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AN ANALYSIS OF THE COURTS' DECISIONS ON ISLAMIC FINANCE DISPUTES

Zulkifli Hasan and Mehmet Asutay***

Abstract

Most Islamic financial institutions operate in an environment where the legislative framework consists of mixed legal systems where the Shari'ah (Islamic law) co-exists with common law and civil law legal systems. As such, every transaction, product, document and operation must comply with the Shari'ah principles as well as relevant laws, rules and regulations. In the case where Islamic law is the ultimate legal authority, such as in Iran and Saudi Arabia, any issue in Islamic banking cases may not pose a big problem; whilst in the countries of mixed legal systems as in the case of Malaysia or in a non-Islamic legal environment such as in the UK, the issue is very significant. This inherent issue will be more complicated if Islamic finance disputes involve parties from different jurisdictions in cross-border transactions. This leads to the question of how Shari'ah principles apply together with the laws of the jurisdiction and how a case will be adjudicated in a court. In view of this unresolved issue, this paper attempts to critically review and analyse the courts' decisions on Islamic finance disputes in four different jurisdictions, namely Malaysia, the United Kingdom, India and the United States. With the emergence of Islamic finance litigation, this paper strongly advocates that a proper legal framework and infrastructure as well as the substantial support of the legal fraternity are the prerequisites for the advancement and significant growth of the Islamic finance industry.

Keywords: Islamic finance, cases, courts, *Shari'ah*

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I. INTRODUCTION

Since its implementation, Islamic finance has enjoyed significant growth in terms of product development, total assets and market shares. It is reported that the Islamic finance industry has consistently achieved an average growth rate of 15-20% per year (The Banker, 2009: 26). McKinsey & Company estimates that the value of assets managed by Islamic Financial Institutions (IFIs) was expected to grow by 33% from USD 750 billion in 2006 to USD 1 trillion in 2010 (Reuters, 2007). In addition, the Banker reported that the total value of Shari'ah-compliant assets managed by the top 500 IFIs in 2009 was about USD 822.1 billion (The Banker, 2009: 26).

While Islamic finance is expected to keep up its growth momentum, certain obstacles and challenges that may be hurdles to its development should be addressed wisely. One of the key unresolved issues pertaining to Islamic finance is the question of having a proper legal regime and framework. In recent years, a number of Islamic finance cases have been brought before the courts for adjudication in different jurisdictions. The recent court decisions on Islamic finance disputes have raised uncertainties for investors and market participants regarding the security of their investments. In Malaysia, the ongoing *bay' bi-thaman ājil* (BBA) saga has to a certain extent negatively impacted the image and credibility of IFIs. In India, the petition to challenge the implementation of Islamic finance in the state of Kerala may create hesitation on the part of investors to invest in this sector. Similarly, the case in the United States where a retired army officer made a petition to challenge the bailout package to AIG, may hinder the development of the Islamic finance industry. The celebrated cases of *Blom Bank* and *Shamil Beximco* raise issues on the polemics of governing laws and the legality of Shari'ah as a valid legal defence in the English court.

With the emergence of Islamic finance litigation as demonstrated above, this paper attempts to critically review and analyse selected court decisions on Islamic finance disputes. This paper highlights the distinctive approaches of courts in making decisions pertaining to Islamic finance issues in four different jurisdictions, namely Malaysia, the United Kingdom, India and the United States. These jurisdictions

were selected on the basis of the interesting case studies they provide, where Malaysia represents a country where the Muslims are a majority and the others where the Muslims are a minority. The rest of the paper proceeds as follows: Section II discusses Islamic finance disputes in Malaysia by highlighting the evolution of Islamic finance cases and the inherent legal issues; Section III provides an outlook on international Islamic finance disputes through analysing selected court decisions in the United Kingdom, India and the United States; Section IV critically examines and reviews the different positions and distinctive approaches of courts in resolving Islamic finance disputes; and Section V finally concludes the discussion.

