Dubai as the Dispute Resolution Center for the Islamic Finance Industry

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Introduction

There is no doubt that the Islamic Finance Industry is booming worldwide. However, to the industry's detriment, there does not exist a sufficient regulatory framework through which to solve disputes in Islamic Finance transactions. If this situation persists, the Islamic Finance Industry will not survive.

I.

Currently the practice is to have Islamic finance disputes settled by the Law of England and Wales or the State of New York often times subject to Sharia'h law. I recognize that these jurisdictions are well-established and well-recognized for handling business transactional disputes, however, inserting these two jurisdictions in the governing law clauses of Islamic Finance contracts is a grave mistake. First of all, these two jurisdictions generally do not recognize Sharia'h law is a system of law capable of governing a financial transaction. However, the Islamic Financial transaction itself is rooted in Sharia'h law and principles as well as the Qu'ran. Therefore, some aspect of Sharia'h must be applied in settling an Islamic Finance dispute to preserve the Islamic Finance transaction. Furthermore, a judge in England and New York may have had no exposure to Islam, Islamic Finance, or Islamic culture except in a negative light. However, a judge in the UK is more likely to have heard of Islamic Finance concepts but most likely has no grasp on Islamic Finance, its' structures, principles, implementation, or how to resolve disputes in such situations. Therefore, when an Islamic Finance dispute goes before a judge in England or New York, the transaction by default turns into a conventional transaction as the judge declares Sharia'h law to be invalid and applies the laws and principles of conventional finance only to the Islamic Finance transaction.

II.

For example in **Beximco Pharmaceuticals Ltd, Bangladesh Export Import Co. Ltd., Mr. Ahmad Solail Fasiuhur Rahman, Beximco (Holdings) Ltd. v. Shamil Bank of Bahrain E.C. [2004] EWCA Civ 19 In the Supreme Court of Judicature Court of Appeal Civil Division On Appeal From the High Court of Justice Queen's Bench Division (Morison J), Lord Justice Potter confirms the judgment of Morrison J and explicitly denies that Sharia'h law could be applied to settle an Islamic Finance transaction. In this matter, the UK judges don't seem to recognize that the Islamic concepts themselves were born from the Qu'ran**

and the Sharia'h and can only be properly settled by a law that incorporates Islamic law and concepts.

According to the Appeal Case, the Court ruled that an Islamic Finance contract could not be governed by Sharia'h law in the UK even if so specified in the contract and that in fact Sharia'h law is not a recognizable form of law that contains principles of law capable of governing a commercial dispute in the UK.

In this case specifically, the governing law clause of the Islamic Finance contract stated, 'Subject to the principles of Glorious Sharia'h, this Agreement shall be governed by and construed in accordance with the laws of England.'

Lord Justice Potter stated in Paragraph 2 of the judgment, 'It is not in dispute that the principles of the Glorious Sharia'h referred to are the principles described by the defendants' expert, Mr. Justice (retd) Khalil-Ur-Rehman Khan as: "the law laid down by the Qu'ran which is the holy book of Islam and the Sunnah (the sayings, teachings and actions of Prophet Mohammad (pbuh). These are the principal sources of the Sharia'h. The Sunnah is the most important source of the Islamic faith after the Qu'ran and refers essentially to the Prophet's example as indicated by the practice of the faith. The only way to know the Sunnah is through the collection of hadith, which consist of reports about the sayings, deeds, and reactions of the Prophet…"'

Lord Justice Potter, in this judgment, recognizes the definition of Sharia'h law stated by Mr. Justice Khalil-Ur-Rehman Khan, however, Lord Justice Potter states that Sharia'h law, which in his opinion is more of a religion than law, could not apply to a commercial banking transaction in the UK. Even if it was a source of law according to Lord Justice Potter, the conflict of law rules of the UK would apply.

Lord Justice Potter referred to the decision of Morison J. In paragraph 38, Lord Justice Potter states, "The judge held and it is accepted by the Bank on this appeal, that if, on a proper construction of the applicable law clause, the court is obliged to concern itself with the application of Sharia'h law and its impact on the lawfulness of the agreements, it is arguable which of the two parties experts was right and that it would offend the principles underlying CPR Part 24 to seek to resolve the conflict between them before a trial.'

