic matters. They are the State Islamic Religious Council, the State Islamic Religious Department, the State Department of Islamic Judiciary, and the State Department of Mufti. Therefore altogether, there are 56 state Islamic religious agencies in Malaysia.

Both human resource in the Islamic sector and academic entrepreneurship in *syariah* and legal studies require graduates who possess religious educational

backgrounds, which assists them in understanding the Quran, Sunnah and various other established religious books written by diverse Muslim scholars throughout the centuries. The understanding and knowledge of Islam is then applied to the current problems and situations to fulfill the needs of contemporary Islamic society. This requires individuals of high intellectual capacity.

Out of 20 public universities in Malaysia, only a few universities offer degrees in *syariah* and legal studies, as indicated in Table 1.

Other public universities have Islamic studies-related faculties for the purpose of offering general courses such as Islamic civilization.

Out of 469 registered private colleges and private college universities, only 12 institutions offer degrees in *syariah*. Other private institutions offering legal studies are Taylors University, HELP University, KDU University College and Multimedia University. However, attendance by students from state Islamic religious schools is not common due to the expensive fees of the institutions.

THE CURRENT SCENARIO

The discussion on human resources in the Islamic sector and academic entrepreneurship in *syariah* and legal studies in Malaysia must take into account the present circumstances in the Malaysian Islamic society. After two decades of Islamic resurgence which has swept across the entire Islamic world, Muslims are not just conscious about their

religion, but also are more concerned about practicing the correct Islamic way of life. This can be seen in two aspects: financial matters and *halal*-compliance. Along with this development, the administration of Islamic matters in Malaysia has undergone significant changes.

In the 1980s, Islamic banking, finance and *takaful* industries began to bloom, but not many Muslim scholars were available to meet the needs of the emerging industries. After several legal developments in the Malaysian Islamic banking and finance sector, the need to have more students and graduates from an Islamic legal background is more pronounced than ever. This can be seen in the requirement of establishing *syariah* committees in banks as well as

having Islamic counters in 2004 (Guidelines on the Governance of *Syariah* Committee for Islamic Financial Institutions 2004, Central Bank of Malaysia).

The beginning of the twenty first century in Malaysia also witnessed further development in the area of *halal* certification due to growing concerns within the Islamic society regarding the *halal* status of food that may be consumed. The final change was made when the Parliament passed the Trade Description Act 2011 containing two regulations on *halal* matters. Although the Act is under the Ministry of Domestic Trade, Cooperative and Consumer Affairs, certification, audit and enforcement activities are actually performed by the state Islamic religious officers. Since the development

TABLE 1
List of Public Universities offering *Syariah* and Legal Studies in Malaysia

No.	Public University	Diploma in Law	LLB	Diploma in <i>Syariah</i>	LLB (<i>Syariah</i>) /Bachelor in <i>Syariah</i> /Bachelor in <i>Syariah</i> & Law
1	Malaya University (Research University)		√		Bachelor in <i>Syariah</i>
2	Universiti Kebangsaan Malaysia (UKM) (Research University)		√		Bachelor in <i>Syariah</i>
3	International Islamic University Malaysia (IIUM) (Comprehensive University)		√		LLB (<i>Syariah</i>)
4	University Institut Teknologi MARA (UITM) (Comprehensive University)	√	√		
5	Universiti Utara Malaysia (UUM) (Focused University)		√		
6	Universiti Sains Islam Malaysia (USIM) (Focused University)				Bachelor in <i>Syariah</i> & Law
7	Universiti Sultan Zainal Abidin (UNISZA) (Focused University)	√	√	√	Bachelor in Islamic Studies (<i>Syariah</i>)

of *halal* certification has grown rapidly in the past few years, many more officers are needed.

Changes in the Islamic society in Malaysia were also reflected in the government sector. The administration of Islamic matters in Malaysia have gradually been transformed from being administered by the State Islamic religious councils and State Islamic religious departments, to being administered by four different agencies: they are the state Islamic religious council, the state Islamic religious department, the state department of Islamic judiciary, and the state department of mufti. This change took place in the 1990's, and the need for human resource to fill in the vacancies in these agencies has never been more apparent than now. For example, states have *syariah* courts in their respective districts. Each *syariah* court must have its own *syariah* court judges, registrar and prosecutor. These officers must be trained in Islamic legal studies and usually were educated in Islamic religious schools.

The Islamic banking and finance sector, *halal* sector and administration of Islamic matters are in dire need of graduates from an Islamic legal background. Unfortunately, the current policy is that most of the academically good students are channelled to do science and technology-based courses, leaving only the students of average quality to take up law or *syariah* courses.

It is submitted that the issue of channelling academically good students from state Islamic religious schools to science and technology based-courses and not to

syariah and legal studies are due to several reasons. Firstly, students from state Islamic religious secondary schools are not aware of job prospects in the Islamic sector in Malaysia. This may be due to the teachers' or parents' failure in exposing students to the courses available at the university level. Federal and state religious agencies also contribute to the lack of information given to students, parents and teachers regarding available career paths for *syariah* and legal graduates from state Islamic religious schools. The students, teachers and parents were not offered relevant information from the respective departments regarding possible career choices, such as *syariah* prosecutors, *syariah* court registrars, *syariah* court judges, *orzakat* officers in charge of collection or distribution.

Secondly, there is a practice in certain schools which encourage excellent students to take up science streams, leaving the average students to take up the arts or go into the Islamic studies stream. For example, Maahad Muhammadi (P) and Maahad Muhammadi (L) are the two schools in Kelantan that introduced science stream classes in 1997. As a result of the move, many top students opted for science classes after sitting for their PMR (Lower Secondary Examination). The idea of establishing a science stream was to enable students with strong Islamic religious education backgrounds to pursue science-based courses at the university level. However, this most students who excelled in their studies decided to pursue science stream classes, leaving the average

ones to pursue arts stream classes. The idea has effectively decreased the number of students opting for religious or arts-based subjects in the schools. Consequently, human resources in the Islamic sector and academic entrepreneurship in *syariah* and legal studies in Malaysian higher learning institutions has been affected.

Thirdly, there is a lack of publicity from higher education institutions in Malaysia that have Islamic Studies faculties, as well as less information pertaining to job opportunities available to graduates of Islamic Studies. As previously discussed, students who enrol in Islamic studies in Malaysian universities are mainly students who have religious education backgrounds, and a large number of such students come from state Islamic religious schools.

The current academicians in *syariah* and legal studies in Malaysian higher learning institutions play an important role in assisting the development of human resource in the Islamic sector and academic entrepreneurship. The academicians identify problems that need to be researched and provide appropriate answers. Academic entrepreneurship in *syariah* and legal studies may not be as lucrative as entrepreneurial activities related to science and technology, but it is equally important to the development of society. Some universities have established centres of excellence for consultation in specific areas. For example, UKM (National University Malaysia) has established several institutes dealing with specific areas in the social sciences and Islamic studies (e.g., Institute of Ethnic

Studies; Institute of Islam Hadhari and Institute of Occidental Studies). These institutes may not directly contribute to the commercialization of knowledge, but they do play an important role in the development of knowledge in the social sciences and Islamic studies in Malaysia.

Some academicians in law and *syariah* faculties owe their knowledge to the education received during periods of study at state Islamic religious schools. The present paper highlights the importance of state Islamic schools to human resource in the Islamic sector and academic entrepreneurship in *syariah* and legal studies, especially as these schools did not receive appropriate funding similar to Islamic religious schools established by the federal government. State religious schools are considered state institutions. Therefore, they have not received the same attention given to Islamic religious schools under the federal government. Despite the lack of attention and funding from the federal government, students continued to pursue their studies there, and the Islamic religious education received at the state Islamic religious schools have provided a solid foundation for the students in understanding law or *syariah* subjects at the university level.

Within the Malaysian education system, there are several categories of religious schools. According to Kraince (2009), they are as follows:

1. People's religious schools (*Sekolah Agama Rakyat or SAR*), which are managed by individuals, communities,

- independent Islamic foundations, or other non-governmental organizations;
2. State Islamic schools (*Sekolah Agama Negeri*), which are administered through state-level bureaucracies as opposed to the federal government;
 3. Private Islamic Schools (*Sekolah Agama Swasta*), which by definition follow the national curriculum even though they are operated by private groups;
 4. National Islamic Schools (*Sekolah Menengah Kebangsaan Agama or SMKA*) which are run by the national government;
 5. National schools (*Sekolah kebangsaan*).

State Islamic religious schools (*Sekolah Agama Negeri-SAN*) are within the purview of State Islamic Religious departments, that have Malay Rulers or Chief Ministers as their patrons. The Education division of the State Islamic religious department is responsible for the administration of the religious schools (Abdul Halim & Che Pee, 2008).

State Islamic religious schools' (SAN) curriculum does not differ very much from what is implemented in SMKA schools, except that adjustments are made to suit local circumstances. Some of the SAN also use the curriculum prepared by *Maahad al-Azharlil-Buhuth al-Islamiyyah*. Similarly, SAN students are allowed to sit for national examinations. With the passing of the Education Act 1996, all schools in the country had to use the national curriculum as stated by the Act. This also includes SAN,

which previously had their own syllabus.

Fig.1 and Fig.2 depict the ideal and actual production line of students from state Islamic religious secondary schools to university, and filling the job market in four key sectors. The four key sectors are federal Islamic religious departments, state Islamic religious departments, professionals and academicians.

In Fig.1, the students from state Islamic religious schools are supposed to enter either the public or private universities, or universities outside Malaysia. If they remain in the arts stream, they usually undertake social sciences courses, Islamic studies, law or commerce. Graduates from Islamic studies or law will be able to obtain jobs either in the federal or state Islamic religious agencies, or become professionals such as *syariah* court lawyers or academicians.

Fig.2 explains the actual situation that is currently taking place. Academically excellent students from state Islamic religious schools had taken science or commerce streams, leaving the average performing students to take arts or Islamic studies. Based on the author's experience, only a few excellent students opt for arts or Islamic studies streams. Students who undertook science would continue to study in science-based courses, while students who undertook Islamic studies would continue to study Islamic studies courses. Contrast the first chart with the second chart.

The latest data from the Ministry of Education website shows that out of 2,296 secondary schools in Malaysia, there are 68 national Islamic religious secondary schools

(SMKA) which constitute approximately 3 percent of the total number of national schools. Out of 54 fully boarding secondary schools administered under the Ministry of Education, 38 are science schools. Only three are Islamic religious secondary schools, while 11 are integrated boarding schools (which offer religious subjects

along with science subjects, also known as Sekolah Berasrama Penuh Integrasi, SBPI). Some of the state Islamic religious schools have been given assistance by the Ministry of Education. These schools are called Sekolah Agama Bantuan Kerajaan (SABK). There are a total of 118 SABK throughout Malaysia (Portal Sistem Maklumat

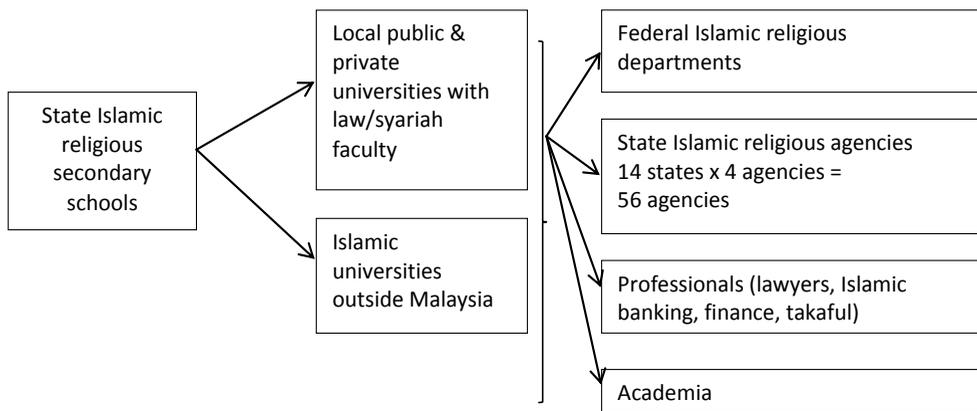


Fig.1: The Supposed Production Line of Students Produced by State Islamic Religious Secondary Schools

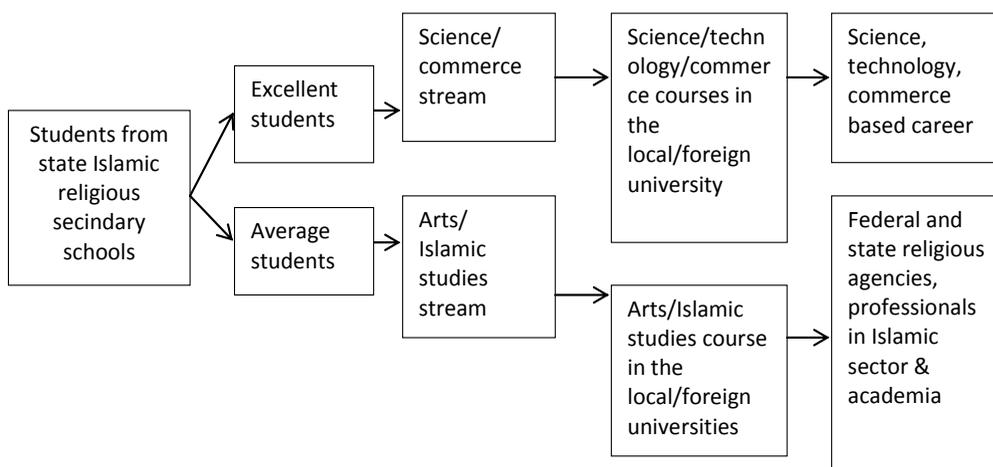


Fig.2: The Actual Production Line of Students Produced by State Islamic Religious Secondary Schools

Pengurusan Pendidikan, emisportal.moe.gov.my). There is no data on the total number of state Islamic religious schools in Malaysia administered directly by state Islamic religious authorities. What can be said is that students from these schools are considered a minority when compared to the students from national schools.

PROPOSED SOLUTIONS

The present paper proposes a three-pronged strategy to overcome the problems faced in relation to human resource in the Islamic sector and academic entrepreneurship in *syariah* and legal studies at Malaysian universities. The first solution is to provide ample exposure to students, parents and teachers in state Islamic religious secondary schools concerning future job prospects, both in the government or private sector. Such exposures may take place in the form of talks or visits to State or Federal religious agencies, as well as organising a Career Day for students following major examinations.

The second solution is for the government to rectify the current policy, which places more emphasis on science and technology, by providing equal attention to social sciences and arts studies. Over the years, there has been an exodus of top students entering the science stream classes in schools run by the Ministry of Education and State-run schools, i.e., State Islamic religious schools. The policy can be demonstrated by the fact that high numbers of MRSM institutions have been built by the federal government as compared to Islamic religious schools. The number of students receiving scholarships to

pursue science- or technology-based courses in universities in or outside Malaysia are higher than the number of scholarships provided to students pursuing arts or Islamic studies streams. These practices result in the less excellent students ending up studying arts and social sciences, which can have deleterious effects upon national society, particularly the Malaysian Islamic society in the long run. This imbalance should be corrected, and equal emphasis should be given to both areas.

The third solution is for the alumni either from state Islamic religious schools or graduates from law or *syariah* courses in universities to return to the state Islamic religious schools they had attended to share their experiences with the current students. Such sharing sessions should be performed regularly so as to inspire the students to do better in their studies, and to enable them to visualise potential careers after completing their studies.

CONCLUSION

Three general conclusions can be drawn from the current examination of human resources in Islamic sector and academic entrepreneurship in *syariah* and legal studies in Malaysia. First, education policies which place greater emphasis on excellent students from schools being channeled into science classes are rather flawed. The flaw effectively decreases the number of students that enrol in *syariah* and legal studies courses, which in turn affects the human resources in the Islamic sector and academic entrepreneurship in *syariah* and

legal studies at Malaysian universities. Therefore, a serious reconsideration of the policy should be performed by the relevant authorities.

At present, the job market for those who have religious background has expanded. There are vacancies for graduates from *syariah* and legal studies in Islamic banking, Islamic finance, *halal* industry and government agencies. Unfortunately, these vacancies are not being filled by graduates from *syariah* or legal studies courses. According to a study conducted upon *syariah* graduates from the Academy of Islamic Studies, Malaya University, out of 190 respondents, more than half are involved in education. The needs of the Islamic community in Malaysia, as well as the nation at large, can and will not be met by scientists, doctors or engineers alone. Skilled individuals are needed from other backgrounds, particularly the fields of Islamic banking and *takaful*, *syariah* judges and lawyers, as well as academics.

Secondly, academic entrepreneurship is only compatible with knowledge of Islamic traditions, to a certain extent. Knowledge can be commercialized, but not all knowledge should be for the sake of making profit. For centuries, Islamic scholars have devoted their time and energy to the development of knowledge for the benefit of the Islamic community. This was accomplished without profit being a principle outcome envisaged in the process.

Thirdly, no concerted effort has been made in relation to a proper strategic

planning for *syariah* and legal studies in Malaysia. The focus of academics in the *syariah* and legal studies in universities has been to fulfill key performance indices in teaching, research and community service. The emphasis is given to the academicians, but no adequate attention is placed on the grooming of excellent students from Islamic religious secondary schools to continue their studies in *syariah* or law. At the undergraduate level, out of 20 public universities in Malaysia, only seven universities (UM, UKM, UIA, USIM, UUM, UITM and UNISZA) have graduates in *syariah* and legal studies. The number of graduates from *syariah* and legal studies is small as compared to students in other field of study. The graduates from these universities are expected to fill vacancies in the job market in the government sector, private sector or in the higher learning institutions.

The shortage of graduates in *syariah* and legal studies requires a strong effort from key players of various fora to develop a proper plan for *syariah* and legal studies in Malaysia.

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Towards Integrated Port Management Systems along Malacca Straits

Dhiana Puspitawati* and Nurdin

Faculty of Law, Brawijaya University, Jl. Veteran, Malang East Java, Indonesia

ABSTRACT

Paperless transaction offers various comforts that have made the world borderless. However, the finalization of international trade needs the goods to be delivered to certain destinations. Although carriage of goods by air guarantees less time, 90% of international trades are still carried out through the oceans. The strategic location of Indonesia in a cross-road position (*posisi silang*), that is between two land-masses of the world, Australia and Asia and between two great waters of the Indian and the Pacific Oceans has made Indonesia a centre of international trade routes. This way, the existence of a well-developed and efficiently run port sector is crucial. However, from the user's perspective, Indonesia does not have a port system which performs well enough to compete with the demand of international markets. Previous research has showed that the lack of competitiveness in Indonesia's ports is underpinned by the existence of too many insufficient and inefficient ports, which are rooted in limited private sector participation and competition in the port system. This is mostly due to the deficiencies in the legal as well as regulatory environments in the port management system, which leads to tight competition both within and between ports. This research seeks to analyse the Indonesian legal framework concerning the Ports Management System. While the current Indonesian Act 17/2008 on Shipping has provided the foundation for port system reform, much remains to be done. One of the implementation strategies of the National Ports Master Plan ((NPMP) envisaged within the draft of NPMP is integrated port planning. The draft further divides strategic ports into six economic corridors; and since this research focuses in ports located along the Malacca Straits, only the Sumatran economic corridor will be considered. This paper proposes the integrated

planning model in the ports located in the Sumatran economic corridor.

Keywords: Competitiveness, efficiency, intergrated, management, malacca straits, port performance

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E-mail addresses:

dhiana@ub.ac.id (Dhiana Puspitawati),

nurdin@ub.ac.id (Nurdin)

* Corresponding author

INTRODUCTION

As the biggest archipelagic state in the world, Indonesia is located in a cross-road position (*posisi silang*), that is between two land-masses of the world, Australia and Asia and between two great waters of the Indian and the Pacific Oceans. Such a strategic location has made Indonesia the centre of international trade routes. Not surprisingly, one of Indonesia's important sectors lies in port sector performance. International as well as national markets competition, the efficiency of national distribution and economic integrity are influenced by the existence of a well-developed port sector, including its management system. The Port Management System is a complex matter which requires detailed regulatory as well as technical frameworks. While Indonesia has so many ports, the absence of a clear and systematic port management regulatory framework has led to the inefficently run port sector. Currently, Indonesia has approximately 1,700 ports that vary in its infrastructure. About 111 ports, including the 25 main strategic ports are controlled by the four state-owned companies known as PT. Pelindo or Indonesian Port Controls (IPCs). In addition to that, there are approximately 614 non-commercial ports of little strategic value and about 1,000 ports dedicated for individual companies. However, from the user's perspective, Indonesia does not have a port system which performs well enough to compete with the demands of international markets. It is reported that the performance of most of Indonesian ports is still considered low and inefficient. This is mostly caused by

technical and operational mechanisms, for instance, berth occupancy rates as well as working time is still below international standards causing vessels too much time at berth or in queues outside ports. Besides the technical problems and port operational mechanisms, there is a geographical problem of Indonesian ports beings usually located at shallow seas. In addition to that, the location of ports which is within internal waters such as along rivers, can be another problem for port performance. In addition, Kurnia (2012) states that other factors that contribute to lower port performance include inappropriate infrastructure, especially containers, container yards and crane availability as well as ports safety and security. However, it is argued that the fundamental reasons underpinning Indonesian ports' inefficiency and low performance is rooted in the limited private sector participation and competition in the port system. Such limited participation is mostly due to the deficiencies in legal matters as well as the regulatory environment in the port management system, which leads to tight competition both within and between ports. The existence of regulatory deficiencies lead to the policy vacuum as to the private sector's confusion of what processes should be pursued, what approvals as well as permits must be obtained from which agencies, in order to participate actively in the port system. In addition to this, the legislated monopoly enjoyed by the IPCs over the main commercial ports, has also made the private sector reluctant to participate increasingly in the port management system.

