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The Legal Nature of Futures Contracts in Commodity Exchanges in Jordanian Legislation

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Abstract: Legal jurisprudence tends to classify futures settlement contracts in commodity exchanges as speculative and betting contracts, based on cash settlement as one of the methods for settling futures contracts. Sometimes, these contracts are settled by the difference between the opening and closing prices over a specified period. Such classification is a limited perspective based on legal jurisprudence viewing futures contracts as ordinary sales contrary to reality. Settlement futures contracts in commodity exchanges are distinctive contracts, and their uniqueness is derived from the nature of the assets traded. These contracts involve essential commodities that play a crucial role in national economies. Moreover, they are subject to a specific legal framework that differs from the legal system governing ordinary contracts. These contracts serve various purposes beyond buying and selling for immediate consumption and trade. They function as financial instruments for investment and risk management, serving purposes beyond simple consumption and immediate trade. The essential distinction that has led to confusion about futures settlement contracts is the time gap between their formation and execution, unlike ordinary contracts that are immediately executed.In this study, we attempted to unveil the ambiguity surrounding futures settlement contracts in commodity exchanges by highlighting their true nature as financial instruments playing a significant role in national economies. This reality has given futures settlement contracts a distinct legal nature.

Keywords: Legal, Contracts, Futures, Commodity, Exchanges, Jordan

1. INTRODUCTION

Commodity exchanges play a significant role in the global economy, serving as a crucial investment tool that facilitates the trading and determination of fair prices for essential commodities. These commodities impact industries and consumers worldwide. These exchanges provide a platform for buyers and sellers to access a broader market, especially important for commodities produced in one region but consumed in another. Electronic trading of commodities is prevalent, making these exchanges vital for hedging against price fluctuations and managing risks.[1]

In Jordan, three key financial institutions contribute to this landscape: the Amman Stock Exchange (ASE)[2], the Securities Depository Center (SDC)[3], and the Jordan Securities Commission (JSC)[4]. These institutions are subject to various laws and regulations, including the Securities Law No. 18 of 2017 and the Foreign Exchange Markets Regulation Law No. 1 of 2017[5].

1.1.Study Hypothesis

In civil law, forward sales initially intended only to settle price differences were considered speculative and linked to illegal gambling, However, the landscape changed with the passage of the law on March 28, 1885, allowing forward sales for the stability of stock exchange transactions[6]. The Jordanian law follows a similar path, allowing settlement futures contracts despite Islamic law considerations[7]. The study aims to argue that settling futures contracts is not mere speculation but serves economic and legal purposes.

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[1] Hull, John, et al. Fundamentals of futures and options markets. Pearson Higher Education AU, 2013. p. p1-24.

[2] https://www.ase.com.jo/ar

[3] https://www.sdc.com.jo/arabic/index.php

[4] https://www.jsc.gov.jo/

[5] https://www.jsc.gov.jo/page/ar/identitycard

[6] Article 1 Loi du 28 mars 1885 sur les marchés à terme.

[7] Decision of the International Islamic Fiqh Academy No. 6, (7/1) in the Academy Journal (Issue 6, Vol. 2, p. 1273, Issue 7, Vol. 1, p. 73, Issue 9, Vol. 2, p. 5)

1.2.Scope of the Study

The study focuses on settling futures contracts as a trading tool in commodity exchanges, covering commodities such as oil, precious metals, and others that influence national economies. These commodities are traded in specialized places known as commodity exchanges or markets. These exchanges are regulated to ensure fair trading practices and protect participants' interests[8].

1.3. Study Methodology

The study employs a descriptive approach to introduce settling futures contracts as a trading tool in commodity exchanges, analyzing their mechanisms, purposes, and governing laws. A comparison is drawn between settling futures contracts and regular sales to identify similarities and differences. The study aims to determine the legal nature of settling futures contracts and whether they fall under speculative or economic and legal contracts.

First Section

2. CONCEPT OF SETTLING FUTURES CONTRACTS

2.1. Subsection 1: Introduction to Settling Futures Contracts and Their Uses

2.1.1. Firstly: Definition of Futures Contracts:

Settling futures contracts are a type of financial contract available for trading on recognized financial markets. These platforms register and monitor settling futures contracts, subjecting them to laws and regulations that govern their trading operations. These regulations aim to protect the rights of investors and participating parties while ensuring transparency and integrity in the markets by providing detailed information about the contracts and their risks. This enables participants to make informed decisions based on market trends and historical data.