In paragraph 39, Lord Justice Potter states, 'On the proper construction of the applicable law clause, he was not concerned with the principles of Sharia'h at all for the following reasons.'

In Paragraph 40, Lord Justice Potter states, 'First it was common ground by concession that there could not be two separate systems of law governing the contract (paragraph 43). Yet, by contending that Sharia'h law and not English law would determine the enforceability of the agreement, the appellants were in substance contending that the agreements were governed both by English law and Sharia'h law (paragraph 48). The judge declined to construe the wording of the clause as a choice of Sharia'h law as the governing law for the following reasons.

First, Article 3.1 of the Rome Convention (which by s.2 (1) of the Contracts (Applicable Law) Act 1990 has the force of law in the United Kingdom) contemplates that a contract 'shall be

governed by the law chosen by the parties' and Article 1.1 of the Rome Convention makes it clear that the reference to the parties choice of law to govern a contract is a reference to the law of a country.

There is no provision for the choice or application of a non-national system of law such as Sharia'h law (paragraphs 39, 48, and 51). In any event, the principles of Sharia'h are not simply principles of law but principles which apply to other aspects of life and behavior (paragraph 53). **Even treating the principles of Sharia'h as principles of law, the application of such principles in relation to matters of commerce and banking were plainly matters of controversy (paragraphs 49 and 53).** In particular there is controversy as to the strictness with which principles of Sharia'h law will be interpreted or applied. In consequence it was highly improbable that the parties to the agreements intended an English court to determine any dispute as to the nature or application of such controversial religious principles, which would involve it in the task of deciding between opposing points of view which themselves might be based on geopolitical and particular religious beliefs (paragraphs 49-54).'

Lord Justice Potter does not recognize Sharia'h as containing principles of law and certainly not principles of law which could govern a commercial/banking transaction.

Lord Justice Potter states in Paragraph 41, 'The judge accepted the submission of the bank that the words 'subject to the principles of Glorious Sharia'h were no more than a reference to the fact that the Bank purported to conduct all its affairs according to the principles of Sharia'h.

According to this statement by Lord Justice Potter, mentioning Sharia'h law in an Islamic Finance contract is not a reference to law, however, just a description of how the parties to the contract do business. Further according to Lord Justice Potter, even if Sharia'h law were a valid source of law with principles that could govern commercial banking transactions, there cannot be two governing laws in the agreements. In addition, according to Lord Justice Potter, the governing law of the contract must be the law of a country, which Lord Justice Potter states that Sharia'h law is not. Lord Justice Potter states that Sharia'h law is classified as a non-national system of law such as 'lex mercatoria' or 'general principles of law'.

In Paragraph 48, Lord Justice Potter states, 'It is conceded by Mr. Hacker that there cannot be two governing laws in respect of these agreements. He further concedes that the governing law is that of England. It seems to me that he is rightly driven to this concession. The wording of Article 1.1 of the Rome Convention ("the rules of this Convention shall apply to contractual obligations in any situation involving a choice between the laws of different countries.") is not on the face of it applicable to a choice between the law of a country and a non-national system of law, such as the lex mercatoria, or 'general principles of law,' or as in this case, the law of Sharia'h. Nevertheless, that wording, taken with Article 3.1 ("a contract shall be governed by the law chosen by the parties") and the reference to a choice of a 'foreign law' in Article 3.3, make it clear that the Convention as a whole only contemplates and sanctions the choice of the law of a country: c.f. Dicey and Morris on The Conflict of Laws (13th ed) vol 2 at 32-079 (p.1223) and Briggs: The Conflict of Laws at p. 159.'

Again, Lord Justice Potter states that mentioning Sharia'h law in the contract merely referred to how the Bank does business rather than the system of law intended to govern the contract.