This research seeks to analyse the Indonesian legal framework concerning the Ports Management System. While the current Indonesian Act 17/2008 on Shipping has provided the foundation for port system reform, much remains to be done. Significant development of port management systems provided by Act 17/2008 was the National Ports Master Plan ((NPMP). While NPMP was planned to be finished by 2009, to date, NPMP is still in the form of a draft with no further progress yet. However, one of implementation strategies of NPMP was the integrated ports planning. The draft further divided strategic ports into six economic corridors; and since this research focuses in ports located along Malacca Straits, only the Sumatra economic corridor will be considered. This paper proposes the integrated planning model in ports located in the Sumatran economic corridor.

MATERIALS AND METHOD

Research Method

This research applies documents of legal instruments relating to Indonesian port regulations and management. In particular, Indonesian Shipping Law, Act no 17/2008 and in specific, provisions regarding ports management system were analysed. It used the juridical normative method and furthermore also looks at the implementation of the port management system. This paper will highlight ports located along the Malacca Straits as a rough example of proposed intergated port management systems which can be considered. Certain

articles in mass media, as well as academic papers articles are also extensively used.

Indonesian ports' officials as well as shipping companies were interviewed to capture their opinions, thoughts and feelings on specific issues. The analysis of ports regulations and national act as well as regulations and their implementation will make a significant contribution towards formulating a proposal to integrate the port management system which will increase a port's performance and competitiveness.

Legal Materials

Legal materials applied in this paper include primary sources and secondary sources as well as tertiary sources, as follows:

1. Primary sources include
 - a. International Maritime Organization Convention 1948
 - b. United Nations Convention on the Law of the Sea 1982
 - c. International Ship and Port Security Code and SOLAS Amandment 2002
 - d. International Safety Management, IMO Resolution A.741(18) as amended by MSC.104(73), MSC.179(79), MSC.195(80) and MSC.273(85)
 - e. Indonesian Act No. 21/1992 revised by Indonesian Act No. 17/2008 on Navigation
 - f. Government Regulation No. 61/2009 concerning Ports Management

- g. Local Government Regulation/Perda No. 12/2011 concerning Ports in Batam
 - h. Presidential Regulation No. 13/2012 concerning Development Planning of Sumatra Island
 - i. *Kitab Undang-Undang Hukum Dagang (KUHD)* or Indonesian Commercial Law which is also known as *Wet Boek Van Koop Handel*
2. Secondary Sources, which can explain and support primary source analyses, include:
- a. Explanatory Section of *Kitab Undang-Undang Hukum Dagang (KUHD)*
 - b. Explanatory Section of Indonesian Act No. 21/1992 jo Indonesian Act No. 17/2008 on Navigation
 - c. Explanatory Section of Presidential Regulation No. 13/2012 concerning Development Planning of Sumatra Island
 - d. Explanatory Section of Government Regulation No. 61/2009 concerning Ports Management
 - e. International Customary Law concerning Ports Management
 - f. International Law Principles on Ports Management as well as Ports safety and security
 - g. Experties Opinion on relevant matters
 - h. Interview with relevant officers and other parties implementing ISPS and ISM Code as well as Port Management System
 - i. Draft on National Port Master Plan
3. Tertiary Sources, which can guide and explain both primary as well as secondary sources include:
- a. Black's Law Dictionary
 - b. Encyclopedia of International Law

RESULTS AND DISCUSSION

Indonesian Ports at Glance

As the biggest archipelagic state in the world, Indonesia consists of approximately 1,700 ports. As many as 111 ports, including 25 main strategic ports, which are considered as commercial ports fall within the control of four geographic coverages of the IPCs as described in table 1. In addition there are approximately 614 non-commercial ports that tend to be unprofitable and are of little strategic value (Ministry of Transport: 2006). There are also approximately 1000 'special purpose' or private ports that serve the needs of individual companies (both private and state-owned) in a number of industries including mining, oil and gas, fishing, forestry etc. Some of these ports have facilities that are appropriate for only one or a group of commodities (e.g. chemicals) and have limited capacity for the accommodation of third party cargo. Others, however, have facilities appropriate for a broad range of commodities, including in some cases, containerized cargo.

Indonesia's ports are currently regulated under the new Act, that is Indonesian Act No. 17/2008 (Act 17/2008) (Indonesia State Gazette No. 64/2008), which replaced the previous Act on the same subject matter, Act No. 21/1992. With regard to the ports management system, the provisions of Act 17/2008 has its significance by providing radical transformation in Indonesian port management system since the removal of IPCs legislated monopoly over major commercial ports. However, such transformation is taking sometime to be put into in place as in reality it is reported that somehow the IPCs' legislated monopoly is only in paper. This is because most sufficient major ports are still under the control of the IPCs, which are divided into four areas of operations, namely: Pelindo I, II, III dan IV. Table 1 shows that areas of operations.

It can be seen from the above table that the removal of the legislated monopoly of IPCs by Act 17/2008 does not change the IPCs' geographical coverage over main commercial ports. Major Indonesian Ports are still under the regulatory of IPCs. Hence, existing port infrastructure is currently still being used by the incumbent IPCs. In addition, while the role of IPCs under Act 17/2008 is significantly reduced to being a mere operator, it is questionable how the newly planned regulator, known as port authorities will interact with the incumbent IPCs. Most civil servants who are port authority staff will obviously have historical, institutional and even personal relationships with IPCs, and therefore there are concerns about possible discriminative treatment against new investors. Hence, it is questionable whether the role of IPCs as a mere operator will actually be implemented in practice. Further discussion on port authority will be elaborated later in this paper.

TABEL 1
Areas of Operation of PT. Pelindo

PT. PELINDO	Province	Managed Ports
Pelindo I	NAD, Sumatra Utara, Riau	Belawan, Pekanbaru, Dumai, Tanjung Pinang, Lhokseumawe
Pelindo II	Sumatra Barat, Jambi, Sumatra Selatan, Bengkulu, Lampung, Bangka Belitung, Banten, DKI Jakarta, Jawa Barat, Kalimantan Barat	Teluk Bayur, Jambi, Palembang, Bengkulu, Panjang, Tanjung Pandan, Pangkal Balam, Banten, Sunda Kelapa, Tanjung Priok, Cirebon, Pontianak
Pelindo III	Jawa Timur, Jawa Tengah, Kalimantan Selatan, Kalimantan Tengah, Bali, NTB, NTT	Tanjung Perak dan Gresik, Banyuwangi, Tanjung Emas, Tanjung Intan, Banjarmasin Kotabaru, Sampit, Benoa Lembar, Tenau/Kupang
Pelindo IV	Sulawesi, Maluku, Papua	Makassar, Balikpapan, Samarinda Bitung, Ambon, Sorong, Biak Jayapura

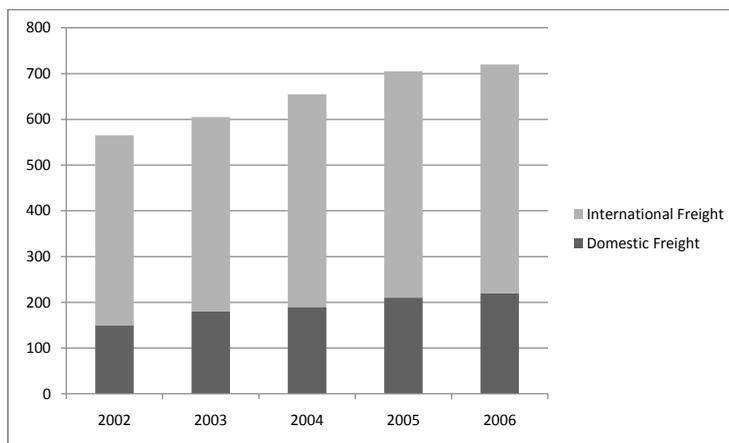
source: www.indonesiaport.co.id

Indonesian Ports Performance

As an archipelagic state having important navigational routes, it is reasonable for Indonesia to have appropriate and competitive ports. However, it cannot be denied that managing ports involves a complex and wide range of factors to be accommodated. Although port commercialisation does not require active business activities, since every vessel will come to available ports, port performance is crucial for Indonesia’s national economy. While Ray (2003) explained that major Indonesian ports performance are still low, it is argued that the key to Indonesia’s poor ports performance is competitiveness. There are at least three factors involved in such incompetiveness. These include: complex geographical port conditions and poor management systems as well as infrastructure. These factors lead to higher handling costs. Indonesia has very few natural deep-water harbours and a river system prone to serious saltation that

restricts port depth. Therefore, dredging is often not feasible. Therefore, vessels have to wait until high tide to enter port. This results in extra costs for vessels. Congested traffic in land is another problem. Since most ports in Indonesia are located near large urban areas, access to port is similarly difficult and takes much time.

In determining the efficiency as well as competitiveness of ports, it is important to describe port traffic and how much cargo is handled by Indonesian ports. However, obtaining this data is not an easy task. Such data take at least 6 to 7 years time to be updated. The latest available data on Indonesian port performance is data from the year 2006. To show Indonesian port efficiency and competitiveness, Fig.1 illustrates total port traffic handled by Indonesian ports (Indonesia Infrastructure Initiative, 2012), whereas Table 2 shows container volumes handled by Indonesia’s main ports (Ports and Dredging Directorate, Ministry of Transport, 2007). In addition,



Source: Indonesia Infrastructure Initiative (2012)

Fig. 1: Total port traffic handled by Indonesian Ports (million tons)

the performance data for Indonesian Ports can be seen from table 3 (Ministry of Transport, 2006).

Almost 90 per cent of Indonesia's trade is done via sea. While Indonesia does not have its own transshipment ports, yet the data shown above presents the fact that there were significant growths of the total tonnage handled by Indonesian ports. The tonnage grew by approximately 154 million between 2002 to 2004 (from 582 million in 2002 to 736 million in 2006). In the other words, the tonnage grew at an

average annual rate of 6 per cent. It can also be seen from the table above that over the period of 4 years domestic freight grew at a rate of 11.5 per cent per annum, whereas international freight grew at a rate of 4.1 per cent. This way domestic freight grew nearly three times the rate for international freight. Furthermore, Table 2 shows container volumes handled by 11 main ports. It shows that container volumes increased by 1 million TEUs between 2005 and 2007. Thus an average annual growth rate of approximately 12 per cent is evident. While

TABLE 2
Container volumes handled by main ports

CONTAINER PORT	UNIT	YEAR		
		2005	2006	2007
Belawan (Medan)	Box	217, 629	237, 703	251, 144
	TEUs	281,106	304, 002	320, 515
Palembang	Box	60, 805	65, 648	76, 803
	TEUs	65, 879	70, 388	82, 546
Panjang	Box	82, 994	70, 586	67, 825
	TEUs	93, 164	81, 545	79, 767
MTI (Jakarta)	Box	192, 005	151, 842	96, 888
	TEUs	295, 477	222, 762	135, 019
JICT (Jakarta)	Box	994, 352	1, 085, 977	1, 212, 564
	TEUs	1, 470, 467	1, 619, 495	1, 821, 292
Koja (Jakarta)	Box	382, 004	391, 582	478, 907
	TEUs	573, 410	583, 065	702, 199
Pontianak	Box	125, 033	129, 375	134, 619
	TEUs	132, 273	138, 991	143, 443
Tanjung Perak (Surabaya)	Box	762, 143	743, 445	799, 966
	TEUs	1, 073, 385	1, 051, 960	1, 113, 478
Tanjung Emas (Semarang)	Box	211, 443	219, 965	233, 582
	TEUs	353, 675	370, 108	385, 095
Makassar	Box	-	-	-
	TEUs	238, 394	255, 998	302, 043
Bitung	Box	-	-	-
	TEUs	-	44, 958	55, 623
11 Port Total	TEUs	4, 061, 161	4, 698, 264	5, 085, 397
Annual Growth			15.7%	8.2%

Source: Ports and Dredging Directorate, Ministry of Transport (2007)

TABLE 3
19 Main Indonesian Main Ports Performance in Domestic Cargo

PORT	1999	2006	1999		2005/2006					
	BOR	BOR	TRT	TRT	WT	PT	AT	NOT	ET	IT
	%	%	HOURS	HOURS	HOURS	HOURS	HOURS	HOURS	HOURS	HOURS
Belawan	62.7	52.4	77.9	72.6	1.4	16.6	1.7	22.4	29.8	0.9
Dumai	73.6	74.0	83.4	81.5	4.2	26.8	9.6	11.4	27.3	2.4
Lhokseumawe	43.2	22.4	88.8	62.7	0.8	5.8	1.3	25.8	27.4	1.6
Pekan Baru	59.2	51.3	109.9	96.5	1.4	14.5	11.4	45.4	22.5	1.2
Tanjung Pinang	82.9	90.3	84.4	82.9	0.0	2.3	2.0	58.4	16.0	4.2
Banten	41.6	39.1	57.9	65.1	1.0	0.8	7.8	34.5	21.1	0.0
Palembang	62.9	34.7	73.6	61.8	0.1	0.0	17.7	20.0	23.3	0.7
Banjarmasin	81.0	74.7	55.0	52.0	1.0	1.0	6.0	23.0	21.0	0.0
Benoa	60.1	56.0	22.0	137.0	0.0	0.0	1.0	122.0	14.0	0.0
Tenau/Kupang	74.4	65.7	79.0	167.0	10.0	1.0	6.0	65.0	85.0	0.0
Tanjung Emas	79.0	27.8	51.0	77.0	1.0	2.0	2.0	11.0	49.0	12.0
Tanjung Perak	63.0	69.0	99.0	38.0	0.0	5.0	4.0	9.0	20.0	0.0
Ambon	60.2	54.2	62.1	54.8	0.1	0.3	0.3	24.0	29.6	0.6
Biak	71.2	49.5	96.0	80.0	1.0	0.0	1.0	10.0	67.0	1.0
Bitung	65.1	70.2	95.6	60.5		0.6	0.4	28.0	31.6	0.0
Jayapura	65.2	70.9	164.5	103.5	0.4	0.1	0.5	23.7	33.9	44.6
Makassar	53.8	43.2	66.7	124.3	0.0	0.0	3.0	15.2	93.4	12.6
Samarinda	64.0	68.9	93.0	88.8	7.3	0.0	5.0	10.0	59.2	7.3
Sorong	72.4	80.0	38.3	50.0	6.0	0.0	1.0	20.0	22.0	1.0
Average	65.0	57.6	78.8	81.9	2.0	4.0	4.3	30.4	36.5	4.7

Note: BOR (Berth Occupancy Ratio), TRT (Turnaround Time), WT (Waiting Time), PT (Postpone Time) caused by Port Administration, AT (Approach Time), NOT (Down Time), ET (Effective Eorking Time) and IT (Idle Time)

Source: Ministry of Transport: 2006

Tanjung Priok Port accounted for about half of all containers, in 2007 total container volume for the four terminals in the port was just under 3 million TEUs. Thus, smaller regional ports will require deeper channel draft as well as basin depth and bigger and faster cranes to improve cargo handling.

Other factors accounted for Ports Performance are berth occupancy rate, turn around time, waiting time, idle time as well as effective working hours, which can

be seen in table 3. It can be read from the above table that the berth occupancy rate for the above 19 ports was 57.6 per cent in 2006, which decreased from 65.00 per cent in 1999. The average turnaround time also showed poor port performance since there was no increase between 1996 and 2006. While in 1999, vessels required an average of 79 hours, in 2006 the average time s worsened to 82 hours. In sum, the table above presents the description that the

TABLE 4
Indicative Funding Requirements by Private and Public Sector for Development of Port Facilities

No	Stage	Total		Government/Public Sector		Private Sector	
		US\$ million	%	US\$ million	%	US\$million	%
1	2011-2015	12,212	100	5,202	42.6	7,010	57.4
2	2016-2020	12,389	100	3,423	27.6	8,965	72.4
3	2021-2030	22,464	100	6,281	28.0	16,183	72.0
	Total	47,064	100	14,906	31.7	32,158	68.3

Source: Draft of NPMP Indonesia Infrastructure Initiative (2012)

Indonesian cargo fleet has been spending too much time sitting idle or waiting in port. Although the data is several years out of date, it nevertheless illustrates low performance of Indonesian Ports. It can be noticed from the table that while the delivery of port services to users has been poor, there has only been little improvement since late 1990s. This can be seen from some key performance indicators, such as berth occupancy rates, vessel turnaround time and working time ratio.

Another factor contributing to port incompetitiveness is infrastructure problems, which exists in Indonesian ports. This is mostly related to the availability of container facilities, which include the lack of space for container storage and stuffing, as well as cranes. Only 16 of 111 commercial ports in Indonesia have container-handling equipment. Such equipment is very crucial to assure non-existence of delays. The example of the importance of relevant equipment happened in Panjang, Lampung when it was reported that a damaged crane caused delays up to a day and a half in May 2008. Another example was long delays that happened in Belawan caused by the breakdown of key-port side equipment,

namely gantry cranes. Poor infrastructure can be noticed from the amount of funding that is required to develop ports having sufficient infrastructure. The draft of NPMP 2011-2030 (Indonesia Infrastructure Initiative: 2012) forecast the funding requirement needed to improve port infrastructure. While port infrastructure improvement is crucial, the funding requirements becomes quite high, as can be seen in table 4, which illustrates funding requirements for developing Indonesian ports.

Another factor that could lead to the increase of costs is port security. It is submitted that poor port security will increase costs. It is further submitted that cargo shipments to and from Indonesia are attracting insurance premiums of 40% higher than Singapore destinations. While the Malacca Straits is well-known for its piracy as well as armed robbery at sea, port-based activities of organized crime groups add to the concerns. This is why nowadays main ports involved in import-export operations must comply with the International Ship and Port Facility Security Code (ISPS Code) produced by IMO. While all three ports located along Malacca Straits have already been given ISPS Code

Certificate, the implementation of such certification is still far from satisfactory. This is because of a lack of suitable infrastructure for implementation as well as human resources availability and competency.

Indonesian Act No. 17/2008 on Shipping

Act 17/2008 also known also as Shipping Law released in April 2008, consisting of 355 articles is a very general act covering a broad-range of maritime issues, among any others such as shipping, navigation, environmental protection, sailor welfare, maritime accidents, human resource development, community involvement and the creation of coast guards. Important provisions which are considered as having impact on reforming Indonesian port management systems is provisions regarding cabotage. According to the cabotage rules, domestic carriage is limited to only those of Indonesia flagged vessels, which is the reaffirmation of pre-existing regulations, Presidential Instruction (Inpres) No. 5/2005. While this rule might increase domestically flagged vessels operating in Indonesian waters and replace foreign-flagged ships on domestic routes, it does not resolve vessel problems concerning the proportion of working time queueing outside the ports; or berthed at the congested port. In fact the rule of cabotage does not contribute anything with regard to port performance. It is submitted that cabotage rule was evidence of strong lobbying skills by certain groups, that is Indonesian Shipowners Association (INSA), who insist on reducing

foreign-flagged vessels navigating through Indonesian waters.

While cabotage rules until recently remain as rules facing difficult implementation, Act No. 17/2008, in fact, has its significance in providing radical transformation in Indonesian port management systems since it removed IPC's legislated monopoly over major commercial ports. According to this act, most regulatory port authority at the port level will be vested in newly formed port authorities. This way, the IPC's role is reduced substantially to one of being a mere operator. However, many shipping companies argue that the IPC's role as an operator is only "on paper" since in reality the IPC's scope of operation is still more than a mere operator. This is because it cannot be denied that the IPC is still the only state-owned company having a complete infrastructure in most port handling.