Commodity exchanges allow the trading of a variety of essential commodities, varying across exchanges and financial markets. These commodities typically include petroleum derivatives, precious metals like gold and silver, agricultural products such as grains, industrial metals like copper and aluminum, and food items like meat. Commodity exchanges often impose standardized specifications for traded commodities to ensure the quality and quantity of bought and sold products.[9]

Settling futures contracts include clear terms and conditions that define the rights and obligations of the contracting parties. These conditions detail the traded product or commodity, specify how settlement and delivery between parties occur at the end of the futures contract, and regulate penalties to prevent any illegal behavior that could lead to a loss of market trust.

The settling futures contract takes the form of a standardized document signed and delivered to investors. The details of the transaction, such as the type and quantity of the commodity, selling price, and contract maturity date, are included in this document. Upon the contract's maturity date, the investor presents the ownership document to the counterparty in the transaction (the seller) as evidence of their right to receive the commodity. The seller, in turn, delivers the actual commodity and signs for its receipt. The contract serves as a delivery instrument documenting the sales process. Thus, settling futures contracts are securities traded on commodity exchanges.[10]

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[8] Futures contracts for settlement can involve a variety of assets, including foreign currencies, market indices (such as the S&P 500), commodities (such as crude oil), and interest rates (such as the annual interest on bonds)

[9] Weber, Ernst Juerg. A short history of derivative security markets. In: Vinzenz Bronzin's option pricing models: Exposition and appraisal. Berlin, Heidelberg: Springer Berlin Heidelberg, 2009. p. 431-466.

[10] Hull, John, et al. Fundamentals of futures and options markets. op. cit.p.104

Settling futures contracts involve commitments to future settlements. The contracting parties must execute the transaction when the contract matures. Forward sales are characterized by depending on future trading, meaning that the asset (commodity) and price are not physically delivered at the time of the contract. The seller is not obligated to deliver possession, and the buyer is not obliged to pay the price. When trading a futures contract for a specific commodity, the seller is not required to own the commodity at the contract's initiation. Since commodities are fungible, the seller can purchase them in the market at the time of delivery. This practice, known as selling futures contracts uncovered, relies on the ability to obtain commodities from the market at the time of delivery. After delivery, the contract is fully executed, and the settlement process is completed.[11]

2.1.2. Secondly: Uses of Settling Futures Contracts

Settling futures contracts serve several purposes; they are a tool for capital investment and risk management, protecting investors from price fluctuations. This is often achieved when settlement involves the actual delivery of the commodity, meaning the investor buys or sells the commodity and either receives or delivers it at the end of the contract.

Settlement can also be in cash instead of the actual delivery of the commodity at the end of the contract. In this case, futures contracts allow investors to speculate or bet on price changes without owning the actual asset. The contract is settled based on the difference between the opening and closing prices during the specified period, and this difference is transferred financially between the parties. The primary goal of futures contracts in cash settlement is often speculation and betting on price changes, especially when both the seller and the buyer intend not to make actual deliveries at the contract's initiation. Some futures contracts provide the investor with the option to choose between actual delivery of the commodity or cash settlement.[12]

2.1.3. Subsection 2: Settling Futures Sales and Ordinary Sales

–Firstly: Differences

Despite similarities between futures sales and ordinary sales, they significantly differ in structure, organization, and execution. Futures sales involve different obligations and different trading objectives. Ordinary sales are simpler than settling futures contracts, where buyers and sellers directly agree on small or large transactions involving various goods, often designated for immediate consumption or business purposes. Ordinary sales can occur anywhere agreed upon by the buyer and seller, including local markets, electronic platforms, and public places. Commodity exchanges, on the other hand, facilitate the trading of a diverse range of essential commodities such as petroleum derivatives and precious metals, playing a crucial role in the economies of many countries. Commodity exchanges often impose standardized specifications for traded commodities to ensure the quality and quantity of the products bought and sold.

While ordinary sales usually involve small quantities of goods and are focused on meeting immediate needs for goods and services, futures sales often deal with large quantities of commodities. Futures contracts are traded on financial platforms dedicated to futures contracts and are supervised, regulated, and controlled by financial authorities. Futures sales serve various purposes, including speculation on price changes, risk management to protect investors from price fluctuations, and capital investment.

Futures sales differ from ordinary sales in terms of the timeframe for execution and the maturity date. Ordinary sales involve the immediate execution of commitments, unless otherwise agreed. The seller commits to delivering the sold item to the buyer at the time of sale, either physically or by judgment[13]. In ordinary sales, the delivery can be deferred within the framework of what is known as a "credit sale." In a credit sale, the sold item is deferred for

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[11] Hull, John. Options, futures, and other derivative securities. Englewood Cliffs, NJ: Prentice Hall, 1993.