In Paragraph 54, Lord Justice Potter states, 'It seems to me that there is an appropriate alternative construction, namely that favored by the judge, **that the words are intended simply to reflect the Islamic religious principles according to which the Bank holds itself out as doing business rather than a system of law intended to trump the application of English law as the law to be applied in ascertaining the liability of the parties under the terms of the agreement.** English law is a law commonly adapted internationally as the governing law for banking and commercial contracts, having a well-known and well-developed jurisprudence in that respect which is not open to doubt or disputation on the basis of religious or philosophical principle. I share the judge's view that, having chosen English law as the governing law, it would be both unusual and improbable for the parties to intend that the English court should proceed to determine and apply the Sharia'h in relation to the legality or enforceability of the obligations clearly set out in the contract.'

Lord Justice Laws and Lady Justice Arden agreed.

In this appeal case, English law only was confirmed as the governing law of the contract and it was confirmed that English law does not recognize Sharia'h law. Furthermore, even if Sharia'h law were recognized under English law, under the conflict of law rules applicable in England and Wales, according to this judgment, English law would prevail as the governing law as the governing law must be the law of a State. Furthermore, two systems of law cannot govern a contract in England and Wales.

III.

It is not advisable to put the laws of England or New York as the governing law for an Islamic Finance contract for the previously mentioned reasons. Alternatively, it is advisable to create a world-recognized Islamic Finance Arbitration Center (the Dubai World Islamic Finance Arbitration Center (DWIFAC)) staffed with the world's top Sharia'h scholars to settle disputes in Islamic Finance Transactions/Contracts. This world-recognized Islamic Finance Arbitration Center shall be based in Dubai, transforming Dubai into the pinnacle of the Islamic Finance Industry, surpassing Malaysia, Bahrain, and Saudi Arabia, and turning Dubai into the dispute resolution center for the all the world's Islamic Finance Transactions. The Dubai World Islamic Finance Arbitration Center (DWIFAC) could have its' own set of rules and could have a Jurisprudence Office and Islamic Finance Education Institute attached to it.

It is imperative that the UAE legislate its' own Federal Islamic Banking Law in conjunction to forming DWIFAC so that the parties to an Islamic Finance contract can designate the Laws of the UAE as the substantive law governing the Islamic Finance Contract. For instance, when drafting the governing law clause of an Islamic Finance contract, it would become standard for the industry to put the Laws of the United Arab Emirates as the governing law of the contract and designate the Dubai World Islamic Finance Arbitration Center (DWIFAC) and the rules of

the DWIFAC as the dispute resolution body and applicable procedural law. DWIFAC would be staffed by the top 20 or so Sharia'h Scholars who could be chosen as arbitrator(s) for the dispute. Most if not all of the top Sharia'h scholars have been highly educated in both Sharia'h law and conventional western finance and law and are highly capable to resolve Islamic Finance Disputes. Not only would Dubai move to the forefront of the Islamic Finance Industry, however, Dubai would save the Islamic Finance Industry by providing effective, streamlined dispute resolution which preserves Islamic Finance concepts and through this would ensure the Islamic Finance industry's survival into the future.

Otherwise, if the Laws of England and other western countries are designated as the governing law of an Islamic Finance contract in conjunction with or without Sharia'h Law, the transaction may be converted from an Islamic Finance to a conventional Western finance transaction by default as the governing law will most likely be construed as the law of the western country only with the result that the Islamic Finance Industry would eventually die out.

I recommend legislating a unified Islamic Banking Law and having it implemented in all countries which are commercial centers to facilitate Islamic Banking dispute resolution. As only a few countries to date actually have an Islamic Banking Law, if Dubai could formulate a strong Islamic Banking Law in conjunction with the Dubai World Islamic Finance Arbitration Center (DWIFAC) – this law may become the universal Islamic Banking Law which all other nations adopt or legislate into their domestic systems. In fact, the UAE could make agreements with other nations to use DWIFAC as the designated dispute resolution center for Islamic Finance disputes and encourage the country in question to implement the Federal Islamic Banking Law of the UAE into their domestic legal systems. In that way, in the case that the jurisdiction of DWIFAC is successfully challenged, the court in the relevant jurisdiction would have an Islamic Banking law to apply to the dispute.