Chapter VII of Shipping Act, furthermore opens ports up to participations by other operators, including those from the private sector as well regional governments. This act also distinguishes clearly between operator (operating port) and regulator (landlord port), as envisaged by article 69. Article 70 divides type of ports into two categories, namely port land and port waters. It also recognizes hierarchy of ports as follows: (i) main ports, (ii) collector ports and (iii) feeder ports. Based on this delination, the new model of port management system provided by the Shipping Act envisages what is known as "landlord port". Such a model sees the government, represented by

port authority, own, provide and regulate access to port land and port waters as well as basic port infrastructure such as breakwaters, sea channels and navigational aids. Port operators then lease these facilities and provide port services under a long-term contract or concession.

Further innovation of the Act 17/2008 is the development of Port Authorities to supervise and manage commercial operations within each port. Their primary responsibility will be to regulate, decide the price and supervise access to basic port infrastructure and services including port land and waters, navigation tools, pilotage, breakwaters, port basins, sea channels (dredging) and port road networks. In addition, the port authority will also be responsible for developing and implementing the port master-plan (including determining land and sea areas of control) as well as ensuring port orderliness, security and environmental sustainability. Port operators on the other hand, can participate in providing cargo handling, passenger facilities, mooring services, refueling and water supply, towage as well as storage and other superstructure, amongst others. In a landlord port setting, such arrangements or divisions across the public and private sector are common (Asian Development Bank: 2000, World Bank: 2001). While the arrangements may vary across countries, it is submitted that in a place where there are public interest or natural monopoly considerations, like Indonesia, such functions are best provided by the government. However, the important

thing which should be considered is whether Indonesia's port authorities will have the requisite technical and financial capacity to effectively carry out these functions. In addition, regarding staffing, while it is expected that port authorities might recruit professional staff with higher salary, such as retired shippers, the Transport Ministry has made it clear that they expect the port authorities to be staffed by a combination of Ministry officials from the Sea Communications Directorate and Port Administration (Adpel) offices (Kholik Kirom: 2008). Another concern that has been elaborated in the beginning of this paper is the interaction between planned port authorities and incumbent IPCs which might lead to bias. While the IPCs is the only port operator having the best sufficient infrastructure, there is a need to develop new terminals as well as operator facilities which will be of an advantage to IPC with their ready to use equipment. It is therefore critical that the port authorities have the capacity to generate their own sources of funding, and not be entirely dependant upon transfers from the central government.

A new model concerning port authority was introduced by the regional government of Batam, which established Batam Authority (*Otorita Batam*) under Local Regulation No 12/2011 which revised Local Regulation No. 1/2008 concerning ports management in Batam. While nowhere in the Act 17/2008 is suggested that port management be regulated under regional autonomy, it is argued that the establishment of the Batam Authority can be seen as

a tendency to direct port management towards the concept of decentralization. However, Djalal (2011) argued that the movement of port management toward autonomy should be considered carefully. This is because the port's asset is not only a national asset, but it involves international aspects, especially those of compliance with the International Maritime Organisations (IMO). The International Convention on the Life at Sea 1974 (SOLAS 1974), established under the auspices of International Maritime Organization (IMO), provides two regimes that are topical and outstanding in the current maritime milieu, namely International Safety Management (ISM) and International Ship and Port Facility Security (ISPS). Both regimes serve as Codes that world-wide ports should comply with. While most major ports in Indonesia already have both ISPS and ISM code, infrastructure gaps exist between those three ports making the implementation of such codes difficult.

National Ports Masterplan

As with many Indonesian laws, in particular those sponsored by the Transport Ministry, Act 17/2008 is very general and important details will be provided in the implementing of regulations and other supporting documents. Another port management transformation provided within Act No. 17/2008 is the introduction of National Ports Master Plan (NPMP), as stated in article 71-78 of the Act. According to this Act, the government should draw NPMP, which consists of national port policy, port location plan and port hierarchy (Article 2

Draft NPMP 2011). Similar to Act 17/2008 the Draft on NPMP stated that the sea port consists of three level of hiererchies, which include main port, collector port and feeder port (Article 6 Draft NPMP 2011). At the port level, port authorities are responsible for individual port masterplans covering such matters as geographic (land and water) working areas, the provision of basic infrastructure and the regulation of port operator access to facilities. Furthermore, Article 73 envisages that every port should have its own port masterplan, which should not be contrary to NPMP. Such a masterplan will determine the locations, functions and hierarchies of Indonesia's ports. The Transport Minister is responsible for this document which has a shelf-life of 20 years. Changes can be made every 5 years or more frequently if emergency circumstances require. However, unfortunately, NPMP will not be articulated within the law, instead, it will remain as a separate supporting document. The Transport Ministry planned to complete NPMP by April 2009. However, to date, such a masterplan is still in draft form, known as Draft on National Ports Masterplan 2011-2030, with no significant progress. Hence, investors are unable to progress with their investment plans until necessary implementing regulations, planning documents and supporting institutions are developed. Fig.2 provides a simple schematic mapping out of the governance structure of the national ports system under the Act 17/2008.

It can be seen from the illustrated scheme above that while such masterplans

will determine both current and planned ports, in terms of locations and hierarchy (function), it is not clear whether there will be a dedicated port authority for each single port (comprising multiple terminals), or other port authorities will oversee multiple ports. While NPMP can be seen as a turning point in Indonesia's ports reform, which might overcome the deficiency in regulatory environment, the non-progressive Draft NPMP might lead to obscurity of regulatory as well as institutional frameworks in a port system. For an investor, it means the existence of a policy vacuum, where they are unsure of what process must be pursued and what approvals and permits must be obtained from which agencies, to be able to participate more in a port system. It is submitted that the clarity of regulatory frameworks in a port system will eliminate the hesitation of investors or the private sector to participate. It would include the

formality of NPMP, since NPMP provides clear national port policy and plan. With more private sector participation, the amount of insufficient and ineffective ports can be reduced and therefore might increase the port's competitiveness.

Port Privatization and Rationalization

Although NPMP will not articulated in the law, NPMP is expected to implement the long-held plan of the Ministry to reduce the number of ports with direct international links. While private participation is crucial, port rationalization is seen as another way to accelerate the port reform system. Currently there are over 100 ports allowed to have direct international connections. This is expected to be reduced to approximately 25 (*Bisnis Indonesia*, 25 March 2008). NPMP was designed to achieve the target of reducing ports having direct international

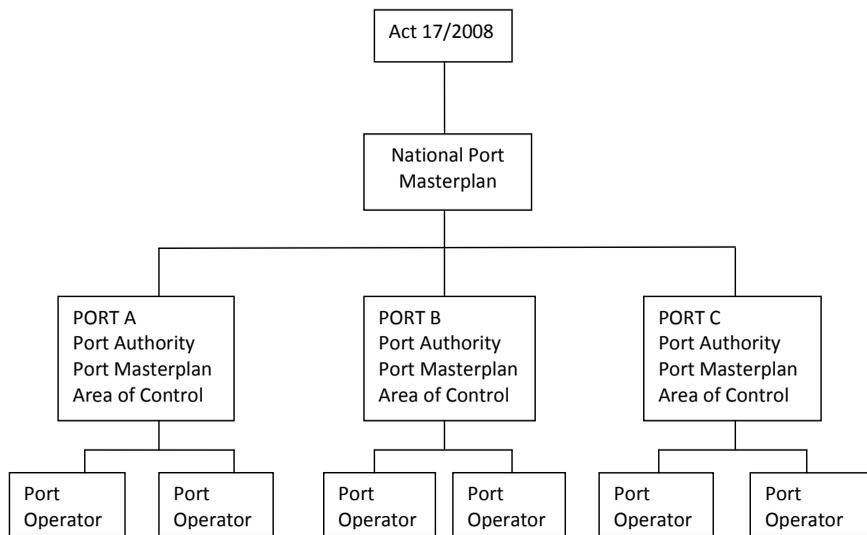


Fig.2: Governance Structure of Port under Act 17/2008: National Port Masterplan

links. Currently there are at least 100 ports allowed to have direct international connections. This number is to be reduced to 25 ports. Port rationalization has its merits. While having a large number of ports might lower per unit cargo-handling as well as freight costs, recent international practice suggests that there is considerable efficiency obtained by using larger vessels visiting deeper harbours ports with more developed cargo-handling infrastructure. It is very costly allowing less developed ports having direct international connections, since, as explained previously, that incapability of cargo-handling would only cause inefficiency as vessels have to wait in long queues to enter into port. In addition to this, insufficient cargo-handling equipment would only cost more for shipping companies. Port rationalisation will also make it easier for Indonesian ports to comply with ISPS Standards since as until now Indonesia is still struggling to meet those standards. Other benefits of port rationalisation are to support the implementation of the cabotage principle as well as addressing smuggling. Batubara (2008) submitted that reducing the number of ports having direct international links will increase the demand for feeder ports and this can benefit domestic shipping companies. However, on the other hand, port rationalisation would scrutinise exporters and importers as it will cost them higher transport costs.

Another consideration that should be taken into account is the possible effects of rationalization on interport

competition. Until now, Indonesia has not been able to enjoy the advantages of ports competing in the same hinterland cargo due to the regulatory and management structures governing the IPCs. According to Act 17/2008, competition is possible also between ports, not only within ports (that is, between competing terminals). However, with the development of NPMP, there are concerns that decisions on port location, functions and hierarchy will be made in such a way as to reduce competitive pressures on the incumbent IPCs. While the IPCs have concerns about such competitive pressures, another IPCs concern on port management is the idea of privatization. Harahap (2005) argued that a port's privatization cannot be denied. Since the reason underpinning poor port performance and competitiveness is mostly infrastructure, port privatization has been seen as the most feasible means to develop port infrastructure. While most ports in Indonesia, including Lhokseumawe, Belawan and Dumai Port have cooperation with the private sector, either by a simple outsourcing system to full divestiture, business performance of this port is still relatively low. Since the selection of such private sector participation depends on traffic volume, port function, competition level, economic growth, local conditions as well as local regulations, port privatization needs the readiness of local government to join with the private sector. While port privatization would scrutinize IPCs to some extent, local governments, empowered by the decentralization process have been able to challenge IPCs in their retaining

port privatization. However, the central government has managed to keep a tight rein on this issue to prevent competition with IPCs.

Integrated Ports Master Plan

The Draft of NPMP (Indonesia Infrastructure Initiative: 2012) has divided strategic ports into different economic corridors, which include: the Sumatran economic corridor, Java economic corridor, Kalimantan economic corridor, Bali-Nusa Tenggara economic corridor, Sulawesi economic corridor and Papua economic corridor. Since this paper focuses only on ports located along the Malacca Straits, only the Sumatran economic corridor will be considered. Fig. 3 illustrates the Sumatran economic corridor. The division of ports according to its economic corridor has some merits by allowing ports located along the same economic corridor to cooperate in order to provide the best port services. It is submitted that port planning must respond to the growing requirements of economic activity and integrate these developments in the development of their master plans. In addition, port development must also be coordinated with national transportation planning and planning decisions cannot be made in isolation of the communities where ports operate; port plans must therefore be in conformity with local land use plans. Ports located along the Malacca Straits fall within the Sumatran economic corridor, which include Lhokseumawe, Belawan and Dumai. Leifer (1978) stated that the strategic value of the Malacca Straits is

obvious but the challenging situation for Indonesian ports along the Malacca Straits, is when they are faced with the capacity and capability of Singaporean as well as Malaysian ports. Of these, the port of Singapore is preeminent among them and is the world's busiest port as well as the second largest container port, handling some 12 million TEUs of containers in 1995. By contrast, Port Kelang handled about 1 million TEUs, while Penang port and Pasir Gudang in the Johor Straits loaded and unloaded some 300,000 TEUs each. On the Sumatran side, the largest port is the Belawan port in Medan. It handles about less than 325,000 TEUs.¹ In providing port services for quite heavy traffic like the one in the Malacca Straits, it is argued that the development of the three ports, Lhokseumawe, Belawan and Dumai should be done together. This means, the efficiency among those three ports should minimally be similar to each other. To achieve this, it is proposed to have integrated port planning among those ports beside the integration with the local land use plan. Since the existence of an integrated port masterplan could lead to the integrated management system, the following section will discuss the nature of the integrated management.

INTEGRATED MANAGEMENT

Dalling (2007) defined integrated management as "the understanding and effective direction of every aspect of

¹ See Table 4 of this paper.

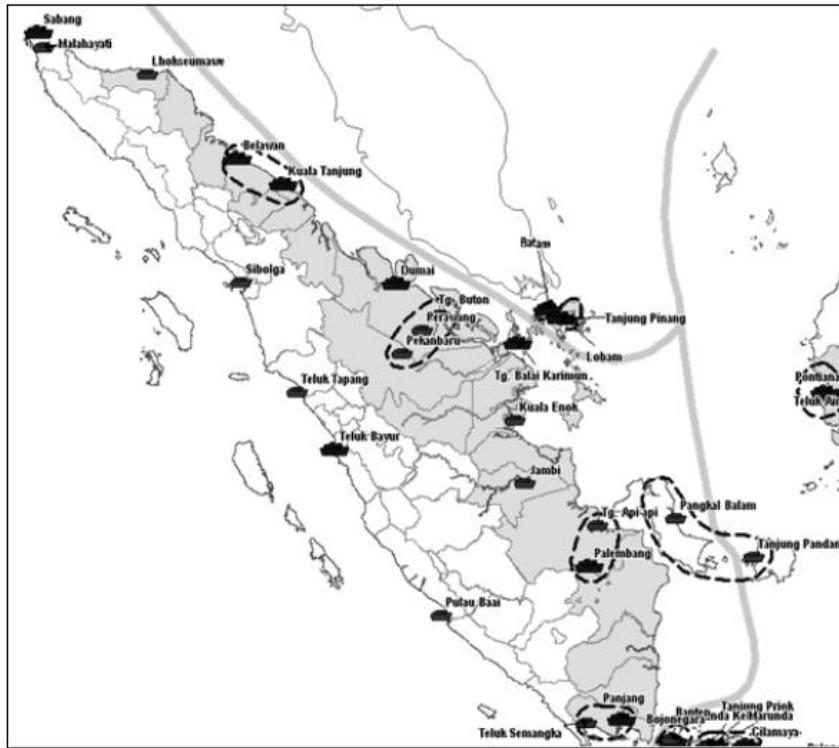


Fig.3: Strategic Ports within Sumatra Economic Corridor

an organisation so that the needs and expectation of all stakeholders are equitably satisfied by the best use of all resources.” He further listed the principal characteristics of integrated management, which include: (i) making no distinction in its general approach to managing potential gain and potential loss; (ii) implementation leading to optimal efficiency and effectiveness; (iii) addressing totally the stakeholder’s needs and aspirations in an equitable way; (iv) value added purposes in all aspect and (v) addressing all aspects that contribute to the organization’s performance.

With regards to ports located along the Malacca Starits, namely Lhokseumawe, Belawan and Dumai, the most appropriate

port which is considered capable and meets international standars as in the criteria of the infrastructure is the Belawan port. Among these three ports, it is to be noted that there is a gap between those three ports concerning the berth occupancy rate, turnover time, waiting time, idle time as well as effective working time. Chapter VIII of the Indonesian Transportation Ministry Regulation No 60/2011 (PerMenhub 60/2011) provides class categorisation of Indonesian ports according to its infrastructure and coverage, which includes main port, port class I, II, III, IV and V. While Lhokseumawe and Dumai are categorized as port class II and I, respectively, Belawan is categorized as a main port.

As explained previously, port performance also depends on the local government's commitment. Therefore, it is argued that to provide better services on ports for navigation along Malacca Straits, integrated management system of ports is needed for Indonesian ports located along Malacca Straits, especially for international links. While it is not necessary to have decentralized management of ports, all these three ports should be centred on the Belawan Port within an integrated management system. In this way, there will be only one developed port serving bigger vessels in deeper waters.

CONCLUSION AND RECOMMENDATION

This research has analysed the Indonesian legal framework concerning the Ports Management System. While the current Indonesian Act 17/2008 on Shipping has provided the foundation for port system reform, much remains to be done, since transforming the Indonesian port system is deemed to be a long and arduous process. It is argued that limited private sector participation contributes much in inefficiency of Indonesian ports, which lead to incompetitiveness. The existence of the regulatory framework completed with planning documents is crucial since this will assure the private sector of the relevant mechanism that should be followed in order to participate in a port system. While Act 17/2008 requires the government to draw up the National Ports Master Plan ((NPMP), unfortunately such a document is still in draft form with no further developments.

One of the implementation strategies of NPMP envisaged within the draft of NPMP is integrated port planning. It is submitted that with regard to the Malacca Straits, it is important for Indonesia to have efficient and competitive ports to serve the international market demand. While the capacity of Lhokseumawe, Belawan and Dumai is varied, it is proposed that these three ports should be developed into an integrated port planning both between ports as well as with local land use plan. Such integrated planning would probably move towards integrated management which would provide a clear mechanism for private sector participation. This could lead to the injection of much needed competition, leading towards the improvement of port services.

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Towards Our Own *Lex Mercatoria*: A Need for Legal Consensus in Islamic Finance

Hakimah Yaacob

*International Shari'ah Research Academy for Islamic Finance (ISRA), Lorong Universiti A,
59100 Kuala Lumpur, Malaysia*

ABSTRACT

Lacking in terms of personal *lex mercatoria* governing the cross border transactions in Islamic finance may lead to uncertainty in trade financing. Global Islamic finance is faced with many unresolved issues that demand urgent attention from all parties involved. One of the pressing issues is the lack of standardisation to face globalisation within the industry. An attempt is made herein to propose a few options in having legal consensus towards the creation of *lex mercatoria* in Islamic finance. This paper proposes that, as the global market continues to increase and as interest in Islamic finance grows around the world, there is a compelling need to make future developments of the industry smoother by having its own treaties, conventions and model laws which form the basic financial instruments in order to avoid possible conflict and gain public confidence.

Keywords: Globalisation, international convention, international treaties, Islamic finance, *lex situs*, *lex contractus*

INTRODUCTION

The decision in Shamil Beximco's case failed to reflect the sanctity of Shariah law observation as the content in Art 5 of UCP600 on letter of Credits does not follow the tenets of Shariah. In light of that, Islamic Finance trades are riding on the existing

conventional *lex mercatoria*. Malaysia and other MENA regions, under the initiative of MIFC have developed standards that are merely guidelines with no binding effects. *Lex mercatoria* is defined as merchantile law. As part of *lex mercatoria* or merchant law, having Islamic finance as a separate *lex mercatoria* is pivotal. Legal Consensus means an agreement among the players to ensure the legal certainty in the industry. The well known *lex Mercatoria* was originally developed as a body of rules and principles

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E-mail address:

hakimah@isra.my (Hakimah Yaacob)

among the European traders to regulate their dealings. The covenant covers usages and customs which are common to merchants and traders in Europe¹. It also includes finance and banking areas. *Lex mercatoria* is the Latin expression for a body of trading principles used by merchants throughout Europe in the medieval times. Meaning literally “merchant law”, it evolved as a system of custom and best practice, which was enforced through a system of merchant courts along the main trade routes. It functioned as the international law of commerce.

It emphasised contractual freedom, alienability of property, while shunning legal technicalities and deciding cases *ex aequo et bono*². The concepts also flow from the problem that civil law was not responsive enough to the growing demands of commerce that was in need for quick and effective jurisdiction, administered by specialised courts. The guiding spirit of the merchant law was that it ought to evolve from commercial practice, respond to the needs of the merchants, and be comprehensible and acceptable to the merchants who submitted to it. International commercial law today owes some of its fundamental principles to the *lex mercatoria* as it was developed in the medieval ages. This includes choice of arbitration institutions, procedures, applicable law and arbitrators, and the goal to reflect customs, usage and good practice among the parties.

One of the challenges in Islamic financial services industry is to develop financial services and instruments that

are Shariah compliant, commercially viable, valid and enforceable based on the prevailing governing laws³. Even in the Middle East, where the legal system is much more sensitive to Shariah, other issues arise. In Saudi Arabia, which uses Shariah as the only basis for its legal system, Islamic banking disputes are dealt with by a central bank panel, not a Shariah court. This was because of a view that the court may be expert in Shariah, but judges are often not expert enough in banking.

METHODOLOGY

This research is primarily based on primary sources of data. Islamic finance trade laws are still riding on the conventional trade conventions. Hence, few UNCITRAL Conventions were analyzed to best suit the practice of mercantile law in Islamic finance. The other main reference refers to the treaties employed in the United Nations Treaty Collection, such as treaties, agreements, conventions, charters, protocols and declarations. The methodology adopted included examination of specific cases decided pertaining to Islamic finance mainly decided in English courts and Malaysian cases were taken for comparative purposes.