II. ISLAMIC FINANCE DISPUTES IN MALAYSIA

A. The Evolution of Islamic Finance Cases in Malaysia

Although the Islamic financial industry has been in operation for more than 45 years, since the formation of the Mit Ghamr Savings Bank on 23 July 1963 in Egypt and numerous court cases have been brought to the courts since then, it is found that to date, there are only a few published court decisions relating to Islamic banking cases. Malaysia is one of the exceptional jurisdictions where Islamic banking cases have been published in various law reports such as the Malayan Law Journal and the Current Law Journal. From 1987-2010, there have been several Islamic banking cases that have been published in law reports, 20 of which have been famously quoted and referred to. Of these 20 cases, the majority involved BBA or the *bay' al-ṭinah* facility, except in the case of *Tinta Press Sdn Berhad v BIMB*, which dealt with the *ijārah* financing facility, *Light Style Sdn Bhd v KFH Ijarah House (Malaysia) Sdn Bhd* on *murābaḥah* and *Tahan Steel Corporation Sdn Bhd v Bank Islam Malaysia Berhad* on *istiṣnā'*. The attitude of the Malaysian courts towards Islamic finance cases can be examined in three main phases of Islamic banking cases in Malaysia.

i. First Phase: 1979-2002

The cases referred to are:

- (i) *Tinta Press Sdn Berhad v BIMB* (1987) 1 MLJ 474; 1 CLJ 474
- (ii) *Bank Islam Malaysia Berhad v Adnan Omar* [1994] 3 CLJ 735; [1994] 3 AMR 44; [1994] 4 BLJ 372
- (iii) *Dato' Nik Mahmud Bin Daud v Bank Islam Malaysia Berhad* [1996] 4 MLJ 295
- (iv) *Bank Islam Malaysia Bhd v Shamsuddin Bin Haji Ahmad* [1999] 1 LNS 275; [1999] MLJ 450
- (v) *Bank Kerjasama Rakyat Malaysia Bhd v Nesaretnam Samyveloo* [2002] 8 CLJ 95; [2002] 7 MLJ 103.

In the first phase, the courts decided in favour of Islamic banks as they were more concerned with the application of the classic common law approach by emphasising the civil and technical aspects and did not tackle the actual Sharī'ah issues. In the case of *Bank Islam Malaysia Berhad v Adnan Omar*, the High Court held that the defendant was bound to pay the whole amount of the selling price based on the grounds that he knew the terms of the contract and knowingly entered into the agreement. In this respect, the court applied the classic common law interpretational approach where the parties are bound by the terms and conditions of the contract. The court did not look further into the issue as to whether the BBA facility involved an element not approved by the Sharī'ah as stipulated under the Islamic Banking Act 1983 (IBA) and the Banking and Financial Institutions Act 1989 (BAFIA).

ii. Second Phase: 2003- 2007

The cases referred to are:

- (i) *Bank Kerjasama Rakyat Malaysia Berhad v Emcee Corporation Sdn. Bhd.* [2003] 2 MLJ 408; 1 CLJ 625
- (ii) *Sea Oil Mill (1979) Sdn Bhd & Anor v Bank Kerjasama Rakyat Malaysia Berhad* [2003] MLJ 207 / [2003] 1 LNS 718
- (iii) *Bank Islam Malaysia Berhad v Pasaraya Peladang Sdn Berhad* [2004] 7 MLJ 355

- (iv) *Tahan Steel Corporation Sdn Bhd v Bank Islam Malaysia Berhad* [2004] 6 CLJ 25; [2004] 6 MLJ 1
- (v) *Arab Malaysian Merchant Bank Berhad v Silver Concept Sdn Bhd* [2005] 5 MLJ 210
- (vi) *Malayan Banking Berhad v Marilyn Ho Siok Lin* [2006] 7 MLJ 249; 3 CLJ 796
- (vii) *Affin Bank Berhad v Zulkifli Abdullah* [2006] 3 MLJ 67
- (viii) *Malayan Banking Berhad v Yakup bin Oje & Anor* [2007] 6 MLJ 398.