As it stands now, even the UAE does not have an Islamic Banking law, however, it has a law allowing Islamic Banks to exist. http://ilovetheuae.com/2010/03/09/uae-banking-series-part-iii-islamic-banks/ The secretary-general of the Fatwa and Sharia'h Supervision Board in the UAE, Mabid Ali Al Jarhi has called for modifications to some civil laws and the introduction of an Islamic banking law. Al Jarhi said that Islamic banks are presently guided by their own Sharia'h boards and have policies that often differ from those of other Islamic finance houses. He said that "To achieve a unified Sharia'h standard for Islamic finance, the civil law should be revised and the law of Islamic banking should be activated. "He added that the law governing Islamic banks was issued in 1985 but it had not been backed up by a decree and therefore that is why the law is not in existence now.

Therefore, attached to the Islamic Finance Arbitration Center, there should be an **Islamic Finance Jurisprudence Office** entrusted with the task of creating a unified **Islamic Banking Law** and to have it implemented in all countries around the world which are commercial centers. This law may incorporate the AAOIFI standards and/ or be based on the 1985 law which was never officially enacted.

IV. The Example of Bahrain

Currently, the Kingdom of Bahrain surpasses the UAE as a hub of Islamic Finance as Bahrain houses AAOFI, the Accounting and Auditing Organization for Islamic Financial Institutions and the very popular Bahrain Institute of Banking and Finance (BIBF). Bahrain also recently launched Bait- al- Bursa, the first Islamic Finance Division of a stock exchange (BFX) to exclusively offer electronically traded Islamic Financial instruments. It currently monopolizes all the exchange traded business in the Islamic finance sector. Furthermore, Bait al Bursa recently launched e-Tayseer, which is a fully automated platform for transactions in supply, purchase and sale of assets for facilitating Murabahah transactions. E-Tayseer allows suppliers to place their assets onto the platform ready to be purchased by financial institutions. Financial institutions can then purchase these assets and conduct Murabahah transactions with counterparties to fulfill their liquidity management requirements in a secure online environment.

V. Dubai World/Nakheel Default

The Dubai World/Nakheel debt re-structuring was essentially an Islamic Finance Dispute over a default in a Sukuk issuance. Instead of creating an ad-hoc tribunal based on a version of the DIFC insolvency laws (Decree No. 57 of 2009 Establishing a Tribunal to Decide

the Disputes Related to the Settlement of the Financial Position of Dubai World and its Subsidiaries) this matter could have been handled at the Dubai World Islamic Finance Arbitration Center (DWIFAC)) **according to the DWIFAC Rules and the laws of the United Arab Emirates including the UAE Federal Islamic Banking Law of the UAE.**

VI.

Blom Bank Judgment

In the case of Investment Dar Co KSCC v Blom Developments Bank Sal [2009] EWHC 3545 (Ch) High Court of Justice Chancery Division, TID successfully claimed that to uphold the Wakalah that it had entered into with Blom Bank would be un-Islamic and a breach of its statutes. TID won the appeal case largely because the dispute was administered by an English Court where the judge had absolutely no understanding of Islamic finance and applied conventional finance and common law to the dispute which by default turned the transaction into a conventional transaction.

The Two Claims

"The two claims were advanced in the Particulars of Claim, one on the contract itself, where it was alleged that default had been made in making payments due pursuant to the master wakalah contract and secondly a claim expressed to be based in trust founding itself also on the terms of the master wakalah contract. The master found that there was an arguable defence to the contractual claim but not to the trust claim. TID appealed and Blom sought to uphold the

decision of the master on the alternative basis that he should have got judgment on the contract claim. The judgment that the master granted was for repayment of all the principal sums advanced or deposited and not for any profit element or as TID would have it, interest."

Judge Perle QC in his judgment stated that the Wakalah Agreement was 'For all intents and purposes the commercial result is equivalent to that of a deposit at interest.' Judge Perle QC applied conventional western finance concepts to the Islamic finance transaction and came to this conclusion thereby turning the transaction by default into a conventional western finance transaction.

Judge Perle QC stated that 'A further recital was that the contract had been entered into and signed by both the parties to regulate the mechanism and procedures for accepting the muwakkil/depositor's funds by the wakeel and their investment in the treasury pool in the agreed manner and the payment of profit to the muwakkil/depositor upon completion of each Wakalah period.' The judge then goes on to say that 'Thus the form was that of an investment by TID as agent' and further applies western concepts to the Islamic finance transaction and further turns the deal into a western finance transaction.