THE NATURE OF INTERNATIONAL COMMERCIAL TRANSACTION

From a legal point of view, trade finance transactions can be particularly challenging when instead of dealing with one set of laws, there are a few sets of law involved- the law of both contracting parties and international laws or rules. In international commercial

law, it involves at least four distinct areas of law. The first is the law of contract. It provides the rules for interpreting the intention of both parties to the contract and fills in any gaps that the parties may leave out. The second issue is the payment system. By providing an alternative payment mechanism the law in this area provides the choices for the parties as to how to minimize the risk of nonperformance. The third area of concern is the security of the transaction. The fourth concern in international law is the bankruptcy law. It sets out various rights of conflicting investors when there is a fall out, financial distress and undermines the future deployment of the sets traded. Here is a brief list of international rules or laws that may affect international trade finance transaction:

- i. The Uniform Customs and Practices for Documentary Credits (UCP 600)
- ii. The Uniform Rules for Collections (URC)
- iii. The UNIDROIT Convention on International Factoring
- iv. The Ottawa Convention of 28 May 1988
- v. The Uniform Rules for Demand Guarantees
- vi. UNCITRAL Convention on Independent Guarantees and Stand-by Letters of Credit
- vii. Article VIII(2)(b) of the Articles of Agreement of the IMF (currency exchange rule)

All of these international rules or laws are governed by the common law and

conventionally recognized at international parlance. In order to penetrate the international market, Islamic finance has to ensure compliance on these laws.

JUSTIFICATIONS OR RATIONALE FOR HAVING OUR OWN LEX MERCATORIA AND LEX CAUCUS

Why do we need our own *Lex Caucus* or law of our own? This small part will explain the justifications on having the above propositions due to few anomalies in Islamic finance. The legal and judicial framework of Islamic finance lies within the Conventional Civil structure.

i) Cross border obstacle

Cross Border obstacles deals with the followings;

- a. Conflict of jurisdiction
- b. Conflict on choice of laws
- c. Pacta servanada Rule
- d. Party Autonomy Rule
- e. Dispute settlement mechanism

Party autonomy Rule is emphasised by Lord Atkin that “the proper law of the contract is the law which the parties intended to apply”. (R. v. International Trustee for the Protection of Bondholders A/G. [1936] 3 All E.R. 407 (C.A.); [1937] A.C 500 (H.L.) Pacta Sunct Servenda means Promises must be kept. It is *An expression signifying that the agreements and stipulations of the parties to a contract must be observed. Conflict of Law Choice maintains two important ingredients as follows;*

- i. *Lex loci contractus* (law of the place where the contract is made);
- ii. *Lex loci solutionis* (law of the place where performance of the contract is due).

lex loci contractus may not be suitable for the contracting parties from different countries; for example, one is from China and the other from Indonesia, and they agree in London to sell property situated in Malaysia. There is no closest connection to say that English law is to prevail. To apply *Lex loci solutionis* may not be appropriate when the parties' respective obligations may take place in different countries, which would mean that their respective obligations would be governed by different laws. In the Amin Rasheed case, Lord Wilberforce held that "in the absence of a choice of law it is necessary to seek the system of law with which the contract has its closest and most real connection." As opposed to the decision in Amin Rasheed that English law prevailed, it is submitted that the term "closest and most real connection" of the transaction should be determined by a "system of the chosen law" chosen by the parties and not by the law of the country where the case is being heard.

ii) *Contradiction of Principles among the English Judges*

Dispute Settlement mechanism may trigger some point of dissatisfaction due to limited avenues among the traders and the merchants opt for the English court to hear their disputes. *Shamil Bank of Bahrain v Beximco Pharmaceuticals*

Limited and Others [2004] 2 Lloyd's Rep 1 involved a *Murabaha* Agreement. In that case, there was a payment default by the defendants. The Agreement contained the following wording regarding the choice of law "Subject to the principles of Glorious Shariah, this agreement shall be governed by and constructed in accordance with the laws of England." The Appeal Court held that "there could not be two separate systems of law governing the contract". Statute in the UK only contemplates the choice of the law of a country to govern contractual obligations. Whilst it is possible to incorporate specific provisions of foreign law into an English law contract (subject to certain limited restrictions), this Agreement referred to Shariah law in general and not to any specific provision that was intended to be incorporated. Principles of Shariah, it was pointed out, are not simply principles of law but relate to other aspects of life and behaviour and, in any event, are susceptible to differing interpretations depending upon the strictness with which they are interpreted or applied. Furthermore, it was said that it was highly unlikely that the parties had intended that English Court should determine any dispute as to the nature or application of religious principles. English Courts, in other words, determine disputes on the basis of English law (although there may be occasions where they also accept expert evidence of foreign law, this will be the law of a country and not religious law).

According to the art 3(1) of the Rome Convention on the Law Applicable to Contractual Obligations 1980, the parties

chose English law to be the governing law of agreement because Shariah is a non-national system of law. In any event, the convention will not permit a situation where two laws simultaneously govern the question of the enforceability of a contract. Firstly the judge remarked that the defenses were methods used by the defendants to get out of paying what was due from them. On deeper analysis the judge Morison J, stated (obiter dicta) if the court were concerned with the application of Shariah law and its impact on the lawfulness of the agreements, then the judge would require further investigation. There was an arguable case as to whether in a contract in conflict with Shariah law, there could be any recovery of any sum at all. The judge held that there cannot be two governing laws. A contract governed by English law may incorporate rules of another law, but clear words would have to be used. It could not have been the intention of the parties that it would ask a secular court to determine principles of law derived from religious writings of matters of great controversies. This is especially so when the bank has its own religious board to monitor the compliance of the bank with the board's own perception of Islamic principles of law in an International banking context.

Few cases involving Islamic Finance contracts have come before the English Courts but where they have, the Courts have traditionally been reluctant to examine issues of Shariah compliance when looking at the enforceability of an English law contract. However, in a recent High Court decision, it was held that there was an arguable case

that a Wakala (agency) agreement did not comply with Shariah law and was therefore void. Summary judgment was denied to the Claimant bank on this issue and the Islamic Investment Company in question will be able to run this argument at trial.⁴

There is no suggestion in this recent case that the English Courts will do anything other than look at English law when construing the terms of an English law document (the decision in *Shamil Bank v Beximco* will therefore be followed) and they will not, therefore, say that a document is unenforceable because it does not comply with some aspect of Shariah law (particularly since this is open to differing views). However, they might entertain an *ultra vires* argument if evidence is adduced that this is relevant as a matter of the law of incorporation of the Defendant.

iii. The Arbitrator's decision.

In the case of Petroleum Development (Trucial Coasts) Ltd. v. Sheikh of Abu Dhabi, Lord Asquith acted as an arbitrator in a dispute arising out of a contract executed in Abu Dhabi.⁵ He acknowledged the law of Abu Dhabi was based on Islamic law, but refused to apply the law because, according to him, "it would be fanciful to suggest that in this very primitive region there is any settled body of legal principles applicable to the construction of modern commercial instruments." He described the ruler of Abu Dhabi as an absolute monarch who administers a "purely discretionary form of justice with some assistance from the Koran." After analyzing the choice of law issue, the

arbitrator relied instead on the principles of English law and ignored the Shariah law *in toto*. The same conclusion has been applied in the Ruler of Qatar v. International Marine Oil Co. Ltd.⁶ The arbitrator in the Ruler of Qatar case made a clear statement as to his belief concerning the inadequacy of Islamic law. After acknowledging that Islamic law was the proper law to apply, he stated that it does not “contain any principles which would be sufficient to interpret this particular contract.” Both arbitrators did not rationalize the decision of refusing Islamic law.

THE MALAYSIAN SCENARIO

Even though Malaysia is known as the hub for Islamic Finance, the conflict of jurisdiction and legal framework of Islamic finance in determining the skirmish between the Civil courts and Shariah courts have been long debated. The debate is based on the nature of the structural law in Malaysia. The Islamic finance cases are decided in Civil courts and not in Shariah court. This is due to the fact that the Civil Courts jurisdiction laid down in List 1 (Federal List), of the 9th Schedule of Federal Constitution shall include civil, criminal procedures, contracts, *lex mercatoria*, (*lex mercatoria* inclusive of banking and financial laws) arbitration, etc and the administration of justice. In contrast, the Shariah Court’s jurisdiction is laid down in Para 1 of List 11 (State List) of the 9th Schedule of the Federal Constitution. Para 1, in essence laid down the matters under the state list inclusive of family law, personal law, religion of Islam, divorce, *waqf*,

succession, offences against the religion of Islam (except which falls under the Federal Law). The amendment made to Article 121(1A) later declared that Civil Courts have no jurisdiction over matters within the jurisdiction of the Shariah courts. The amendment is to grant exclusive jurisdiction to Shariah Courts in the administration of Islamic laws. In other words article 121(1A) is the proviso to prevent conflicting jurisdictions between the civil courts and the Shariah courts. Many have argued that Islamic finance matters falls under the text of *lex mercatoria*. The term of “Islamic law” in Para 1, List 11 of the Ninth Schedule in Federal Constitution covers a wider interpretation. It was construed as a person professing the religion of Islam. Furthermore many commentaries on this issue propose that the list only applies to a person professing the religion of Islam and ignores the issue on Islamic law written in the same List.

Thus, it has no general application to other persons and legal persons⁷ such as banks and financial institutions who cannot be construed as professing the religion of Islam. Section 2 of the IBA however defines Islamic Banks as any company which carries out Islamic Banking business which is defined as any operations which do not involve any elements not approved by the religion of Islam.⁸ The scope is very comprehensive and includes banking and the constitution, organization, jurisdiction and powers of all courts other than Shariah courts and native customary courts. List II in the State List provides for the constitution,

organization and procedure of Shariah courts, which shall have jurisdiction only over persons professing the religion of Islam and in respect only of any of the matters included which exclude Islamic banking.

Currently, the application of English law in Malaysia is based on the provisions of Section 3 and 5 of the Civil Law Act 1956. Section 5 of the Act provides that, in matters of mercantile law or commerce, English law is to be applied. As such, the jurisdiction is certainly vested in the civil courts. In addition, s. 3 of the Act provides for the application of the English law and rules of equity when there is a lacuna in the provision of any written law. In Malaysia, although there is the IBA, but as mentioned earlier, the Act is not exhaustive. Thus, any ambiguity, clarifications and interpretation will be referred to the civil courts.

i. Civil courts apply common law principles in deciding cases in muamalat law

Since the Civil courts hear Islamic banking matters, without doubt, the matters would be governed by the English common law principles. This has been decisively ruled in *Bank Kerjasama Rakyat Malaysia v Emcee Corporation*⁹, when the court held that:

“As was mentioned at the beginning of this judgment, the facility is an Islamic facility. But that does not mean that the law applicable in this application is different from the law that is applicable if the facility were given under conventional banking. The charge is a charge under the

National Land Code. The remedy available and sought is a remedy provided by the National Land Code. The procedure is provided by the Code and the Rules of the High court 1980. The court adjudicating it is the High Court. So, it is the same law that is applicable, the same order that would be, if made, and the same principles that should be applied in deciding the application”.

The same principles followed later on in *Bank Islam Malaysia Bhd v. Pasaraya Peladang Sdn Bhd* held that although the BBA facility was granted under Islamic principles, the laws applicable were the NLC and the Rules of the High Court 1980. The plaintiff in this case was granted an Islamic banking facility known as Al-Bai Bithaman Ajil (‘the said facility’) to the defendant pursuant to a property purchase agreement and a property sale agreement (‘PSA’). As security for the repayment of the said facility, the defendant charged in favour of the plaintiff ten pieces of land (‘the said lands’). The charges were effected by way of two Forms 16A of the National Land Code (‘NLC’). The charges were registered on 23 July 1997. The defendant defaulted in the repayment of the instalments and a notice of demand was accordingly issued to the defendant. The defendant failed to comply with the notice of demand. Consequently, the plaintiff issued and served on the defendant the statutory notice in Form 16D of the NLC. Again, the defendant failed to

pay the amount demanded. In this case, it was the plaintiff's application for an order for sale of the said lands under s. 256 of the NLC.

The court allowed the plaintiff's application where in this case, and explained Al-Bay Bithamin Ajil facility as a common Islamic banking facility involving immovable properties as collateral. It involved three separate agreements. The bank would purchase the property concerned from the chargor pursuant to the first agreement. In the second agreement, the bank would sell the property to the chargor. The third agreement was a charge given by the chargor to the bank to enable the bank to sell the property in the event of default by the chargor.

The use of term in Islamic finance was also disregarded by the court. In *Bank Islam Malaysia Bhd v Adnan bin Omar* [1994] 3 CLJ 735, the court still used the word loan when in fact sales and loans are two different concepts in Islam. There is also no noble attempt made by the court to examine the BBA features and framework from any Shariah experts.

The conflict of general laws like Malay Reservation Land law and Islamic finance principle is also highlighted in *Dato Hj Nik Mahmud bin Daud v Bank Islam Malaysia Bhd* [1996] 4 MLJ 295 (High Court). In this case, the transaction involved sale contracts, and under the Islamic law, the transfer of land is governed under the concept of the acquisition of ownership (tamlik wa tamalluk). However, the judge referred to National Land Code 1965. Examples of other

cases that follow English law principles and procedures are *Tinta Press v Bank Islam Malaysia Bhd* [1986] 1 MLJ 474 and; [1998] 3 MLJ 396 (Supreme Court).

In essence, the civil courts in the above cases failed to consider whether the application of the existing law and procedure would have contradicted the Shariah and affect the validity of the documents. The cases decided also indicate that the courts prefer to apply common law principles rather than refer to the Shariah rules. In such conflicts, it seems that the rules of the civil court system will prevail and consequently restrict the litigants to apply Islamic rules and principles unless ruled otherwise by the court or judge concerned. As a precaution, it also creates a limbo of limits to the growth of Islamic rules and principles in Islamic finance tributary.

ii. Reference to Shariah Advisory Council (SAC) was regarded as ouster clause and unconstitutional

Ouster clause means ousting the court's jurisdiction. The new Section 56(1) reads (1) Where in any proceedings relating to Islamic financial business before any court or arbitrator any question arises concerning a Shariah matter, the court or the arbitrator, as the case may be, shall (a) take into consideration any published rulings of the Shariah Advisory Council; or (b) refer such questions to the Shariah Advisory Council for its ruling. Section 56(1) made it compulsory for the courts to refer to any established rulings should there any disputes pertaining to Shariah issues. Section 56(1)

(b) make it compulsory for the court to refer to the decision of SAC as expert evidence in court under section 45 Evidence Act 1950, should there a need to refer to any non established rulings pertaining to the practice.

The newly amended Act seems to possible problems faced by industry players. Hopefully there will be no excuse used by the civil courts to deliver their equitable interpretation without referring the disputes to the SAC. But one may ponder to what extent can the ruling survive in the Civil courts? The Federal Constitution provides for separation of powers between executive (Article 39) the legislature (Art 44) and the Judiciary (Art 121). In Sugumar Balakrishnan[1976]2MLJ 262, the Court of Appeal considered the relationship between the organs of government. Gopal Sri Ram JCA observed, “The Federal Constitution has entrusted to an independent judiciary the task of interpreting the supreme law and indeed all laws enacted by the legislative arm of the government. Hence, it is to the court that a citizens must turn to enforce their rights...the judicial power was vested impliedly in the judiciary as discussed in *Liyanage v The Queen* [1967] 1 AC 259. In other words it is important to ensure that powers of the judiciary are not usurped by the legislature or the executive. This would maintain the separation of powers which aims to prevent concentration of powers that may increase the likelihood of abuse of powers. Rule 137 of the Rules of the Federal Court clearly give inherent power to the court to hear any application or make any order as may be necessary to prevent

injustice. The Federal Court also has the inherent jurisdiction under the common law to deal with cases with a view to preventing injustices in limited circumstances. This is line with Section 3(1)(a) of the Civil Law Act 1956, which was promulgated in accordance with cl.(c) of art 121(2) of the Constitution which confers the Federal Court “such other jurisdiction as may be conferred by or under federal law” .

PROPOSING ON MECHANICS OF HAVING OUR OWN LEX MERCATORIA UPON LEGAL CONSENSUS

Highlighted above are some of the hick ups that may hinder growth to the Islamic finance industry. Thus, this paper attempts to propose our own *Lex mercatoria* in Islamic finance to avoid uncertainty in the market, consequently recognize the sanctity of Shariah contract. The proposed *Lex Mercatoria* may brings the industry to the next level of being recognized and adopted by the member countries and consequently enable to standardize the practice. The proposal on *Lex Marcatoria* in Islamic Finance may feature some of the ideas as follows;

i) International Treaties:

The creation of many international Model Laws in Commercial transactions was based on Euro-Centric since 100 years ago. Regardless of any issues, the westerners will take the lead. Now it is timely for Muslim countries like OIC to stand up and have their own Conventions on having an International

Convention on Islamic Finance. This is made possible. The creation of UN on human Rights Declaration was ousted by Islamic countries due to non compliance with Shariah values. As a result of that, the Cairo Declaration had their own human Rights Convention which is Islamic in nature. If that could be made possible, then the issue of having Islamic finance at Cross border transaction could be resolved. It is timely for us to have our standard guidelines and rules to be followed. To make that possible, one supervisory body needs to be on board. This is where the issue of World Islamic bank comes for centralization and uniformity of laws. Even international law is a mere soft law, but it gives at least a move out and options to the parties in Islamic finance to feel at least at ease to cater their problems.

ii) Centralization or decentralization?

The concept of decentralization is made possible if one country has its own uniformity of laws. However, to realize the centralization, the World Islamic Bank become the central body and uniforms all the scattered laws to become one. If we continue to have one law on board then Islamic law will definitely boom the market.

iii) Model Law in Arbitration, Mediation and other hybrid ADR

The Asian-African Legal Consultative Organization (AALCO), originally known as the Asian Legal Consultative Committee (ALCC) was constituted on 15 November 1956. It is considered to be a

tangible outcome of the historic Bandung Conference, held in Indonesia, in April 1955. Seven Asian States, namely Burma (now Myanmar), Ceylon (now Sri Lanka), India, Indonesia, Iraq, Japan, and the United Arab Republic (now Arab Republic of Egypt and Syrian Arab Republic) are the original Member States¹⁰. Later, in April 1958, in order to include participation of countries of the continent of Africa its name was changed to Asian-African Legal Consultative Committee (AALCC). At the 40th Session, held at the Headquarters of AALCC in New Delhi, in 2001, the name of the Committee was changed to Asian-African Legal Consultative Organization (AALCO). It might seem to be a small nomenclature change, however, it has great symbolic significance reflecting the growing status of the Organization and the place it has secured among the family of international organizations¹¹Forty-seven countries comprising almost all the major States from Asia and Africa are presently the Members of the Organization.¹²Since one of the mandates given to their respective Arbitration bodies includes Islamic finance, then this will be a great avenue to have one set of Model laws on arbitration and other ADR types.

The industry will entirely have the standardization of laws and rules which they may opt to settle disputes. Promoting hybrid ADR techniques like Med-Ex may also be the best option. The expert is already being named in the contract and dispute settlement clause. Since it is an optional binding approach, it creates more space for the parties to settle their disputes.

Strengthening the Existing Alternative Dispute Resolution ADR avenues like Kuala Lumpur Regional Centre for Arbitration KLRCA is a good start. In fact this is one of the objectives to promote Malaysia in Islamic finance. The facilities offered by KLRCA and incentives in Malaysia may invite litigants to settle disputes in Malaysia. By virtue of the Arbitration Act 2005, the court should not intervene in any proceeding or award given by the arbitrators.

Steps should be taken to promote more Islamic finance experts to become the Muslim mediators and arbitrators. This may also convince the industry that their case will be dealt with by someone who is knowledgeable in that particular area and a Muslim. Maybe KLRCA and Bar Council should take the challenge of training the experts on becoming well known and good Muslim arbitrators and mediators.

iv) Optional Protocol under International Commercial Arbitration & Conciliation UNCITRAL

An Optional Protocol to a Treaty is an instrument that establishes additional rights and obligations to a treaty. It is usually adopted on the same day, but is of independent character and subject to independent ratification. Such protocols enable certain parties of the treaty to establish among themselves a framework of obligations which reach further than the general treaty and to which not all parties of the general treaty consent, creating a “two-tier system”. The Optional Protocol to the International Covenant on Civil and

Political Rights of 1966 is a well-known example.¹³

It is hoped that the above suggestions and recommendations may instigate improvement of the present legal dilemma and guarantee a more practical approach for the industry.