In the second phase, the courts indicated their intention to examine critically the underlying principles and financing facility offered by the IFIs. Unlike the earlier cases in the first phase, several judges initiated a different approach in resolving issues involving Islamic finance, particularly in the cases of *Affin Bank Berhad v Zulkifli Abdullah* and *Malayan Banking Berhad v Marilyn Ho Siok Lin*. The learned judges in these two cases indirectly criticised the attitude of the earlier court decisions for using a narrow interpretation and heavily applying the classic common law approach. The proper approach, they opined, was for the court to examine further the practices of Islamic banking as to whether they were contrary to the religion of Islam. The courts held that the Islamic contract of BBA was similar to a conventional loan and hence the Islamic banks could not claim the unearned profits because it was equal to interest calculation.

Although the learned judges arrived at their decisions by rejecting the Islamic banks' claim on the unearned profits, the judgment in these two cases did not question the validity and legality of profits derived from the BBA facility. The courts also were silent upon the interpretation of *ribā* and usury and did not declare the profits gained from the BBA facility as unlawful. A similar approach was observed in the case of *Malayan Banking Berhad v Ya'kup bin Oje & Anor*.¹ Interestingly, the learned judge in this case presented a

1 The court's view was that BBA had similar characteristics with conventional loans but upheld its validity. The learned judge ordered the customer to pay the full amount of the BBA facility, deducting the amount of mandatory *ibrā'* (rebate) given by the plaintiff.

comprehensive examination of the application of the BBA facility in his 30-page judgment by analysing the overall aspect of the facility both from the legal and Sharī'ah perspectives. This position indicates the improvement in the judges' level of awareness and understanding of Islamic finance.

iii. Third Phase: 2008-2010

The cases referred to are:

- (i) *Bank Kerjasama Rakyat Malaysia Bhd v PSC Naval Dockyard Sdn Bhd* [2008] 1 CLJ 784; [2007] MLJ 722
- (ii) *Arab Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors (Koperasi Seri Kota Bukit Cheraka Bhd, third party)* [2008] 5 MLJ 631; [2009] 1 CLJ 419
- (iii) *Light Style Sdn Bhd v KFH Ijarah House (Malaysia) Sdn Bhd* [2009] CLJ 370; [2009] 1 LNS 193
- (iv) *Majlis Amanah Rakyat v Bass bin Lai* [2009] 2 CLJ 433
- (v) *Bank Islam Malaysia Bhd v Lim Kok Hoe & Anor And Other Appeals* [2009] 6 CLJ 22; [2009] 6 MLJ 839
- (vi) *Tan Sri Khalid Ibrahim v Bank Islam Malaysia Berhad* [2009] 6 MLJ 416
- (vii) *Bank Islam Malaysia Bhd v Azhar Osman & Other Cases* [2010] 5 CLJ 54 [2010] 1 LNS 251.

After more than a decade of the practice of Islamic finance in Malaysia, the Islamic banking players faced the legal reality of the High Court ruling in the case of *Arab Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors* that the application of the BBA was contrary to the IBA and the BAFIA. Unlike the case of *Bank Kerjasama Rakyat Malaysia Bhd v PSC Naval Dockyard Sdn Bhd* that upheld the earlier decisions on the validity of the BBA contract, the 54-page written judgment in the case of *Arab Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors* clearly indicated the new constructive approach of the courts towards Islamic banking cases, particularly in resolving issues pertaining to the BBA facility. This judgment may to a certain extent affect the Islamic financial sector in Malaysia, as 90% of the Islamic finance cases registered in 2003-2009 related to BBA (Muhammad, 2010: 157).