A Wakalah is not a deposit at interest.

According to HM Revenue and Customs, (A UK entity), a Wakalah Investment is the following:

"This is an investment product, which functions in the same way as Mudarabah, which is discussed at VATFIN8600. The difference between the two is that with a Mudarabah all the profit is divided between the parties, whilst with **a Wakalah the investor receives only the agreed ratio against investment. Anything made above that ratio is kept by the financial institution and not given to the investor.**

Example: An investor agrees to invest a sum with the bank for an agreed return (e.g. 5%). The bank pools the investor's funds with the funds of other investors and its own capital and invests in Sharia'h compliant assets. At the end of a given period (e.g. a month) the bank returns the invested sum to the investor along with the agreed 5%. Any additional revenue that the bank makes on the customer's money is kept by the bank (e.g. if the bank makes 6% then 5% is given to the customer and the additional 1% is kept by the bank). If the bank does not make the agreed percentage return then the investor gets what has been made whilst the bank gets nothing (e.g. if only 4% is achieved then the investor gets the full 4%)."

Judge Perle QC states that "That example seems to presuppose that any shortfall is at the risk of the depositor or investor so that it can fairly be seen as a true investment agency, the bank in that example keeping any surplus over the agreed return, whilst the shortfall is borne by the depositor/investor." However the Judge has got it wrong here again. If TID as the agent does not reach the agreed target, than the investor or Blom retains the entire return. However, if TID

exceeds the target, TID gives Blom the funds plus the agreed 5% return and anything over that TID keeps. Any shortfall is not at the risk of the depositor or Blom. Either way Blom gets funds. The risk lies with the agent TID. IF TID does not meet the target, the investor keeps all of the return.

In this matter the Judge re-states clauses 5.4 and 5.5 of the Wakalah Agreement in question and states that 'We appear in those circumstances to be moving away from the concept of pure agency or trust.' However, a Wakalah is not a common law agency or trust. The judge goes onto nullify the agreement based on the fact that the Wakalah Agreement does not meet the criteria of a common law trust.

In the judgment, Judge Perle QC repeatedly states, 'Thus there was an unconditional obligation to pay the on account profit in the amount of the anticipated profit whether or not it had in fact been earned by the investment (so called) in the treasury pool.' The judge goes on to say, " That is to say, although the on account payment of the anticipated profit was expressed as an on account payment, any surplus in fact went to the wakeel, TID, as an incentive so that the anticipated profit was in fact the only profit that could be made by Blom." But this is how the Wakalah works. However, the judge uses this argument to discredit the validity of the Wakalah and consider it null and void.

The Judge goes on to state: "There was no provision anywhere down to that point (or later) for the muwakkil/depositor, Blom, to bear any losses should losses be made or to receive less than the anticipated profit should the actual profit be less than that. (But this is how Wakalah works) "On the contrary, the unconditional obligation to make an on account payment of profit in the amount of the anticipated profit was in the other direction." (But this is how Wakalah works)

The Judge states, "Furthermore, under clause 9.11, the wakeel, TID, undertook to indemnify the muwakkil/depositor, Blom, against amongst other things, any loss it might suffer or incur as a result of any wakalah transaction or the wakeel acting as its agent." (But this is how Wakalah works). The Judge than states, "Thus Blom was in a position where the only risk it took was of the insolvency of TID." However, this is again incorrect because Blom would lose the excess profit in the event that the investment resulted in excess of a 5% return, the amount of which TID would be entitled to keep under the Wakalah Agreement.

The Judge goes on to say that 'The Wakeel, TID, was bound to pay that sum unconditionally and the depositor, Blom, under no circumstances had the right to anymore than that sum.'

True but that is the way Wakalah Investment works. The Judge elaborates this argument to deny the existence of a trust. The Judge says, ' That was objected to before me by TID on the basis that, if one looks at the contract as a whole, and in particular the provisions for pooling of funds

and the actual obligations of TID, which were essentially obligations to pay sums irrespective of whether they had been earned, the label of trust used in the contract is something which I should ignore.'