CONCLUSION

In conclusion the separate law on Islamic finance is paramount to ensure the success of the industry at international level. This is also to avoid uncertainty in the market. It has been very difficult for the Court to resolve fundamental differences between scholars about Shariah principles, but on the other hand the Courts are accustomed to dealing with controversy between experts. Parties looking to enter into agreements incorporating Shariah principles should nonetheless consider including a dispute resolution provision referring disputes about Shariah and its applicability to a Shariah expert chosen by the parties or by a suitable institution. This might help to streamline the resolution of disputes and avoid the need for court proceedings which could be more costly. In addition, on the construction of the governing law clause which insisted on the application of Shariah law, the Court applied conventional *lex mercatoria*. Relying merely on the existing conventional *lex mercatoria* may affect the sanctity of Shariah contract as shown in few cases discussed above. As emphasised, cogent and well argued laws need to be formulated to avoid breathing within the conventional practice legally. The spirit to implement the Shariah law

in financial tributary in true mode will be fulfilled and realised only if we have a good legal framework acceptable and viable by all norms. There should be a comprehensive reform of judicial system.

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ENDNOTES

- ¹ Roy Goode(2004) Commercial Law, 3rd Ed, Penguin Book, USA, p 1173.
- ² Ex aequo et bono (Latin for "according to the right and good" or "from equity and conscience") is a legal term of art. In the context of arbitration, it refers to the power of the arbitrators to dispense with consideration of the law and consider solely what they consider to be fair and equitable in the case at hand. Article 38(2) of the Statute of the International Court of Justice provides that the court may decide cases ex aequo et bono, but only where the parties agree thereto. Through 2007, ICJ has never decided such a case. Article 33 of the United Nations Commission on International Trade Law's Arbitration Rules (1976) provides that the arbitrators shall consider only the applicable law, unless the arbitral agreement allows the arbitrators to consider ex aequo et bono, or amiable compositor, instead. retrieved from <http://www.answers.com/topic/ex-aequo-et-bono-2>
- ³ See also List I Feral List and List II State List Malaysian Federal Constitution defines Finance to include inter alia: Currency, legal tender and coinage; National savings and savings banks; (c) Borrowing on the security of the Federal Consolidated Fund; Loans to or borrowing by the States, public authorities and private enterprise; Public debt of the Federation; Financial and accounting procedure, including procedure for the collection, custody and payment of the public moneys of the Federation and of the States, and the purchase, custody and disposal of public property other than land of the Federation and of the States; Audit and accounts of the Federation and the States and other public authorities; Taxes; rates in the federal capital; Fees in respect of any of the matters in the Federal List or dealt with by federal law; Banking; money-lending; pawnbrokers; control of credit; Bills of exchange, cheques; promissory notes and other similar instruments; Foreign exchange; and Capital issues; stock and commodity exchanges
- ⁴ In *Islamic Investment Company of the Gulf v Symphony Gems NV & Others*[2002], the Islamic investment company, IICG, entered into a *Murabaha* Agreement with Symphony Gems. Under a *Murabaha* Agreement, the Islamic financial institution ("IFI") purchases an asset identified by its customer from the seller/manufacturer and then immediately sells the asset to the customer on deferred terms at a mark-up to the original purchase price. In that case, it was also argued that the terms of the *Murabaha* Agreement contradicted IICG's

constitutional documents which required that IICG carry out its business in a “*manner which is consistent with Islamic laws, rules, principles and traditions*”. The Agreement was therefore ultra vires or beyond the powers/capacity of IICG to enter into. In the UK, statute intervened many years ago to bring to an end the external operation of the *ultra vires* doctrine in invalidating transactions entered into by a company beyond its objects and powers as a protection for third parties who, when contracting in good faith, are entitled to assume that their counterparty has the requisite power/capacity to enter into the contract concerned. The Bahamas, where IICG was incorporated, has enacted a similar law. In any event, English Courts have shown some reluctance to apply the doctrine (described as a “technical” rule in another case) to enable a party to avoid its contractual obligations.

⁵ In re Arbitration Between Petroleum Dev. (Trucial Coast) Ltd. v. Sheikh of Abu Dhabi, 1 INT’L & COMP.L.Q. 247, 250–51 (Sept. 1951).

⁶ Ruler of Qatar v. International Marine Oil Co. Ltd., 20 I.L.R. 534 (1953).

⁷ See Solomon v Solomon [1897]AC 22

⁸ A company is defined as a legal person, amongst others is capable of owning property, being subjected to legal rights and obligations, suing and being sued. The concept of legal entity (syakhshiyah l’tibariyah) is considered valid in Islam based on the foundation of baitul mal and waqf institutions. See for detail on the status of legal entity in Islam, Mahmood M Sanusi, The Concept of Artificial Legal Entity (Saksiyyah Ictibariyah) and Limited Liability in Islamic Law [2009] 3 MLJ lxxv; [2009] 3 MLJA 65

⁹ [2003] 1 CLJ 625

¹⁰ Refer to <http://www.aalco.int/content/research-and-trainings>

¹¹ *ibid*

¹² These countries are: Arab Republic of Egypt, Bahrain, Bangladesh, Brunei Darussalam, Botswana; Cameroon; Cyprus; Democratic People’s Republic of Korea; Gambia; Ghana; India; Indonesia; Iraq; Islamic Republic of Iran; Japan; Jordan; Kenya; Kuwait; Lebanon; Libya; Malaysia; Mauritius; Mongolia; Myanmar; Nepal; Nigeria; Oman; Pakistan; People’s Republic of China; Qatar; Republic of Korea; Saudi Arabia; Senegal; Sierra Leone; Singapore; Somalia; South Africa, Sri Lanka; State of Palestine; Sudan; Syria; Tanzania; Thailand; Turkey; Uganda; United Arab Emirates; and Republic of Yemen.

¹³ For details refer to http://treaties.un.org/Pages/Overview.aspx?path=overview/definition/page1_en.xml

Migrant Workers in Malaysia: Protection of Employers

Siti Awanis Othman* and Rohani Abdul Rahim

Faculty of Law, Universiti Kebangsaan Malaysia, 43600 Bangi, Selangor, Malaysia

ABSTRACT

Among the Asian countries, the importation of migrant workers in Malaysia is a necessity when the country is facing an acute shortage of labour force in its multi-sectoral development programs. Malaysia desperately needs the migrant workers in order to keep up with sustainable economic development and rapid economic progress in the country. However, the government should be very vigilant and play an active role in employing the optimum number of foreign workers. While their rights and welfare must be taken care of as not to affect the existing political relationship between the sending and receiving countries, the rights of the employers must not be ignored. Migrant workers are always portrayed as victims of abuse, exploitation and harassment by their employers. In reality, employers of the migrant workers deal with bigger responsibilities such as adhering to the rules, regulations and policies laid down by the law. Apart from that, employers of migrant workers also have duties towards the country, society and respective immigrant workers. Employers have to ensure that the productivities of their immigrant workers contribute to the stability of economy and their employment benefit the society. Employers also have to ensure that the rights and welfare of the immigrant workers are well taken care of. In spite of the challenging responsibilities, employers of the migrant workers lack assistance and protection with regards to their rights. This research looks into the protection of employers of migrant workers, the effect and recommendations to improve the relationships of both groups. The focus of this research is on three sectors, namely manufacturing, construction and domestic.

Keywords: Economy, employers, employment, migrant workers

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E-mail addresses:

sitiawanis_othman@yahoo.com (Siti Awanis Othman),

rar@ukm.my (Rohani Abdul Rahim)

* Corresponding author

INTRODUCTION

In the last few decades, Malaysia has experienced a very high level of industrial development. Currently, its industrial sector is becoming increasingly important

day by day. This sort of industrial development, obviously, generates a huge demand of the work force for immediate employment especially in the industrial and manufacturing sectors. The rapid expansion of the manufacturing and industrial sectors creates a large number of employments in the country. But as there is a great scarcity of domestic labour force in the country, they have to depend largely on the migrant workers for their burgeoning industrial plans. The importation of migrant workers into Malaysia is a necessity when the country has been facing an acute shortage of labour force.

THE POSITION OF MIGRANT WORKERS IN MALAYSIA

The Immigration Department, under the Ministry of Home Affairs, bears full responsibility for the policy implementation. The government reviews the employment situation regularly. Industries that require migrant labour will be scrutinized before importation is allowed. Prior to this, the employers are required to forward their recruitment advertisements and reminded that local workers should be given priority. The employers can apply to the Immigration Department when such vacancies are not filled by the locals. Only then, are the employers issued with a certificate to recruit immigrant workers who must have a valid passport and visa, and pass the medical check-up. The employment of migrant workers is just a temporary measure to fulfill the vacancy in the organization. The migrant workers should leave once their permit and

visa expire. An employer is responsible to each and every migrant worker employed. There must not be discrimination between local and migrant labours.¹

Malaysia pursues an implicit policy to “hire first and fire last” all Malaysian nationals with respect to the recruitment of low-skilled foreign labour. Import of contract migrant labour is subject to the labour market test. For example, employers must prove that there are no local workers for the particular job by having the post advertised before they are allowed to hire foreign labours. Foreigners must go first in the event of retrenchment..

The entry, residence and employment of foreign labour are governed by the Employment (Restriction) Act 1968 and the Immigration Act 1957. These overarching regulations have been amended and substantiated with other ad hoc policies and measures to deal with the import of low-skilled and high-skilled migrants. However, the major part of immigration and migrant employment policies deal with contract migrant workers and irregular migrants since the former accounts for an overwhelming 98.0 per cent of the total migrant workers with close to a third in irregular status. Such creates tremendous challenges to managing migration.² Given the dynamics of International Labour Migration (ILM), policies to regulate the import of labour have evolved over the years. A number of factors that include labour market imbalances, pressure from labour and human rights organizations, national security and foreign relations,

high incidence of irregular migration, and legal and social infractions by migrants influence the amendments. In general labour migration policies aim to:

- i. control and regulate the import of migrant workers;
- ii. reduce clandestine or irregular migration; and
- iii. protect the rights of migrant workers.³

Wide arrays of policy instruments and measures have been used to regulate the inflow of migrant workers in maintaining equilibrium of the short-term versus long-term needs of the economy. These include the use of authorized employment agencies to recruit contract migrant workers, bilateral agreements with selected sending countries, issuance of work permits, imposition of a levy and a freeze or ban on import of contract migrant workers from time to time. These policy instruments have recorded mixed success. To a large degree, they determine the trends and patterns of labour migration in Malaysia since the mid-1980s.⁴

Private Employment Agencies Act 1981 is to permits the establishment of private agencies to recruit foreign labours. These recruitment agencies play a vital role in sourcing migrant workers. Competition among these agencies has ensured that they provide fairly efficient services at competitive fees. These agents deal with recruitment agencies in source countries and they process all administrative paperwork and provide the logistics. Such services alleviate employers on the complexities in hiring foreign labour. Government attempts

to remove their intermediary role and to deal directly with agents overseas have failed in the past. Recognizing their beneficial role, the present bilateral Government-to-Government (G to G) agreements use labour recruiters to facilitate the recruiting process.

Not all agents are registered even though agents and recruiters fall under the purview of the Private Employment Agencies Act 1981.. Many migrants opt to use unlicensed labour recruiters or agents. Some migrants are unaware of their legal status or some find services of unlicensed labour recruiters or agents to be more economical. Unlicensed labour recruiters and agents have been guilty of charging exorbitant fees, falsifying documents, misleading workers about wages, and other abuses.⁵ It has been estimated that on the average of 3,000 workers, mainly from Indonesia, Nepal and India, are left in the lurch every year. Authorities have not been too successful in monitoring the recruitment practices of the agents. ⁶New recruitment mechanisms have been introduced to ensure that the migrants are not exploited by labour agents. At present, most of the foreign workers are being recruited through agents or directly by employers. As of August 2005, companies intending to hire fewer than 50 foreign workers have to use the services of labour outsourcing companies. A total of 58 outsourcing companies have been appointed by the government to supply and manage labour. Government has appointed a total of 58 outsourcing companies to supply and manage labour. However, the initial ban on agents has been lifted when

the authorities realize that the use of agents is an “unstoppable trend”.⁷ Illegal agents can be fined up to RM5000, three year jail or both under the Private Employment Agencies Act 1981. Outsourcing companies has to post bonds on each worker, provide housing and a minimum salary if the worker does not have a job. The labour outsourcing firms have been in operations since the end of 2005. It is too early to assess their effectiveness.⁸ Policy experiences have revealed the inherent limitations of the unilateral approach to curb irregular migration. For instance, irregular migrants apprehended without proper identification papers could not be deported to their country of origin.

Recognizing the importance of greater state involvement to stem irregular migration, the Government-to-Government (G to G) agreement was reintroduced in February 2006. It is to ensure that the process of recruitment to be more systematic and transparent, and beneficial to all parties. Sending countries are more forthcoming in engaging with the bilateral agreements following Malaysia’s tough legislation and other repressive preventive measures in combating irregular migration. The wide publicity in sending countries on the harsh treatment of irregular migrants has brought immense public pressure on their governments to play a more active role in protecting their workers overseas.⁹ Streamlining the role of recruiting agencies addresses many of the shortcomings of earlier bilateral agreements. The bilateral agreements include several clauses dealing

with the responsibilities of the signing parties, the employers and the migrant workers on conditions of residence and employment.

THE POSITION OF EMPLOYERS OF MIGRANT WORKERS IN MALAYSIA

As stated earlier, in order to hire migrant workers, employers must adhere to the government policies and procedures. Employers must give priorities to the local employees. Advertisements must be made and continued for the period of six months. Upon expiration of that period, if no locals is interested or the locals are not enough to fulfil the vacancies, then only the vacancies are offered to migrant workers. However, application must be made through the relevant ministry according to employment sector e.g. manufacturing sector must make an application through the Ministry of International Trade and Industry (MITI), and construction sector through the Construction Industry Development Board (CIDB). The application is subject to approval by the Immigration Department.

Once approved, cost is another burden for all employers. Consider that an employer has to spend around RM2500.00 to RM8000.00 for each and every migrant worker. This amount excludes the costs on medical check-ups, accommodation, transportation and food once the employees are in the country.

Application for migrant workers in domestic sector must be made through registered agents i.e. agents registered under

the Labour Department. Apart from the high cost of employing domestic migrant workers, employers have to deal with “middle person” or the agent. These agencies operate to gain profit even though all agents must be registered as required under the Private Employment Agencies Act 1981¹⁰ and subjected to this legislation.. They operate their businesses with the objective of gaining profit and the welfare of the employers and the migrant workers are not the priority.

It is the norm that employers expect some level of skills from the employees and the same goes to migrant workers. Employers are often promised by agents to provide employees with basic skills either skilled or semi-skilled. Employers in the manufacturing sector, especially requires employees with some level of skills i.e. skilled or semi-skilled to operate machines or equipment. Level of education can also be an advantage with regards to skills. Employers are left with no options except to provide training or short courses to the migrant workers if they are unskilled. Trainings and courses not just incur cost but also time in order for the migrant workers to get into full employment. It may lead to decline in productivity. There are also cases where these workers left their employment and look for other companies to get a better and higher salary¹¹ after they have been developed to become skilled or semi-skilled. When this happens, employers have to bear the losses in terms of hiring, recruiting and others costs.

Another problem that employers have to face includes migrant workers, especially

in the domestic sector, run away or flee from their employment. Theft, abuse of the employers’ children or elderly, damage to properties and belongings are among other problems that employers have to bear.

In the construction and manufacturing sectors, crime is the biggest problem that employers have to deal with. Fights among migrant workers, usually from different groups, race and countries and sometimes it may lead to murder. At the same time, employers must ensure that the migrant workers do not hurt the sentiment of the local people and these migrant workers integrate well with the locals. Employers have the challenging duties in these aspects.

These are only among a few problems that employers of the migrant workers are currently facing. These few problems mentioned are merely tip of the iceberg that employers of the migrant workers currently face. Obviously, employing migrant workers come with bigger responsibilities and heavier tasks compared to locals. It is clear that employers of the migrant workers should also be accorded enough protection in order to ensure the development of the country. Employers contribute to the development of the country either directly or indirectly.

THE NEED TO PROTECT EMPLOYERS OF MIGRANT WORKERS IN MALAYSIA

Legally speaking, the rights and protections accorded to employers of migrant workers in Malaysia are still unclear. Employment Act 1955 and Industrial Relations Act 1967 clearly protect the rights and welfare of

employees. The Employment Act 1955 is more concerned with monetary benefits such as annual leaves, sick leaves, maternity allowance, overtime and so on. The Act is of compelling nature that failure to provide any of those benefits is an offence. Employer can be prosecuted in court should they fail to adhere to the Act. On the other hand, the Industrial Relations Act 1967 is more of persuasive nature. Industrial Relations problems are resolved through negotiation and conciliation.

Employers may find these legislations as legal guidelines in employment. Part XIIB of the Employment Act 1955 contains provisions regarding employment of foreign employees. However, the Act is silent on the right and protection accorded to the employers of the migrant workers. Sections 60K,¹² 60L,¹³ 60M,¹⁴ and 60N¹⁵ provide duties of employers towards the Director General and foreign employees. The employers' groups lack legal protection and the principle of "Equality before the Law" is not achieved. Labour laws, as the term itself suggests concerns and protects the employees groups which are often perceived as the underprivileged ones.

From the perspective of economy, the productivities of a particular sector are expected to increase if employers of the migrant workers are protected legally. In this case, the employers know that they are subjected to the legislations, not only as guidance and responsibilities to employ migrant workers, simultaneously they are provided with assurances and protections of their rights. Indirectly, productivity and

economy can improve when both groups, employers and employees, recognize their roles, duties and responsibilities towards each other. At the same time, it creates conducive working environment.

Issues regarding migrant workers are always the subject between the sending countries and a receiving country like Malaysia. People in both countries become tense when migrant workers are abused or subject to unfair treatment. In such case, employers in Malaysia are blamed and, indirectly, the political ties between both countries are affected. It would be better that groups, employers and employees, understood their rights, duties and responsibilities in employment in view of their interdependent relationships. If both groups know that their rights are protected and well taken care of, they will know how to channel respective grievances should the need arise.

Generally, if the employers of the migrant workers are given enough rights and protections as their fellow employees, both groups will respect each others' rights and will not take advantage or abuse their positions.

One should remember that migration will increase in the future not decrease, given the global demographic trends, widening disparities in income, human securities and rights across countries, increasing migrant networks and environmental and climate changes.¹⁶ In this context, there are currently three major migration issues that demand attention: governance of migration, protection of migrant workers

and maximizing development benefits of migration.

Thus, the governance challenge is not on how to stop or prevent migration, In point of fact, it should focus on how to govern it for the benefit of all concerned that encompass the source countries, destination countries and migrant workers through international cooperation. Malaysia needs more and improved policies, not more policing, and intensified border controls.

Globalization has also led to the emergence of global production chains initiated by multinational corporations involving various levels of subcontracting and outsourcing to different suppliers. In the process, 'labour' brokers have emerged supplying the needs of different enterprises. This has undermined the traditional employer-employee relationship, under which employers are accountable for conditions of work offered to workers.¹⁷

Employers have a vital role to play in all the three areas identified above: governance of labour migration, protection of migrant workers, and promoting development benefits of migration. The employer group has played a valuable role in all of these processes.¹⁸ However, employers are still facing challenges in relation to migration.

Employers confront numerous policy and practical challenges in employment of foreign workers: identifying, recruiting and ensuring entry of foreign workers through regular channels; complying with complex and lengthy administrative procedures; addressing document control; facing risks of sanctions for employing migrant workers

without authorization; managing relations in multi-ethnic workplaces; and ensuring proper training and workplace protection.¹⁹

RECOMMENDATIONS

A number of suggestions can be made to address the challenges discussed above:

1. Migrant workers are now an international issue. From this perspective, it now requires international and regional co-operation. A harmonized labour policy should be formulated to deal with them efficiently. Laws should be enacted for preserving migrants' basics rights and also the rights of the local employers. As discussed above, labour laws provide protection for the employees groups. While, the employers of the migrant workers are subjected to rules, regulations and policies towards their migrant employees.
2. It has been recognized that Malaysia has been experiencing a rapid economic growth in its multifarious development sectors. Therefore, it is quite obvious that the country requires a huge number of manpower. In view of acute shortage of work-force, it has been suggested that the country should immediately implement high-powered technology for its development programmes which will reduce dependence on migrant workers.
3. Malaysia may request the sending countries to introduce some orientation programmes to their workers before sending them off to work in this country.