[12] Mcdonald, Robert L. Derivatives markets. Pearson, 2013. p.25-61

[13] Articles (488-498) of the Jordanian Civil Law.

delivery at an accelerated price[14], and the buyer commits to paying the price upon contracting and before taking possession of or claiming the sold item, unless otherwise agreed[15]. While deferring or installment payments are allowed, deferring both the delivery of the item and the price together is strictly prohibited.[16]

Therefore, ordinary sales involve fewer risks as long as delivery occurs immediately. In contrast, settling futures contracts, being futures sales, are settled on a specified future maturity date, either in cash through the difference between the opening and closing prices at contract maturity or through the actual delivery of the commodity. Prices are subject to change between the contract's initiation and its maturity date, making settling futures contracts a risk management tool.

One of the fundamental differences between settling futures contracts and ordinary sales is that investors in settling futures contracts can speculate on price changes without the need to own the actual commodity through uncovered sales. Neither the seller is obligated to deliver the sold item, nor is the buyer obligated to pay the price until a specific date known as the settlement day[17]. Often, both the seller and the buyer opt not to make the actual delivery, turning the sales transaction into a mere payment of differences between prices[18]. In contrast, ordinary sales require the seller to be the owner of the commodity at the time of contracting[19].

In terms of legal regulation, futures sales usually fall under different legal regulations than ordinary sales. Futures sales depend on entirely different financial laws and regulations.

–Secondly: Points of Similarity

Despite some points of similarity between settling futures contracts and ordinary sales, settling futures contracts remain distinct from ordinary sales in their trading location, legal regulation, and execution mechanism. One point of similarity is that settling futures contracts allow what is known as margin trading, where investors can trade with a higher value than their capital. If an investor wishes to buy a futures contract with a significant value, they do not have to pay the full amount upfront. Instead, they deposit a small amount, akin to a down payment, representing a percentage of the total contract value as collateral. This ensures that investors have the ability to bear potential losses. Trading on margin in settling futures contracts may resemble earnest money in ordinary sales. Generally, earnest money and margin serve as financial guarantees in contracts, although earnest money has different implications in ordinary sales. In Jordanian civil law, paying earnest money at the time of contracting gives each contracting party the right to withdraw from the contract. If the earnest money payer withdraws, they lose it, and if the recipient withdraws, they must return it and an equivalent amount[20]. However, earnest money can have different implications, such as being part of the agreed price. Regardless of the earnest money's implication, its purpose is to guarantee contract execution. On the other hand, margin in settling futures contracts aims to trade larger amounts than the investor's balance. Margin can take the form of a loan to finance significant transactions.

Another point of similarity is that futures contracts are standardized agreements between two parties to buy or sell a specified quantity of a commodity at a predetermined price on a specific future date. Parties engaging in these contracts must agree to the terms and conditions outlined in standardized contracts developed by exchanges or

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[14] Article (532) of the Jordanian Civil Law.
[15] Articles (2/526 ‹522)of the Jordanian Civil Law.
[16] Islam, Misbahul; Chakraborti, Jayanta. Futures and forward contract as a route of hedging the risk. Risk Governance and Control: Financial Markets & Institutions, 2015, 5: 68-79.
[17] Settlement, as defined by Article (2) of the Jordanian Securities Law, is: 'The process by which the execution of any trading contract is completed, transferring ownership of securities from the seller to the buyer and settling their prices in a final and unconditional manner.
[18] Abdul Razzaq Al-Sanhouri, Al-Wasit in Explaining Civil Law, Part Seven, Volume Two (Contracts of Deception, Gambling and Betting Contracts, Life Annuity Contracts, and Insurance Contracts), Dar Al-Nahda Al-Arabiya - Cairo, 1964.p. 1032-1033
[19] Article (465) of the Jordanian Civil Law.
[20] Article (107) of the Jordanian Civil Law.

market-regulating institutions. In most cases, parties to settling futures contracts do not have much freedom to significantly change these conditions. Consequently, settling futures contracts are closer to contracts of adhesion. This aligns with ordinary sales in some cases where acceptance by one party is limited to simply accepting delivery under specified conditions set by the other party and not subject to negotiation[21]. However, these cases serve as exceptions to the general principle of freedom of contract in ordinary sales. In ordinary sales, parties can negotiate and agree on terms and conditions freely according to their specific needs.