The judge says, "I do not think it is established that the contract gives rise to a trust." The Judge goes on to state that the contract is null and void incapable of being saved by severance.

The Judge then goes on to say that, 'It is said on behalf of TID that that contract amounted to a non-compliant Sharia'h transaction because in reality and substance what TID was doing was taking deposits at interest.' The Judge goes on to agree with TID and refers to the Wakalah Agreement as simply an agreement to take deposits at interest, turning the transaction into a de facto western finance transaction. The Judge says, "I agree that the court should approach the matter with some circumspection, but that does not take anything away from what is essentially a simple point, albeit difficult to apply, namely, that where one finds, as one does in this master wakalah contract, a device to enable what would at least to some eyes appear to be the payment of interest under another guise, that is at least an indirect practice of a non-Sharia'h compliant activity.' Thus, here we have a UK Judge with absolutely no Sharia'h law training ruling on whether a transaction is Sharia'h compliant!

Based on the Judge's opinion that the transaction was not Sharia'h compliant and that the Wakalah did not form a trust, the Judge then goes on to suggest common law remedies, further turning the transaction into a conventional western finance transaction. The Judge says, "On the footing that the transactions were ultra vires and void, that would give rise to a restitutionary claim in principle either based upon a failure of consideration or payment under a mistake but it would not in the absence of knowledge of the invalidity or mistake on the part of TID necessarily give rise to a trust claim. Moreover, if there were a trust claim the appropriate remedy would be for an account and possibly an interim payment, not for the whole judgment sum.' That would be good if this were a conventional western finance transaction, but in Wakalah, the money was being held on trust according to the terms of the Wakalah Investment Agreement (contractual) and the dispute should not be settled according to English trust law. Contrary to English Trust Law but according to the Wakalah Agreement, if TID did not reach a certain target, Blom was entitled to whatever return TID had made using Blom's deposits as breach of contract and trust. However, the Judge allowed the appeal by TID of the judgment for $10,733,292.55 USD in favor of Blom and instead ordered an interim payment to Blom Bank as the Judge stated that TID was liable for at least the whole of the amounts deposited. But under the Wakalah, Blom Bank was entitled the rate of return which TID had made if the target wasn't met.

The Judge ordered an interim payment to be paid to Blom based on the fact that the contract was null and void (no trust) and that the transaction was ultra vires (not Sharia'h compliant), however, in reality the amount paid to Blom should have been the rate of return and should have been paid to Blom based on the fact that TID defaulted on the contractual obligation of gaining a return on investment according to the Wakalah Agreement, which was also a breach of trust. By applying Western Trust Concepts to an Islamic finance transaction, the judge defacto turned the transaction into a western finance transaction (in both the first instance and appeal). The UK appeal judge was also in no position to make rulings on Sharia'h law and compliance.

VII. Conclusion

It is advisable to create a world recognized **Islamic Finance Arbitration Center (**Dubai World Islamic Finance Arbitration Center (DWIFAC)) to be set up immediately in order to handle current Islamic banking disputes staffed by the worlds' top Sharia'h and Islamic Finance Scholars. Currently, there is an Islamic Finance Arbitration Center in existence, but it is not widely used or recognized. http://www.iicra.net/English/m1_1.htm Other people are working on this concept now, such as in Cairo and possibly other locations, therefore, the process must be swift and speedy with immediate action and implementation in order to lift Dubai to the forefront of the Islamic Finance Industry. In addition, a unified Islamic Banking Law should be enacted in the UAE as soon as possible. Furthermore, attached to the DWIFAC, it is advisable to attach a Jurisprudence Office to oversee the creation and implementation of Islamic Banking Law in the UAE and worldwide as well as oversee the creation of an Islamic Division to all UAE stock exchanges including the NASDAQ, the Abu Dhabi Securities Exchange (ADX) and the Dubai Financial Market (DFM). In addition, attached to the Arbitration Center, there should be a world-class Islamic Finance Training Institute which offers world-recognized certificate programs for Islamic Finance professionals.

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