Orientation programmes are not necessarily limited to work training; it may include knowledge of the country, working culture and environment, social culture, religions and sensitivities of the society. It may help in preventing or minimizing the culture shock, different working environment in terms of weather, language and social issues. Basically, this orientation can provide the do's and the don'ts while working in Malaysia. Most migrant workers only focus on getting their salaries and saving enough to return to their countries of origin. Orientation programmes will most likely overcome the problems discussed above.

4. Employing migrant workers should be at national level whereby Malaysian government deals directly with the government of the sending countries (G to G) to reduce or possibly abolish the middle contractor that deals with the employment of migrant workers. This may reduce the cost of employing migrant workers especially in the domestic sector. It is due to the possibilities that these agents or middle contractor can easily charge exorbitant fees, while the welfare of both the employers and the migrants' workers are not taken into account. The government initiative can also prevent unregistered agents from operating and bringing in illegal immigrants to the country.
5. Owing to bureaucracy, the processes of employing migrant workers are

tedious, lengthy and costly. In view of the challenges, employers are more interested in employing illegal migrant workers. If recommendation (4) can be achieved, these three issues may have a good solution.

CONCLUSION

It is clear that foreign workers migration phenomenon is difficult to avoid especially when most countries in the world today are focusing on maximizing their economic development. The roles of human resources are still important especially in particular sectors such as manufacturing, construction and domestic even though the world today is getting hi-tech. Shortage of human resources in a country will cause development of foreign resources in order to cater for domestic employment demands.

It is critical that the government of receiving and sending countries to initiate efforts towards migration benefits development. Simultaneously, both employers and employees need to collaborate, and provide support and understanding towards the same goal. Policy makers should formulate a more transparent and comprehensive policy in dealing with migrant workers.

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- ⁹ International Trade Union Confederation (ITUC) (2010). *Internationally recognized core labour standards in Malaysia*. Report for the WTO General Council review of the Trade Policies of Malaysia, Geneva, January 18-20.
- ¹⁰ Private employment agency” means-- (a) an employment agency conducted with a view to profit, that is to say, any person, company, institution, agency or other organization which acts as intermediary for the purpose of procuring employment for a worker or supplying a worker for an employer with a view to deriving either directly or indirectly any pecuniary or other material advantage from either employer or worker; the expression does not include newspapers or other publications unless they are published wholly or mainly for the purpose of acting as intermediaries between employers and workers; (b) an employment agency not conducted with a view to profit, that is to say, the placing services of any company, institution, agency or other organization which, though not conducted with a view to derive any pecuniary or other material advantage, levies from either employer or worker from the above service an entrance fee, a periodical contribution or any other charge;
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Sukuk Ijarah: To What Extent They Comply or Contradict the Ijarah Contract and Bay' Inah?

Asma Hakimah Ab Halim^{1*} and Mahdi Zahraa²

¹Faculty of Law, Universiti Kebangsaan Malaysia, 43600 Bangi, Selangor, Malaysia

²Department of Law, Economics, Accountancy & Risk, Glasgow School of Business and Society, Glasgow Caledonian University, Glasgow, Scotland

ABSTRACT

The purpose of this paper is to identify and compare the characteristics and rulings of Ijarah contract, the contract of *'inah* and *sukuk ijarah*. The identification of their characteristics and rulings is a necessity to determine whether these contracts are similar to, or different from one another, and the extent of their compliance with the shariah. Furthermore, if the characteristics of these contracts could be ascertained, the rulings could be extended to the actual contracts in practice. This study analyses the characteristics and rulings of ijarah and *'inah* contracts based on views of Hanafis, Malikis, Shafi'is and Hanbalis. The findings are then compared with the characteristics of *sukuk ijarah* as standardized by AAOIFI. The analysis is also focused on the terms and conditions of SenaiDesaru Express Berhad (SDEB) as an example of *sukuk ijarah* practice. The result suggests that *sukuk ijarah* as defined by AAOIFI has some differences from the original ijarah contract. *Sukuk ijarah* also has a few characteristics of ijarah contract. To certain extent, *Sukuk ijarah* has similarities with the *'inah* contract. This study suggests that the terms represented in a particular contract may not truly represent the real characteristics of an original shariah contract. A particular contract may contain characteristics belong to different form of contracts. It may even be undesirably similar to the characteristics of the controversial contract of *'inah*.

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E-mail addresses:

hakimah@ukm.my (Asma Hakimah Ab Halim),

m.zahraa@gcal.ac.uk (Mahdi Zahraa)

* Corresponding author

INTRODUCTION

Malaysia International Islamic Financial Centre (MIFC) has recently observed that *sukuk* has experienced tremendous development with an average of 40% annual growth rate. Although the report showed a

decline in 2008 due to the market turmoil, *sukuk* prospects has since remained strong. Malaysia has been recognized as a leading nation in the issuance and origination of *sukuk* in global market, representing 61% of total global *sukuk* by the end of 2008 (MIFC 2012). The total global *sukuk* issuance has increased from just US\$1 billion at the end of 2001 to US\$136 billion as of 30th of June 2009, a compounded annual average growth rate or CAGR of 88% (IIFM, 2011). Although the *sukuk* structure is claimed to be in accordance with the Islamic contractual rules and principles such as *musharakah*, *ijarah*, *mudarabah*, *istisna* and *salam*, these have been criticized as not in full compliance with the *Shari'ah* (Islamic law). Other critics have claimed that the *sukuk* structure is actually similar to the substance of other controversial contracts, the *bay' inah*. To what extent this assertion is true? This paper shall highlight these issues in one of the types of *sukuk* that is *ijarah sukuk*. The characteristics of *ijarah sukuk* as standardized by AAOIFI will first be clarified. Then, the *ijarah* contract as deliberated by traditional Muslim jurists will be analysed. Subsequently, this paper shall further discuss the rulings and juristic opinions on *bay' inah*. Henceforth, analysis shall be made on the terms and conditions of Senai Desaru Express Sdn Bhd (SDEB) which is claimed to be based on *ijarah* contract. The collective analyses shall clarify the characteristics of these contracts and the extent of compliance or contradiction with the characteristic of *ijarah* contract as pronounced by the traditional jurists.

SUKUK IJARAH AND IJARAH CONTRACT: AN ANALYSIS

Generally, AAOIFI Shariah Standards define *sukuk* as:

“...certificates of equal value representing undivided shares in the ownership of tangible assets, usufructs and services or (in the ownership of) the assets of particular projects or special investment activity.”

Furthermore, *ijarahsukuk* is defined as:

“Certificates of equal value, issued by the owner of a leased asset, or a tangible asset to be leased by promise, or issued by a financial intermediary acting on behalf of the owner with the aim of selling the asset and recovering its value through subscription so that the holders of the certificates become owners of the assets.” (AAOIFI Shariah Standard 2010)

These definitions suggest that *ijarah sukuk* represent the *sukuk* holders' prospective ownership over the assets, hence raising the issues whether these definitions comply with the *ijarah* contract according to classical jurists' exposition.

The *ijarah sukuk* are claimed to be structured based on the Islamic contract of *ijarah*. Henceforth the characteristics and elements of *ijarah* shall be discussed. Majority of jurists agree that an *ijarah*

contract involves the exchange of the usufruct with remuneration (Afandi, 2003; Al-Zuhayli, 2002a; Al-Sharbini, 1997; Al-Bahuti, 1997). The offer and acceptance should use the term of *ijarah* or *kira'* which represents the intention to rent the property. Al-Bahuti (1997) asserts that the [*ijarah*] contract should be based on the corpus because it is the subject matter and originator of the usufruct. The contract can use the term 'sale' but it should be associated with the term '*naf'*' or usufruct. In this case the seller can say 'I sold you the usufruct of this house' (Bahuti, 1997).

However, some Shafi'is and Hanafis jurists postulate that *ijarah* contract cannot be concluded with the term 'sale' (Al-Shirbini, 1997; Al-Shirazi, 1996; Al-Mawsili). The reason is that the usufruct is associated with the term '*ijarah*' (Al-Shirbini, 1997; Al-Shirazi, 1996; Al-Mawsili). The term *ijarah* is viewed as contradicting the term 'sale' because the latter shows the possession of the corpus of the property. While, *ijarah* is the possession of the usufruct which is not yet exist. (Al-Shirbini, 1997; Al-Shirazi, 1996; Al-Mawsili). Moreover, the subject matter of sale must exist at the time of concluding the contract. However, the usufruct is an abstract term denoting the utilization of the property usufruct in the future even if its existence is subject to the existence of the corpus. Therefore, the strong view of the said jurists agree with the use of the term '*ajjartukamanfa'ah*' or 'I rent you the usufruct [of this house]' in order to constitute a valid *ijarah* contract (Al-Shirbini, 1997; Al-Shirazi, 1996).

The majority of jurists agree with the conditions that the contract must be with the purpose of exchange and that the amount of rent should be defined (Al-Shirazi, 1996; Al-Qarafi, 1994; Al-Bahuti, 1997; Al-Shirbini, 1997; Al-Quduri, 1997). Therefore, it is not permissible if the contract is agreed without stating the exchange value (Al-Shirazi, 1996; Al-Qarafi, 1994). This condition is supported by the *hadith* reported by Sa'id al-Khudri.a. that the Prophet said: '*whoever hires or rents, he must know the rental amount.*' (Al-Shirazi, 1996) This *hadith* is classified as a valid *hadith*, but an exception is as stated by Khudri, that it is *Sahihmawquf*¹ (Al-Zayla'i, undated). However, according to Kamali it can be a 'valid proof and basis of judgment' (Kamali, 2005)

The usufruct must be known in terms of the substance, the proportion as well as the duration of the lease (Al-Shirazi, 1996; Al-Qarafi, 1994; Al-Shirbini, 1997; Al-Bahuti, 1997; Al-Sarakhsi). According to some scholars, those terms are similar to that of a sale contract. The rationale is that selling of usufruct is similar to sale contract. It can be governed by the rules of sale contract. Therefore, the contract is not valid unless all the specifications stated above are known (Al-Shirazi, 1996; Al-Qarafi, 1994). For example, Al-Mawsili states that duration of house rent should be stated (Al-Mawsili, undated). Otherwise, the rental will only be covered for the first month and the rest will no longer be considered valid (Al-Mawsili, undated). The property from which the usufruct is derived also should be defined

(Al-Shirazi, 1996). The activities of a rented land should be specified, such as the lease of the land for agriculture. However, if someone rents a house, it is not a condition to specify the type of activities to be done in the house (Al-Quduri, 1997). Among other conditions are, the usufruct must be: a property of value, permissible (Al-Qarafi, 1994), not perishable by use (IbnQudamah, 1997) and validly possessed by the owner (Al-Qarafi, 1994). The payment is for the usufruct and not for the corpus of the asset (Al-Qarafi, 1994). It must also be capable of delivery to the buyer (Al-Qarafi, 1994).

BAY' 'INAH IN ISLAMIC LEGAL TREATIES

According to Al-Hattab, "*Al-'Inah* with *kasrah* under '*ain* is the act from '*aun* (help), because the seller intends to help the buyer in securing what he wants or intends" (Al-Hattab, undated). Imam Malik termed this transaction as *bay' bi'aynihi* as he stated: "One man sells a man a slave for an amount of 100 dinar with deferred price. Then he buys the slave back with an instant price less than the price that he sold. "This is not right" (Al-Hattab, undated). In other words, *Bay' al-'inah* is the selling of something for a deferred price, then the sold item is bought from the buyer with a lesser price; and the payment is made on the spot (IbnQudamah 1997, p.40). In general, it refers to the advancement in the acceptance of the subject matter of contract but payment is deferred (Al-Matruk, 1992).

Jurists differ in their opinions regarding this type of sale. The majority of jurists from

the Hanafi, Hanbali and Maliki schools do not allow '*inah* sale because of the suspicion that this transaction involves an element of usury (*riba*) and uses a *hilah* (trick) to hide it (Al-Zayla'i; IbnTaymiyyah, 2005; Abadi, 1969; IbnRushd, 1986; Al-Bahuti; IbnQudamah, 1997; SC; BNM, 2007). Therefore, if the intention is to get liquidity, but the apparent form is sale, they described this contract as fictitious. Hence not permissible. According to them, this sale is a way (*zari'ah*) or a legal trick (*hilah*) to legitimize *riba* (Al-Zayla'i; IbnTaymiyyah, 2005; Abadi, 1969; IbnRushd, 1986; Al-Bahuti; IbnQudamah, 1997). They base their argument on the case of Zayd ibn Arqam with 'A'isha (mAbpwh):

"Al'Aliyabinti 'Ayfa' said: the wife of Zayd, the mother of his child and I visited 'A'isha, then the mother of his child said: 'I sold a slave to ZaydibnArqam in exchange for 800 dirhams deferred, then I bought him back for 600 dirhams in cash", 'A'isha said: "Woe to what you sold and what you bought, tell Zayd that he has voided his fighting with the Prophet (pbuh) unless he repents." (Al-Shafi'i, 2001; Al-Zuhayli)

Al-Shafi'i, as proponent of the sale '*inah*, criticised this hadith as not being confirmed (*thabit*) from 'A'isha (Al-Shafi'i, 2001; Al-Zuhayli). He further commented that "even if it is true that this hadith emanates from 'A'isha, she actually criticised the selling of the slave without

knowing the duration to pay the deferred payment (Al-Shafi'i, 2001; Al-Zuhayli). This is the reason why this transaction is not valid." (Al-Shafi'i, 2001; Al-Zuhayli). Imam Shafi'i further argued that this hadith showed the divided opinions among the companions on this matter, hence this matter is open for ijtihad. (Al-Shafi'i 2001; Al-Zuhayli). Besides, Shafi'i's, the Zahiris also support the permissibility of *'inah* sale based on the general permissibility in the Qur'an which states:

"Allah hath permitted trade and forbidden usury"

(Al-Baqarah:275)

However, Imam Nawawi highlighted some of Shafi'i jurists' view that this form of transaction can be invalid if the practice has become customary, to the extent that the practice has been understood as the second contract is subject to the first contract (Al-Nawawi, 1991). IbnHumam from Hanafi School argues that the defect (*fasad*) is in the undeserved profit from the sale and buying back. In other words, the profit gained from this kind of transaction is not just (IbnHumam, 2003). Imam Al-Sarakhsi says, the buyer can buy the subject with a lesser price if he or she finds a defect. On the other hand, if there is no defect, then buying the subject back with a lesser price is not allowed because it amounts to unjust profit (IbnHumam, 2003). Those who oppose this transaction also base their ruling on the hadith of the Prophet (IbnTaymiyyah, 2005) which translates as follows,

"When people are miserly with their dinars and dirhams, trade in 'ina, follows the tails of cows, and desert the striving in the cause of Allah. Allah will send unto them a suffering that he will never lift until they rediscover their religion".

(Al-Zayla'i; Al-Zuhayli)

Al-Zayla'i points out, that this hadith according to Imam Ahmad is a valid hadith, as it is transmitted through a reliable chain of narrators (Al-Zayla'i, undated). Therefore, this hadith can be a strong justification for the non-permissibility of *'inah* transaction (Al-Zayla'i, undated). Some Hanafi jurists, for example Imam Abu Yusuf, state that *Al-'Inah* is permissible and those who practice this will get the reward (IbnAbidin, undated). However, Imam Muhammad states that this sale is not permissible (IbnAbidin, undated). Other Hanafi writings, which exclude the views of Imam Abu Yusuf, indicate that the most preferable views is that this transaction is not permissible (ShamsiahMohamad, 2007). Similarly, IbnTaymiyyah rules that this contract is not valid (IbnTaymiyyah, 2005). He states that this contract is *riba* based on the views of the companions and the majority jurists (IbnTaymiyyah, 2005). In justifying that this transaction is not permissible, he cites the hadith of Zayd ibn Arqam which has been criticized by Imam Shafi'i as stated above.

Contemporary scholars have divided views on this issue. The Malaysian Shariah Advisory Council accepts this form of

transaction as permissible based on the view of the Shafi'is and Zahiris that "the contract was valued by what is disclosed and one's *niyyah* (intention) was for Allah to judge" (Securities Commission). They also justify the validity of this contract relying on the fulfilment of the elements and conditions of a valid contract (Securities Commission). This form of buying and selling is accepted as primary principles defined under a set of Guidelines as sale with immediate repurchase. The Guidelines state as follows:

'... a contract which involves the sale and buy back transaction of an asset by a seller. A seller will sell the asset to a buyer on a cash basis. The seller will immediately buy back the same asset on a deferred payment basis at a price that is higher than the cash price. It can also be applied when a seller sells the asset to a buyer on a deferred basis. The seller will later buy back the same asset on cash basis at a price which is lower than the deferred price'.

(Appendix 1, Guidelines of Islamic Securities 2004)

Other contemporary views regard this contract as not permissible. They base their argument on the economic substance of the contract in view of its structure mimicking a loan with interest. Rosly and Sanusi criticize this structure by describing this practice as amounting to a loan and 'the difference between the two prices' representing interest (Rosly and Sanusi 2001). Usmani, in his

judgment on Riba, criticizes the practice as "to make fun of the original concept." (Usmani, 1999). Chammas also asserts that:

"A loan in the form of a sale, called inah (façade) because it is a sale in appearance only. This is accomplished by one's buying back what one has sold for a lower price than that for which one originally sold it. The difference, ostensibly profit, is actually a loan".

(2006, p.ix)

The above arguments suggest that the majority of contemporary scholars agree with the majority of classical jurists' view on the non-permissibility of '*inah*. However, some Malaysian scholars take different approach by allowing '*inah* for regional transaction due to the need of the people and the market, as evidenced in the structure of *sukuk* discussed in the following.

SUKUK IJARAH IN PRACTICE: A RESEMBLANCE TO CONTROVERSIAL 'INAH

Ijarah Sukuk Senai Desaru Express Berhad (SDEB) are Islamic securities issued as Medium-term Notes (MTNs).² These Islamic MTNs consist of Senior Islamic MTNs (Senior IMTNs), with nominal value of up to RM1,890 million pursuant to Senior IMTNs Programme; and Junior IMTNs of up to RM 3,690 million in nominal value pursuant to the Junior IMTN programme. These *sukuk* are issued under the principles of *ijarah* as approved by the *Shari'ah* Advisory Council (SAC) of the SC (SC Shariah Resolution).

These sukuk were issued in 2010 with the purpose to early redeem the BaIDS³ of up to RM1, 460.0 million in nominal value in full (Private Term and Condition, 2010). The tenure of the facility is different between the senior IMTN Programme and Junior IMTN Programme. The tenure for senior IMTN Programme is twenty and a half years from the date of first issuance of this instrument (PTC). On the other hand, the tenure for Junior IMTN Programme is twenty eight years from the date of first issuance of the Junior IMTNs with the final maturity date not exceeding 30th June 2038 (PTC).

In this transaction, the trustee shall purchase the identified asset from the SDEB on behalf of the *sukuk* holders. This is affected by way of 'transfer of the beneficial ownership' of the Identified Assets pursuant to a purchase agreement for a purchase price Private Term and condition (PTC of SDEB). The 'transfer of the beneficial ownership' indicates that the transferee has the right to use the usufruct of the asset. The purchase price will be equivalent to the redemption value of the *Bay' Bithaman Ajil* Islamic Debt Securities (BaIDS) (PTC of SDEB, p.5), which according to Rosly, is made at par value (2005). The trustee as well as the lessor agree to lease the identified assets to SDEB at a pre-determined rental amount. The trustee on behalf of the *sukuk* holders will receive the *ijarah* payment from the lease during the tenure of *ijarah* agreement. In this situation, the lessee or obligor leases his or her own asset within certain period. Subsequently, he or she repossesses the asset 'upon any declaration of an event of

default or upon the occurrence of an early redemption of all the outstanding *sukuk*' (PTC of SDEB).

The trustee uses the *sukuk* payment from the *sukuk* holders to pay the purchase price of the assets (PTC of SDEB). The lessee also pays the rental to the trustee who receives the payment on behalf of the *sukuk* holders. The payment is made during the tenure of *ijarah* agreement. In the event of default or upon the occurrence of an early redemption of all the outstanding *sukuk*, the SDEB as the obligor shall undertake to purchase the trust assets from the *sukuk* holders at the exercise price. The exercise prices in these *sukuk* come in various transactions as mentioned below (PTC of SDEB):

- (i) In the Sale Undertaking upon maturity, the Exercise Price shall be equal to nominal value of RM1 plus the relevant Ownership Expenses to be reimbursed by the *Sukuk* holders to SDEB under the Service Agency Agreement.
- (ii) In relation to a Purchase Undertaking upon occurrence of the Early Redemption, the Exercise Price shall be equal to the Senior IMTNs Accreted Value or Junior IMTNs Accreted Value, as defined under 2(z)(5), whichever applicable plus the relevant Ownership Expenses to be reimbursed by the *Sukuk* holders to SDEB under the service Agency Agreement.
- (iii) In relation to a Purchase Undertaking upon any declaration of an Event of Default, the Exercise Price shall be equal to the Senior IMTNs Accreted

Value or Junior IMTNs Accreted Value, whichever applicable, plus Ownership Expenses to be reimbursed by the *Sukuk* holders to SDEB under the Service Agency Agreement.