We mentioned that futures contracts allow investors to speculate or bet on price changes without owning the actual asset. The contract is settled based on the difference between the opening and closing prices during the specified period, and this difference is transferred financially between the parties. Price differentials can be considered a form of barter and are used in various economic and commercial contexts to facilitate exchange and achieve mutual benefits between parties. For example, they are used in Contracts for Difference (CFDs), allowing investors to benefit from price fluctuations without the need to buy or sell the actual asset. Barter and price differentials are also employed in ordinary sales[22].

Second Section

3. SPECIAL LEGAL NATURE OF SETTLING FUTURES CONTRACTS

3.1. Subsection 1: Settling Futures Contracts, Speculation Contracts, and Betting Contracts

In some cases, the contract can be settled by the difference between the opening and closing prices without the need for the actual delivery of the commodity. Consequently, settling futures contracts are considered, in some instances, a form of speculation and betting as they involve mere speculation on price differentials without the actual delivery of the goods. They rely on luck or speculation rather than clear analysis or knowledge. This characterization is applicable to settling futures contracts if the parties' intention from the outset was to speculate on price differences. In other words, if the primary intent was to profit from changes in futures contract prices without the intention of actual delivery. While some investors may engage in speculation and betting for the purpose of profit, the majority of futures contract investors aim to hedge and protect against price fluctuations. Their intention is to use these contracts as investment tools, manage and reduce financial risks, and enhance market stability. Futures contracts also contribute to increased transparency in financial markets, being openly traded at predetermined prices with specified future maturity dates.

Proving the intent of parties to engage in speculation and betting through settling futures contracts is challenging. Even if such intent is established, the goal of profiting through speculation on price differentials does not categorize settling futures contracts as gambling or betting contracts. The critical factor lies in the assets traded through these contracts. These contracts commit, from the beginning, to delivering the actual goods or settling in cash on a specified future maturity date. If the contract is concluded by actual cash settlement instead of physical delivery of the underlying asset, it contrasts with Contracts for Difference (CFDs), for instance. CFDs rely solely on price differentials between two time periods without a commitment to actual delivery. In other words, CFDs depend solely on realizing profit or loss based on price differences without the need for the actual delivery of assets.

Settling futures contracts and CFDs may share similarities when settled through selling short, allowing investors to benefit from price changes without owning the assets. However, the main goal and settlement methods differ significantly. The primary objective of Contracts for Difference (CFDs) is to profit from price differences between two time periods without owning the underlying assets. On the other hand, selling short involves selling a financial asset, despite not owning it, with the aim of profiting from the asset's price decline and repurchasing it at lower prices to realize the difference between selling and repurchasing. Regarding settlement methods, CFDs are settled

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[21] Article (104) of the Jordanian Civil Law.

[22] Article (343) of the Jordanian Civil Law.

based on price differentials without the need for actual asset ownership, whereas selling short involves buying financial assets after a period to cover the short position. [23]

In civil law, forward sales intended to be reduced to mere payment differentials between prices are considered speculative and associated with illegal gambling. In such transactions, the seller bets on a price decrease, while the buyer bets on an increase. This practice is a form of gambling and betting relying on chance and luck; therefore, it is deemed void. The losing party is not obligated to pay the price differentials, and if they do, it is permissible for them to reclaim the payment. This was the ruling concerning forward sales in French law, as per Articles (1965) and (1967) of the French Civil Code. However, this judicial trend led to instability in stock exchange dealings through forward sales. To address this, the law of March 28, 1885, was enacted, allowing forward sales for the purpose of stabilizing stock exchange transactions[24]. Some French courts made a distinction between forward sales explicitly intended for mere payment differentials, considering them unlawful gambling, and forward sales initially not intended for this purpose but later agreed upon by the parties to involve payment differentials. The latter was recognized as a valid sale according to the law of March 28, 1885. However, the French Court of Cassation rejected this distinction, holding in multiple judgments that there is no need to examine the intentions of the contracting parties. According to the court, the law of March 28, 1885, validates all forward sales involving payment differentials. [25]

The legal position in Jordan aligns with the conclusions reached by French law. The Civil Transactions Law in Jordan permits settling futures contracts contrary to Islamic law, as futures sales are inherently prohibited for deferring both counter-values. Furthermore, they fall under the category of trading money without a benefit. Ideally, money should generate a dual benefit for both private and public interests by investing it in projects that benefit individuals and society. Thus, forward sales contradict these principles[26].