These exercise prices, as some scholars opined, do include the element of guaranteeing the capital. In the case of *ijarah*, the charge should not be made at par in view of the promise to purchase at par value will lead to *shari'ah* risk. The value of the property might increase or decrease depending on the types of assets (Yahya, 2008). Therefore, the value should be marked to the market price (Yahya, 2008). Nevertheless, the actual objective is still criticised in view of its structure that suggests 'the turns *sukuk* into instruments that completely resemble interest-bearing bonds in their economic effect.' (Bouheraoua, Sairally & Hasan, 2012). In other words, the *sukuk* instrument, intended to act as an alternative to interest bearing bonds, may not serve this purpose due to the effect of the transaction similar to the one in the conventional instrument. In addition, if the originator's re-purchase value is based on the exercise price as defined previously, this practice suggests high similarity to the transaction of *'inah*. The recent study supports this view and claims that the transaction, 'though may not be explicitly deemed as *riba*, it can be identified as *riba's* little sibling.' (Bouheraoua, Sairally and Hasan, 2012)

CONCLUSION

Based on the AAOIFI definition, there seems to be certain prevalent contradictions in the *ijarah* contract which relates to ownership over the asset. In practice, *ijarahsukuk* might have some characteristics of *ijarah* contract because the transaction involves the right to use the usufruct of the asset. However, to a certain extent, similarity with *bay' 'inah* is apparent in a situation where a buyer re-releases the asset to the originator, and after a certain period re-sells it to the originator. This practice suggests that the leasee does not utilize the usufruct because the asset at all material time is under the possession of the originator, during the whole of the transaction. Therefore, it is not impossible to question the intention of the parties. Furthermore, the analysis on SDEB *ijarahsukuk* reveals the evidence of contradiction. It calls for the *sukuk* structure to be reviewed to ensure that the name applied represents the substance of the contract. Henceforth, the most important task is to consolidate common Islamic regulatory standards to ascertain that the transaction of *sukukijarah* is fully in compliance with the *Shari'ah* in the future.

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ENDNOTES

¹ Sahihmawquf hadith is the hadith that has its own strength and can be presumed to have been authorized by the Prophet pbuh – See Kamali, M. (2009) *A Textbook of Hadith Studies* (United Kingdom: The Islamic Foundation) p.159.

² “MTNs are debt papers issued on a medium-term basis, with tenures of more than 1 year and redeemable at par on maturity. They may carry fixed or floating rate coupons. Islamic MTNs provide semi-annual dividends depending on the structure used. This type of instrument was introduced to bridge the gap between short-term CPs and long-term corporate bonds. They differ from corporate bonds in that they are sold in relatively small amounts, or either on a continuous or on an intermittent basis. All else being equal, the coupon rate on MTNs will be higher than for other short-term notes, reflective of the longer duration of these papers. This type of debt programme is used by a company to obtain a constant stream of cashflow from its debt issuance. It allows a company to tailor its debt issuance to meet its financing needs, only tapping the market for funds as and when required. MTNs allow a company to register with the SC only once, instead of for every issue with differing maturities.”- BNM & SC (2009) *Malaysian Debt Securities and Sukuk Market: A Guide for Issuers & Investors* (Kuala Lumpur:BNM:SC) p.23; Private Term and Condition of *IjarahSukukSenaiDesaru Expressway Berhad* (SDEB) available at <http://www.sc.com.my/SC/download1.asp?docId=892&docType=PTC> (accessed on 8th of May 2011)

³ This is the outstanding Islamic debt securities issued by SDEB.



Hostile Takeovers and Anti-Monopoly Regulations in China and Malaysia with Special Reference to US and UK Experiences

Liu Kai and Hasani Mohd Ali*

Faculty of Law, Universiti Kebangsaan Malaysia, 43600 Bangi, Selangor, Malaysia

ABSTRACT

Along with the evolution in business and commerce, types and techniques of mergers and acquisitions (M&A) especially in the form of hostile takeovers are developed and diversified to meet the varying interests of acquiring companies. At the same time, the growing concerns emerge where a number of large conglomerates begin to conduct hostile takeovers with the objective of monopolizing certain industries and obtaining control on the market. This is in adverse to the normal operation of overall market order which emphasis is on fair competition. Consequently, the target companies may be responding by raising monopoly issues if they become subject to a threat of hostile takeover. This Article will review hostile takeovers regulations in China and Malaysia, as the emerging markets where takeovers' regulations are relatively still at their infancy. The main focus of the discussion is to look into the extent of which the target companies in China and Malaysia may rely on anti-monopoly rules as a response in defense instead of relying on conventional techniques. A brief appraisal is made to US and UK anti-monopoly legislations. Both jurisdictions had experienced intense Mergers and Acquisitions since 1950s, because then they had among the most modernized companies.

Keywords: Hostile takeovers, anti-monopoly, China, Malaysia, US, UK

INTRODUCTION

Monopolization and elimination of competitors are among the main drives behind a hostile takeover. Theoretically, a hostile takeover occurs when an acquiring company purchases the target company by acquiring the shares of the latter from the shareholders and against the wishes of its management and board of directors. This is

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E-mail addresses:

liukailaw@hotmail.com (Liu Kai),

hmohdali@ukm.my (Hasani Mohd Ali)

* Corresponding author

in contrast with a friendly takeover, which requires consents of the management of the target company. Practically, an acquiring company may be successful in a hostile takeover attempt when the target company is publicly held and its ownership is widely dispersed among the shareholders. On the contrary, it is very difficult for an acquiring company to conduct a hostile takeover when the target company is privately held considering its management team usually owns the company and holds the absolute power to refuse any takeover bids (Steven M. Bragg, 2009). With the constant changes in business activities, hostile takeovers are gradually evolving and diversified to meet the interests of acquiring companies. Similarly, various defensive measures are developed to protect the target companies from disadvantageous situations while they are dealing with corporate acquisitions (Jennifer Payne, 2002).

Defensive tactics employed by the target companies should not amount to preventing the shareholders from exercising their freedoms in accepting the offers. The same may apply to the State when introduces certain anti-takeovers measures. However, the emerging issues on fair competition have introduced rooms for anti-monopoly issues to be raised in defense. For a company, getting a monopoly may be a viable option in order to curtail competitions resulting from the restricted development of product, price, quality or innovation (Mark R. Joelson, 2006). It is usually conducted through a strategic mergers and acquisition (M&A), particularly a hostile

takeover, via the public securities market to obtain maximum economies of scales and dominant market positions.

This interesting development will be discussed with a brief reference to the development in UK and US, which experiences Malaysia and China, may draw.

THE BACKGROUND OF HOSTILE TAKEOVERS IN CHINA AND MALAYSIA

China's capital market was established relatively recent in comparison to those older markets in the western countries. The first related case occurred in 1993 involving Shenzhen Baoan Group Company Limited (Shanghai Branch) which acquired Shanghai Yanzhong Industrial Company Limited. This case has prompted Chinese companies to adopt anti-takeover measures in the stock markets. There are only a few of hostile takeover cases among the corporate acquisition practices in China, most of which were successful. These successful cases have a common characteristic, namely there is a wide dispersion of target companies' shareholdings. Such a characteristic precisely is a weakness which provides a good opportunity for acquiring companies to conduct their hostile takeover activities by accumulating shareholdings in the target companies through stock markets. Nowadays, Chinese government also strongly encourages State-owned companies to acquire foreign companies through international stock markets to raise their global competitiveness. Among the example of cases include Sinosteel Corporation v.

Midwest Corporation Limited in 2008 and Aluminum Corporation of China v. Rio Tinto Group in 2009, etc.

Malaysia has experienced a vigorous development of capital market with quite a number of hostile takeovers cases came into sight since the late 1980s. There are some examples of such cases. In 1989, the takeover of Muti-Purpose Holdings Berhad (MPHB) by Kamunting Corporation Berhad (KCB) was regarded as the first ever hostile takeover case in the Malaysian corporate scene which involved a consideration in excess of one billion ringgit. It was an important event to the former Kuala Lumpur Stock Exchange (KLSE) as it tested whether the market was able to handle this event effectively and efficiently. In March 2006, after five months of market speculation over the behind closed doors negotiations, another successful takeover took place. It was the takeover of Southern Bank Berhad (SBB) by CIMB Bank, a unit of Bumiputra-Commerce Holdings Berhad (BCHB). This case was a rare experience in Malaysian corporate history where the deal was swinging from a mere merger to a hostile takeover. It was the largest-ever successful hostile takeover in the Malaysian banking sector. Currently, Malaysian companies also keep moving closer to their hostile takeover bids for foreign companies in the international stock markets. Among the recent cases include Malaysian-controlled conglomerate Guoco Group Limited trying to increase shareholdings of Bank of East Asia Limited (BEA) through the Hong Kong Stock Exchange (HKEx). Guoco

Group Limited intends to become the largest shareholder of BEA and subsequently control it by a hostile takeover.

ANTI-MONOPOLY IN HOSTILE TAKEOVERS

Monopoly may become a strategy of choice by a particular company in order to thwart competition among companies in terms of product availability, price, quality and innovation. It affects operators, employees, competitors, consumers, regulators, and even market structure, industrial organization and competitive status.

Business operators always have instinctive impulse to undertake industrial concentrations through corporate restructuring activities which may give them monopolistic competitions of the market while at the same time may bring a maximum economy of scale and dominant market positions (Dale A. Oesterle, 2001). Prior to taking any action business operators usually conduct investigations on their industrial concentrations. They delve into information such as whether the concentrations strengthen their existing market positions or promote in achieving absolute dominant market positions, whether the concentrations are in conflict with anti-monopoly legislations or prohibited by anti-monopoly regulatory bodies. These investigations may drive business operators to make strategic arrangements before undertaking their industrial concentrations. For instance, business operators may combine anti-monopoly preliminary studies with concentration feasibility studies before

the concentration negotiations. They may request the appointed lawyers and economists to put forward their suggestions on anti-monopoly in the concentration feasibility reports. Once the concentration agreements are reached after negotiations, business operators may decide whether to declare their anti-monopoly studies to the related regulatory bodies. If the declarations are considered necessary, the regulatory bodies will begin investigations on the industrial concentrations. Whereas, business operators have to take further actions to deal with them.

Business operators may do everything possible to undertake their industrial concentrations. They may adopt various strategies, particularly in the stage of notifications and investigations, to tackle anti-monopoly regulatory bodies. Simultaneously, they may also get opportunities to conduct strategic mergers and acquisitions, particularly hostile takeovers, through the public securities market in favour of their industrial concentrations (Steven Newborn, 2009).

In a hostile tender offer, the target company may assert that it is violated by an unwanted offeror and seek protection from a court in the form of a preliminary and permanent injunction blocking the offeror from continuing with its offer (Simon Peck & Paul Temple, 2002). The putative anti-monopoly violation may arise from a long-standing relationship in the marketplace of the offeror and the target. The target may also attempt to create an anti-monopoly problem where none before

existed by quickly acquiring new lines of business or new business locations that would be problematic for the offeror to acquire (Brent W. Huber, 1991). Serious anti-monopoly problems that cannot be cured by divestiture or other means can end a hostile takeover. But the prospect of being successful is not the only reason to commence an anti-monopoly challenge. Even a target company that has little hope of prevailing may have a strong incentive to bring an anti-monopoly action against the offeror since the prosecution of an anti-monopoly action can provide the target company with considerable time to pursue its other takeover defences or to find a white knight. Thus, anti-monopoly can effectively decelerate or stop the deal of takeovers and assist the target company in securing a better tender offer price if it is subscribed into hostile takeovers. Should stopping the deal is paramount, the target company should do everything possible to help the regulatory agency or court to collect evidence that the deal is anti-competitive, including creating potential competition problems. On the other hand, the target company should get the regulatory agencies concerned and make the greatest efforts to increase value for shareholders, if getting a better price is paramount. The target company should prepare anti-monopoly strategies at the early stage of the hostile takeovers. It should consider all possible methods of arguments against monopolistic hostile takeovers.

Most anti-monopoly legislations regulate the industry requiring companies to notify the related regulatory body of

its intention to build up concentration including through an M&A. It may trigger a monopoly if the acquiring company engages in the restricted practices or conducts. The regulatory bodies concerned will be vested with powers to review or conduct investigations and other necessary powers in controlling the practices. It comes within the restriction under anti-monopoly and competition legislations. In addition, the law shall impose a duty on the acquiring companies to employ professionals such as lawyers and accountants to conduct due diligence exercises. The objective is to ensure law compliance and averting any restricted practices.

ANTI-MONOPOLY LEGISLATIONS AND HOSTILE TAKEOVERS IN US AND UK

In the western world, corporate monopolies may occur more often within US and UK. The corporate restructuring exercises are active and vibrant in those countries. As a result, these two countries promulgated a number of specialized anti-monopoly laws to seek fair business competitions in the marketplace. The anti-monopoly laws forbid several types of restraints on trade and monopolization, such as agreements between competitors, contractual arrangements between sellers and buyers, pursuit or maintenance of monopoly power, mergers and acquisitions. These restraints may generally induce positive effects on business practices and industrial organization.

Anti-monopoly Legislations in Relation to Mergers and Takeovers in US

The US has the oldest history of anti-monopoly regulation since the introduction of the Interstate Commerce Act of 1887, followed by the Sherman Anti-trust Act of 1890, the Clayton Anti-trust Act of 1914, the Robinson-Patman Act of 1936, the Celler-Kefauver Act of 1950, etc (Sudi Sudarsanam, 2003).

The Interstate Commerce Act of 1887 was passed as a result of public concern with the growing power and wealth of corporations. It was originally designed to prevent unfair business practices in the railroad industry. Subsequently, it shifts the responsibility for the regulation of economic affairs from the States to the Federal Government. This Act clearly provides the right of Congress to regulate private corporations engaged in interstate commerce. It has remained as one of the most important documents for the US government regulation of private business.

The Sherman Act of 1890 was the first law passed by the US Congress to prohibit corporate monopolies. It was named after Senator John Sherman of Ohio, who was a chairman of the Senate finance committee and the Secretary of the Treasury under President Hayes. This Act addresses single-firm conduct by providing a remedy against any person who shall monopolize or attempt to monopolize any part of the trade or commerce among the several States. It also addresses multi-firm conduct by prohibiting any combination in the form of trust or otherwise, or conspiracy in restraint of

trade or commerce. It authorizes the Federal Government to institute proceedings against trusts in order to dissolve them. The Clayton Anti-trust Act of 1914 was drafted by Henry De Lamar Clayton to further clarify and supplement the Sherman Act of 1890. In its effort to capture anti-competitive practices in their incipiency, it prohibits actions that may substantially lessen competition or tend to create a monopoly in any line of commerce. This Act is the basis for a great many important and much-publicized suits against exclusive sales contract, unfair price cutting, inter-locking directorates and inter-corporate stock holding (Martin, David Dale, 1959).

The Robinson-Patman Act of 1936 was passed by the US Congress to supplement the Clayton Anti-trust Act of 1914. It prohibits anti-competitive practices by producers, specifically unfair price discrimination on the sale of goods to equally-situated distributors when the effect of such sales is to reduce competition. This Act protects the independent retailer from chain-store competition and also prevents the wholesalers from buying directly from the manufacturers at lower prices. The Celler-Kefauver Act of 1950 was passed to amend the Clayton Anti-trust Act of 1914 by plugging a loophole that had allowed companies to avoid anti-trust suits by acquiring the assets of another company. It is aimed to eliminate any merger between the competing firms which take place by the sale of physical assets that in a way leads to a decrease in competition in the market. Thus, this Act is also known as the Anti-merger

Act that gives the government the ability to prevent vertical mergers and conglomerate mergers which could limit competitions.

The Interstate Commerce Act of 1887 has created a precedent for the anti-monopoly regulation in US. Followed by other Federal Acts that focus on the anti-trust aspects of mergers and takeovers. It is noteworthy that the Sherman Act of 1890 is not very suitable for the prevention of potential mergers and monopolies, especially in the form of stock acquisition to obtain the controlling power of companies. In order to overcome such a weakness, the US Congress has successively promulgated the Clayton Act 1914, the Robinson-Patman Act of 1936 and the Celler-Kefauver Act of 1950 in support of the Sherman Act of 1890 to deal with mergers and takeovers more effectively (Emest Gellhorn & William E. Kovacic, 1994). In particular, Section 7 of the Clayton Act 1914 states that 'no person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.' This Section clearly regulates the stock and asset acquisitions affecting the trade and commerce of the US with foreign

nations. It can be applied even in the case of merger between two foreign corporations based on their potential anti-competitive effects on the US imports resulting from such a merger.

Generally, these Federal Acts jointly provide a contrasting approach to the US anti-trust regulation in terms of investigative procedure, judicial review and institutional arrangement. Usually, the Federal Department of Justice and the Federal Trade Commission enforce these Federal Acts. Once potential mergers and takeovers are notified to these agencies, they will embark on cautious investigations, and even initiate proceedings in Federal courts, if necessary.

Anti-monopoly Legislations in Relation to Merger Controls in UK

Historically, the UK anti-monopoly regulation can be traced back to the introduction of the Monopolies and Restrictive Practices Act 1948. It is followed by the enforcement of the Monopolies and Mergers Act 1965, the Fair Trading Act 1973, the Competition Act 1998, the Enterprise Act 2002, etc.

As the earliest competition legislation in UK, the Monopolies and Restrictive Practices Act 1948 has created the Monopolies Commission. It is given the power to investigate industries where a single firm or a group of firms acting in collusion could restrict competition. Once the investigation is completed, a report shall be released to the public accordingly. It is the responsibility of the relevant government

department to take whatever necessary actions in order to protect the public interest (Helen Mercer, 1995). The Monopolies and Mergers Act 1965 is enacted to enlarge the Monopolies Commission and widen its jurisdiction and powers. It extends the powers available to the Board of Trade in taking action against practices referred to in reports of the Monopolies Commission. The Monopolies and Mergers Act 1965 also provides a procedure in assessing the effects of mergers, and the power to prohibit or dissolve mergers not considered in the public interest (DG Goyder, 1965).

The Fair Trading Act 1973 was passed to make provision in substitution for the Monopolies and Restrictive Practices Act 1948 and the Monopolies and Mergers Act 1965. The new Act further clarifies the powers of the Monopolies and Mergers Commission. It deems that 'a monopoly exists when one company controls at least twenty five percent of the market; an investigation can be conducted where two companies together control at least twenty five percent of the market; mergers and takeovers resulting from gross assets in control of at least twenty five percent of the market can be investigated; the Director General of Fair Trading has the power to refer investigations to the Monopolies and Mergers Commission.'

The Competition Act 1998 harmonizes the UK law with the European Union legislation on restrictive practices and abuse of a dominant position. It introduces an important change to the administration of the UK competition policy, namely

establishing the Competition Commission. It replaces the long-standing Monopolies and Mergers Commission responsible for the investigation, control and evaluation of restrictive practices, abuse of dominant position, and mergers (David Parker, 2000). The Enterprise Act 2002 has made major changes to the UK competition law with respect to mergers. It reformulates the law relating to mergers and markets, creates the Competition Appeal Tribunal for companies to appeal against decisions by the Competition Commission, penalizes with disqualification to directors of companies engaged in anti-competitive practices, extends the collective protection of consumers, and makes substantial changes to personal and corporate insolvency law.

Mergers and takeovers became the focus of the UK competition policy in 1965 with the introduction of the Monopolies and Mergers Act. It is a further expansion from mere restrictive trade practices by the government supervision since 1948 under the Monopolies and Restrictive Practices Act. Corporate monopolies and mergers were mainly administrated by the Monopolies and Mergers Commission created by the Monopolies and Mergers Act 1965. It was subsequently replaced by the Competition Commission established by the Competition Act 1998. This independent body conducts thorough inquiries with regards to mergers, markets and the regulation of the major regulated industries in examining the cases of anti-competitive practices, or abuses of monopoly power, and accordingly determining whether the

mergers as a whole or in parts operate against the public interests. These actions largely guarantees the healthy competition between companies in UK for the benefits of companies, customers and the economy.

In addition, the UK Enterprise Act 2002 is one of the most important legislations that governs anti-monopoly through M&A activities. It makes the Office of Fair Trading independent from the government and gives it additional powers. Under this power the investigations on potentially illegitimate mergers become feasible in practice. Particularly, Part 3 of this Act provides for a new merger regime covering the definition of a qualifying merger and the duty of the Office of Fair Trading to make references to the Competition Commission. It sets out how references are to be determined, prescribes certain public interest case exceptions and other special cases, and confers powers of enforcement including undertakings and orders (Mark Furse, 2008). Under the Enterprise Act 2002, the Competition Commission also launches innovative procedures to improve its transparency and accountability such as publication of guidance on new competition tests, provisional findings during an enquiry and reports explaining core decisions (Sudi Sudarsanam, 2003). These procedures largely decreases the unpredictable results of merger enquiries and the uncertain merger regulation.

As mentioned earlier, the US and UK anti-monopoly legislations have the most comprehensive laws governing M&A activities including that govern hostile

takeovers and anti-monopoly practices. In particular, the US anti-trust and UK competition laws may provide rich and invaluable legislative experiences for China and Malaysia. In consideration of the emerging economies of the two latter countries, they need to implement similar laws within their jurisdictions.

ANTI-MONOPOLY LEGISLATIONS AGAINST HOSTILE TAKEOVERS IN CHINA AND MALAYSIA

Both China and Malaysia have a short history of anti-monopoly regulations following the introduction of Chinese Anti-monopoly Law in 2008 and Malaysian Competition Act in 2010. Those legislations are the principal laws that govern monopoly including through M&A activities in China and Malaysia respectively.

Mergers and Takeovers under Anti-monopoly Regulation in China

In China, following the adoption of a socialist system, quite a number of public listed companies have become State-owned enterprises. Their business operations may naturally result in industrial monopolies since they already control the lifeline of Chinese national economy. These monopolies are viewed strategically different in contrast from any unsolicited monopolies especially by foreign companies. However, the reform and opening-up of China's economy induce the influx of foreign investments. Chinese companies may face a great risk of becoming the monopoly target of foreign conglomerates. Accordingly, Chinese

government cautiously considers anti-monopoly as an important issue against any unsolicited monopoly which may amount to a 'market concentration' including through hostile takeovers.

At present, corporate monopolies are principally regulated by Chinese Anti-monopoly Law in China. It was promulgated on 30th August 2007 through the 29th Session of the Tenth National People's Congress. The objectives are to prevent and restrain monopolistic conducts, protect fair competition in the market, enhance economic efficiency, safeguard the interests of consumers and social public interest, and promote the healthy development of the socialist market economy. This Law is applicable to monopolistic conducts in economic activities within China and also applicable to the conducts outside the territory of China if they eliminate or have a restrictive effect on competition within the domestic market of China. With regards to merger and takeover control, Chapter 4 of Chinese Anti-monopoly Law defines a variety of takeovers together with mergers as 'the concentration of undertakings.' In particular, Article 21 of the Chapter 4 provides that if any concentration that falls under the notification criteria issued by the State Council of the People's Republic of China, a report must be notified in advance with the anti-monopoly execution authorities. Without notification the concentration shall not be implemented. This Article sets up a new mandatory regime for the review of mergers and takeovers in China.

In order to implement the merger and takeover related provisions of the Chinese Anti-monopoly Law, the Anti-monopoly Bureau (AMB) of the Chinese Ministry of Commerce (MOFCOM) published a number of draft guidelines and rules in January 2009. They include Guidelines on the Definition of Relevant Markets, Provisional Rules on Investigation and Handling of Concentrations of Undertakings that are not Legally Notified, Provisional Rules on the Collection of Evidence regarding Concentrations of Undertakings under the Notification Thresholds but Suspected of Being Anti-Competitive, Provisional Rules on the Notification of Concentrations of Undertakings, Provisional Rules on the Examination of Concentrations of Undertakings. These draft guidelines and rules clarified MOFCOM's procedures for enforcing a mandatory regime for the review of mergers, takeovers and joint ventures. For instance, MOFCOM shall conduct a two-phase pre-concentration review. The first phase is the preliminary examination which shall be completed within 30 days from the date of MOFCOM's official acceptance of the notification. If MOFCOM determines that further investigation is needed, the review will enter the second phase which lasts 90 days. It can be extended to another 60 days under certain circumstances as specified under the Chinese Anti-monopoly Law. The specific circumstances include (1) the business operators concerned agree to extend the time limit; (2) the documents or materials submitted are inaccurate and need further verification; and (3) the things

have significantly changed after declaration. Both phases of the pre-concentration review involve substantive review of the cases. It may entail written objections, defences, and hearings. Furthermore, MOFCOM must determine whether a proposed transaction will eliminate or restrict competitions. Accordingly, MOFCOM should consider a series of factors to make this determination including the business operators' share in and control over the relevant market of the parties; the degree of market concentration in the relevant market; the impact of concentration on market access, technological advancement, consumers and other involved parties, and national economic development; as well as any other factors that MOFCOM considers important or impactful with respect to market competition (Jun Wei, 2009).

The mandatory review under the Chinese Anti-monopoly Law was implemented by MOFCOM when it announced its pre-concentration decisions on the following cases in the Table 1.

These decisions together with the draft guidelines and rules clarifies numerous questions about notification of transactions under the Chinese Anti-monopoly Law. Nevertheless, there are still some uncertainties about MOFCOM's procedures and substantive analysis. For instance, although the merger notifications require a significant amount of information, they must be accompanied by vaguely but broadly defined categories of documents that are rarely relevant to the anti-monopoly analysis of concentrations. This gives

TABLE 1
Decisions of MOFCOM Published in Acquisition Cases

Time	Case	Decision
18 November 2008	InBev N.V. / S.A. v. Anheuser-Busch Companies Inc.	MOFCOM approved the acquisition with conditions. MOFCOM found that the acquisition would not eliminate or restrict competition in the Chinese beer market.
18 March 2009	Coca-Cola v. Huiyuan Juice Group	MOFCOM blocked the acquisition in the first prohibition decision adopted under the Chinese Anti-monopoly Law. This case had been closely watched as an indication of MOFCOM's approach to foreign companies' acquisitions of well-known Chinese companies.
24 April 2009	Mitsubishi Rayon Co., Ltd. v. Lucite International Group Ltd.	MOFCOM approved the acquisition with conditions. MOFCOM determined that the concentration would eliminate or restrict competition and adversely affect competition in the Chinese methyl methacrylate market and its downstream market.

Source: Matthew Bachrack, Cunzhen Huang & Jay Modrall, *Merger Control under China's Anti-monopoly Law: The First Year*, The China Business Review, 2009.

MOFCOM great powers to claim that the notification is incomplete and discontinue the progress of the review. In order to solve these problems, the Legislative Affairs Office of the State Council published second drafts in March 2009 after review of the comments received accordingly. On 27th November 2009, MOFCOM finalized the merger control rules by publishing Rules on the Notification of Concentrations between Undertakings and Rules on the Examination of Concentrations between Undertakings. The former sets out the basic procedures for the notification of transactions under the merger control provisions of the Chinese Anti-monopoly Law, and the latter provides an overview of MOFCOM's procedures for the investigation of notified transactions. Both of the final rules provide transaction parties with the clarity and certainty to certain extent.

In general, the publication of these guidelines and rules largely standardizes

the merger review notification process under the Chinese Anti-monopoly Law. Compliance to procedural rules and documentation requirements may block hostile takeovers from the anti-monopoly perspective. Nevertheless, China still lacks a comprehensive and sophisticated pre-concentration review procedure. Business operators still face significant practical difficulties in dealing with notification issues. Thus, Chinese government should move forward to establish better rules on concentration notification and review. Business operators should enhance their communication and coordination with MOFCOM to benefit from its consultation mechanism.

Mergers and Takeovers under Anti-monopoly Regulation in Malaysia

In Malaysia, although the Malaysian Code on Takeovers and Mergers 2010 generally regulates the M&A activities, it does not

address any controlling measures for merger and takeover abuse with regards to monopolistic competitions (Cassey Lee, 2004).

The Malaysian government has never established a designated institution that can specifically focus on the monopoly-related issues. Nevertheless, monopolistic competitions in Malaysia may be regulated according to the specific sectors. For instance, in the road sector, the Road Transport Department under the Ministry of Transport regulates public roads; and the Malaysian Highway Authority under the Ministry of Works regulates privatized roads. The Road Transport Act 1987 regulates both public and privatized roads. In the port sector, the Ministry of Transport regulates federal ports; while, respective authority of corporatized ports regulate corporatized ones. Both federal and corporatized ports are regulated by the Port Authorities Act 1963, the Ports (Privatization) Act 1990, and other Port Commission Acts for each port (Cassey Lee Hong Kim, 2003). It is noteworthy that the market regulations in these sectors generally take the form of government control over entry conditions such as capital subscriptions, licences and permits. Although these regulations may effectively defend Malaysian companies against hostile takeovers in particular sectors in the market entry stage, they are far enough to regulate various industrial competitions in the nationwide market.

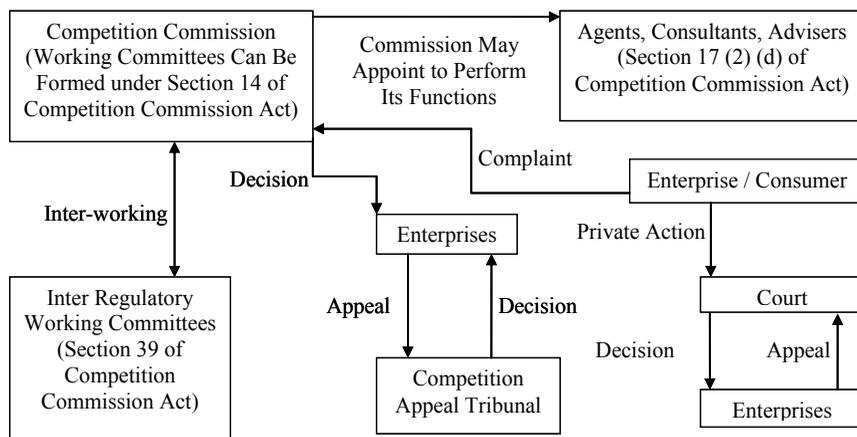
Malaysian Parliament approved the Fair Trade Practices Policy on 26th October 2005. It aims to promote and protect competition

in the market; provide fair and competitive market opportunities for businesses; create dynamic and competitive entrepreneurs; encourage socio-economic growth, generate efficiency and equity; promote consumer welfare and rights of Small and Medium Enterprises to participate in the market place; and prohibit unfair trade practices such as abuse of dominant position, hard core cartels in the economy and anti-competitive practices including those originating from outside the Malaysian territory and affecting the domestic territory. Meanwhile, a framework for an enforcement system has also been established to implement the Fair Trade Practices Policy. Similar to the administrative bodies for the Fair Trading Act 1973 in UK, the Fair Trade Practices Commission is established at the Federal level to promote competition and eliminate anti-competitive activities within the economy, and the Fair Trade Practices Appeal Tribunal is established to review decisions taken by the Fair Trade Practices Commission. Although the Fair Trade Practices Policy and its administrative bodies jointly lead the Malaysian monopolistic competitions into the right track, the business operators still claim many anti-monopoly issues, particularly corporate merger and takeover control, for further clarification.

On 22nd April 2010, Dewan Rakyat, Malaysia's House of Representatives, eventually passed Competition Act 2010 and Competition Commission Act 2010 to govern corporate monopolistic competitions. The Competition Act 2010 is designed to

prevent large companies from engaging in monopolistic activities. It is in line with global trends to promote healthy competition among businesses for the ultimate benefit of consumers. Generally, the Competition Act 2010 provides for laws prohibiting anti-competitive agreements and abuse of dominance. It not only applies to commercial activities both within and outside Malaysia, but also applies to commercial activities transacted outside Malaysia which have effects on market competitions in Malaysia. Currently, the Competition Act 2010 does not apply to commercial activities regulated by the Communications and Multimedia Act 1998 or the Energy Commission Act 2001. The energy, communications and multimedia industries, which are subject to market monopolies in Malaysia, are regulated by independent commissions. The Competition Commission Act 2010

is designed to establish the Malaysia Competition Commission (MyCC) and the Competition Appeal Tribunal as competition regulatory bodies. It empowers MyCC to carry out functions such as implement and enforce the provisions of the Competition Act 2010, issue guidelines in relation to the implementation and enforcement of the competition laws, and conduct general studies in relation to issues connected with competition in the Malaysian economy or particular sectors of the Malaysian economy. It empowers Competition Appeal Tribunal to review any decision made by the MyCC on interim measures, finding of non-infringement and finding of an infringement. The Competition Act 2010 and Competition Commission Act 2010 work complementally as the following Fig.1 to regulate various monopolistic activities in Malaysia.



Source: Mohd Aidil Tupari, *Implementation of the Malaysian Competition Law and Policy, and Functions of the Commission*, Seminar on Competition Laws and Policies, Bar Council Auditorium, 24th January 2011.

Fig. 1: Malaysian Legal System for Monopolistic Competitions

As shown in Fig.1, the MyCC may appoint agents, consultants and advisers to perform its functions. It may work with the Inter Regulatory Working Committees to make decisions on the enterprises. If the enterprises appeal to the Competition Appeal Tribunal for Committee decisions, the applications will be thoroughly assessed and eventually the Tribunal decisions will be made. If the enterprises take private actions and bring lawsuits, the Court will hear the cases and make judgements. The enterprises can also reject the Court judgements and appeal to the Court for further proceedings.

Business operators in Malaysia should take measures to ensure that their business contracts and dealings comply with the Competition Act 2010 and Competition Commission Act 2010. Their practices and procedures should be in compliance with both Acts while they are restructuring their business ventures, utilizing information acquired from competitors and dealing with upstream and downstream partners. Section 4(2) of the Competition Act 2010 covers practices such as price fixing, market sharing, limiting or controlling market access and bid rigging arrangement.

It is however noteworthy that neither the Competition Act 2010 nor the Competition Commission Act 2010 has an explicit provision for a merger control or fair trade practices which are commonly found in most anti-trust legislations. The only indirect provision related to corporate merger control is Section 4 of the Competition Act 2010. It states that ‘a horizontal or vertical agreement between enterprises is prohibited

insofar as the agreement has the object or effect of significantly preventing, restricting or distorting competition in any market for goods or services’. Usually, a horizontal agreement is very likely to occur in a friendly takeover. For example, through shares swap, cartel, collusion or oligopoly arrangements. A dominance, on the other hand, may be found in the aftermath of a hostile takeover which, if abused, gives rise to an anti-competitive practice. As such, the MyCC issued Guidelines on Market Definition, Anti-competitive Agreement, Complaints Procedures and Abuse of Dominant Position in 2012 to act as references to the public to interpret the Competition Act 2010. These guidelines provides for enterprises to conduct self assessment exercises of their businesses in respect of their conducts, procedures, management and control. They should also have competition compliance procedures in place for all their employees at all levels, including Board of Directors.

The introduction of Competition Act 2010 and Competition Commission Act 2010 is commendable as the first step in the right direction to regulate monopolistic competitions. They largely guarantee a free and fair market economy in Malaysia. The MyCC to a large extent relies on complaints from the general public in its enforcement of the law. Any person who has reason to suspect that an enterprise, competitor, supplier, customer, individual or any other business or trader is involved in an anti-competitive agreement or has abused its dominant position may lodge a complaint with the MyCC. Although neither

Act explicitly includes a merger control, business operators are strongly advised to conduct self assessment exercises and ensure that all merger activities are in compliance with the Acts. For the better regulation of corporate monopolistic competitions in the future, Malaysia should also carefully incorporate a systematic merger control regime into both Acts comprising potential hostile mergers and takeovers.

CONCLUSION

Unlike the anti-monopoly laws in US and UK, both China and Malaysia are still at the initial phase of implementing their anti-monopoly legislations. They still lack comprehensive laws and regulations to further clarify certain critical issues on M&A and anti-monopoly. For instance, the Chinese anti-monopoly law lacks certainty for the pre-concentration review procedure; whereas, the Malaysian competition law lacks clarity for the M&A regulation. However, certain parts of the Chinese anti-monopoly legislations and Malaysian competition legislations do draw on certain experiences and lessons from the US anti-trust legal regime and UK competition legal regime respectively. In particular, the Chinese Anti-monopoly Law and Malaysian Competition Commission Act 2010 similarly provides for the notification of concentration of undertakings and investigation of competition regulatory bodies respectively. These laws may to a large extent restrain the occurrence of hostile mergers and takeovers, and prohibit the monopolistic competitions in China and

Malaysia.

Therefore, there is a need for both Chinese and Malaysian Legislatures to formulate clear and more detailed regulations for such issues drawing on lessons from other jurisdictions like those of US and UK. At the same time, Business operators should instill self-regulatory skills and quality to closely cooperate with anti-monopoly regulatory bodies in maintaining fair market competitions in China and Malaysia.

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**REFEREES FOR THE PERTANIKA
JOURNAL OF SOCIAL SCIENCES AND HUMANITIES**

VOL. 22(S) JAN. 2014

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Pertanika

Our goal is to bring high quality research to the widest possible audience

Journal of Social Sciences and Humanities

INSTRUCTIONS TO AUTHORS (Manuscript Preparation & Submission Guidelines)

Revised: February 2013

*We aim for excellence, sustained by a responsible and professional approach to journal publishing.
We value and support our authors in the research community.*

Please read the guidelines and follow these instructions carefully; doing so will ensure that the publication of your manuscript is as rapid and efficient as possible. The Editorial Board reserves the right to return manuscripts that are not prepared in accordance with these guidelines.

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Pertanika is an international peer-reviewed journal devoted to the publication of original papers, and it serves as a forum for practical approaches to improving quality in issues pertaining to tropical agriculture and its related fields. *Pertanika* began publication in 1978 as Journal of Tropical Agricultural Science. In 1992, a decision was made to streamline *Pertanika* into three journals to meet the need for specialised journals in areas of study aligned with the interdisciplinary strengths of the university. The revamped Journal of Social Sciences & Humanities (JSSH) aims to develop as a pioneer journal for the Social Sciences with a focus on emerging issues pertaining to the social and behavioural sciences as well as the humanities, particularly in the Asia Pacific region. Other *Pertanika* series include Journal of Tropical Agricultural Science (JTAS); and Journal of Science and Technology (JST).

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Our goal is to bring the highest quality research to the widest possible audience.

Quality

We aim for excellence, sustained by a responsible and professional approach to journal publishing. Submissions are guaranteed to receive a decision within 12 weeks. The elapsed time from submission to publication for the articles averages 5-6 months.

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We are continuously improving access to our journal archives, content, and research services. We have the drive to realise exciting new horizons that will benefit not only the academic community, but society itself.

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George Swan¹ and Nayan Kanwal²

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Swan and Kanwal (2007) reported that ...

The results have been interpreted (Kanwal *et al.*, 2009).

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 - Hawe, P. (2005). Capturing the meaning of "community" in community intervention evaluation: Some contributions from community psychology. *Health Promotion International*, 9, 199-210.
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- **Proceedings:** Amir Awang. (2006). Counseling, human resources development and counseling services. In Sulaiman M. Yassin, Yahya Mat Hassan, Kamariah Abu Bakar, Esah Munji and Sabariah Mohd. Rashid (Eds.), *Proceedings of Asia Pacific Conference on Human Development* (p. 243-246). Serdang: Universiti Putra Malaysia.

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In 1992, a decision was made to streamline *Pertanika* into **3 journals**. i.e.,

1. Journal of Tropical Agricultural Science (JTAS)
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3. **Journal of Social Sciences and Humanities (JSSH)**

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 - 2000 words for short communication papers, or
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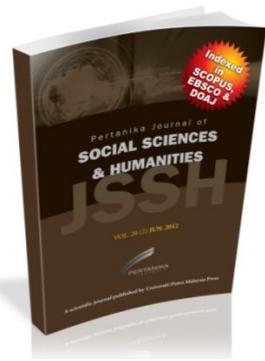
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Ruzita Azmi and Adilah Abd Razak



Pertanika Editorial Office, Journal Division
Office of the Deputy Vice Chancellor (R&I)
1st Floor, IDEA Tower II
UPM-MTDC Technology Centre
Universiti Putra Malaysia
43400 UPM Serdang
Selangor Darul Ehsan
Malaysia

<http://www.pertanika.upm.edu.my/>
E-mail: executive_editor.pertanika@upm.my
Tel: +603 8947 1622 / 1619

PENERBIT
UPM
UNIVERSITI PUTRA MALAYSIA
P R E S S

<http://penerbit.upm.edu.my>
E-mail : penerbit@putra.upm.edu.my
Tel : +603 8946 8855 / 8854
Fax : +603 8941 6172