However, a valid forward sale is one that conforms to the Securities Trading Law and its regulations[27], governed by financial institutions such as the Amman Stock Exchange (ASE), the Securities Depository Center (SDC), and the Jordan Securities Commission (JSC). If a forward sale is not conducted according to these regulations and is evidently a mere wager between two parties, where one bets on an increase and the other on a decrease, earning the differences between prices upon winning the wager, then it constitutes an illegal and void wager. The loser is not obligated to pay the price differentials, and if paid, they are eligible to reclaim the amount[28].

In summary, a valid forward sale is one that adheres to the Securities Trading Law and its regulations. If it does not comply with these rules and appears to be a mere wager between parties, it is considered an unlawful and void wager, and the loser is not bound to pay the price differentials, with the option to reclaim any payments made.

3.2. Subsection 2: Futures Settlement Contracts: Diverse Financial Instruments

Futures settlement contracts are financial instruments with various economic purposes. They are derivative contracts whose value is determined based on the value of their underlying assets. The value of these contracts' changes with the fluctuations in the value of the underlying assets. This allows investors the opportunity to profit from these changes, with price differentials playing a crucial role. The profit or loss depends on how the price of the underlying commodity changes at the contract's expiration compared to the opening price. If the commodity price

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[23]TATE, Joshua C. Gambling, Commodity Speculation, and the Victorian Compromise. Yale JL & Human., 2007, 19: 97. p.108-113

[24]Article 1 Loi du 28 mars 1885 sur les marchés à terme.

[25] Abdul Razzaq Al-Sanhouri, Al-Wasit in Explaining Civil Law, op. cit.p.1033-1032

[26] Ahmed Ibrahim Qirouz, Al-Maysar Wal-Qimar - Its Reality and Contemporary Forms (A Comparative Jurisprudential Study), Ministry of Awqaf and Islamic Affairs, Doha, Arwaaq for Studies and Publishing, Amman, 1st Edition, 2016 AD, p. 311.

[27] Jordanian Securities Law No. (18) of the year 2017

[28] Al-Sanhouri, Al-Wasit in Explaining Civil Law, op.cit, margin page 1036

rises, profit is realized; if it falls, a loss occurs. This process reflects the challenges of futures trading and how they are utilized. These financial instruments serve diverse purposes such as investment, profit generation, hedging against risks by protecting parties from price fluctuations, and providing the ability to plan and predict future costs.

Given the above, futures settlement contracts require precise technical analysis regarding expectations of the movement of underlying asset prices in the future. They are not based on mere luck or chance. For instance, one can discuss "Contango" and "Backwardation" as possible scenarios for futures contracts, which relate to changes in futures contract prices concerning actual commodities. In Contango, the futures contract price is higher than the current price of the actual commodity in the market. This occurs when there are expectations that prices will rise in the future. In the case of Backwardation, the futures contract price is lower than the current price of the actual commodity in the market. These two scenarios represent disparities in prices between futures contracts and cash prices and are used in financial market analysis to understand investors' expectations regarding the future price trends of commodities.

CONCLUSION

The researcher has arrived at the following conclusions:

1. Nature of Futures Settlement Contracts in Commodity Exchanges:

Futures settlement contracts in commodity exchanges are versatile trading instruments serving diverse purposes. They function as tools for financial investment and risk management, with commodities as their underlying assets playing a significant role in national economies. These contracts are traded in specialized and regulated markets, subject to specific legal regulations.

2. Legal Distinctiveness of Futures Settlement Contracts:

Futures settlement contracts possess legal distinctiveness. They cannot be simply measured against ordinary sales contracts, even if some similarities exist. Differences lie in their legal regulation, purposes of use, and execution mechanisms.

3. Not Gambling Contracts but Derivative Instruments:

Futures settlement contracts are not gambling contracts; instead, they are derivative contracts deriving their value from the value of underlying assets. Their uniqueness lies in their legal and financial structure, relying on technical analyses that enable parties to anticipate possible changes in commodity prices.

Recommendations

1. Legal Focus on Futures Settlement Contracts

Many studies on futures settlement contracts in commodity exchanges are primarily economic. The researcher recommends redirecting legal attention towards these contracts to elucidate their legal distinctiveness and regulatory framework.

2. Inclusion of Legal Provisions in Jordanian Laws

The texts of Jordanian civil law do not explicitly address futures settlement contracts despite covering various types of contracts. Similarly, Jordanian execution law lacks specific provisions regarding the nature of executing futures settlement contracts. The researcher recommends incorporating specific clauses related to futures settlement contracts in these laws.

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