The judgment of the High Court in the case of *Arab Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors* was the beginning of the proactive attitude of the courts in examining the validity of

Islamic banking practices and determining the issues involved in Islamic banking cases. The case encompassed twelve separate civil suits involving Bank Islam Malaysia Berhad and Arab-Malaysian Finance Berhad as the plaintiffs.² All the twelve civil suits involved issues pertaining to the BBA facility where the defendants were asked to pay the whole amount of the selling price in the event of default. In short, the court's decision can be summarised as follows:-

- (i) The Federal Constitution, the IBA and the BAFIA do not provide an interpretation regarding which *madhhab* is to prevail. The BBA facility must not contain any element which is not approved by the religion of Islam under the interpretation of any of the recognized *madhhab*.
- (ii) The court accepts that the BBA facility is a *bona fide* sales transaction and the interpretation of selling price in the case of *Affin Bank Berhad v Zulkifli Abdullah* was referred to where the court rejected the plaintiffs' interpretation and applied the equitable interpretation.
- (iii) Where the bank recalls the BBA facility at a higher price in total, the sale is not a *bona fide* sale but a financing transaction and this rendered the facility contrary to the IBA and the BAFIA.
- (iv) The court holds that the plaintiffs are entitled under section 66 of the Contracts Act 1950³ to return the original facility amount they had extended. It is equitable that the plaintiffs must seek to obtain a price as close to the market price as possible and account for the proceeds to the respective defendants.

2 *Arab Malaysian Finance Berhad v Taman Ihsan Jaya Sdn Berhad & Ors* (Suit No: D4-22A-067-2003), *BIMB v Ghazali Shamsuddin and Ors* (Suit No: D4-22A-215-2004), *BIMB v Nordin Suboh* (Suit No: D4-22A-1-2004), *BIMB v Peringkat Kaya (M) Sdn. Berhad and Anor* (Suit No: D4-22A-185-2005), *BIMB v Ramli Shuhaimi and Anor* (Suit No: D4-22A-399-2005), *BIMB v Azhar Osman* (Originating Summons No: D4-22A-395-2005), *BIMB v Mohd Razmi A. Rahman and Anor* (Writ No: D4-22A-166-2006), *BIMB v Nor Azlina Baharom* (Writ No: D4-22A-167-2006), *BIMB v Zawawi Osman and Anor* (Writ No: D4-22A-178-2006), *BIMB v Mohammad Rizal Othman and Anor* (Suit No: D4-22a-192-2006), *BIMB v Baharom Harun and Anor* (Writ No: D4-22A-203-2006) and *BIMB v Nadiah Chai Abdullah and Anor* (Writ No: D4-22A-204-2006).

3 Section 66 of the Contracts Act 1950 states that "when an agreement is discovered to be void, or when a contract becomes void, any person who has received any advantage under the agreement or contract is bound to restore it, or to make compensation for it, to the person from whom he received it".

The judgment in this case nevertheless was overturned by the Court of Appeal. The Court of Appeal held that the BBA contract was valid and the notion of replacing the sale price under the Property Purchase Agreement with an “equitable interpretation”, which would lead to the obligation of the customer to pay the sale price with a “loan amount” and “profit” computed on a daily basis, constituted an act of rewriting the contract of the parties. It is trite law that the court should not rewrite the terms of a contract between parties that it deems to be fair or equitable. This decision then was followed in the cases of *Light Style Sdn Bhd v KFH Ijarah House (Malaysia) Sdn Bhd*, *Bank Islam Malaysia Bhd v Lim Kok Hoe & Anor and Other Appeals*, *Majlis Amanah Rakyat v Bass bin Lai* and *Bank Islam Malaysia Bhd v Azhar Osman & Other Cases* where the courts upheld the validity of the BBA, *bay' al-‘inah* and *murābahah* contracts.

Due to the potential significant impact on the Islamic finance industry because of the case of *Arab Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors*, the Malaysian government took a further step in enhancing the legal framework by passing the Central Bank of Malaysia Act (CBA).⁴ Unlike the earlier Act, the CBA inserts a new provision in Part VII which covers matters pertaining to Islamic finance. Part VII, Chapter 1 of the CBA aims at resolving issues pertinent to Shari‘ah matters. Sections 51-58 of the CBA further clarify and enhance the Shari‘ah governance framework for IFIs in Malaysia (see Hasan, 2010: 105-108). The differences between Part VII, Chapter 1 of the CBA and Section 16B of the Central Bank of Malaysia (Amendment) Act 2003 are delineated in Table 1.

The CBA provides a clear and precise legal framework for Islamic finance, particularly regarding the legal status of Shari‘ah resolution and the SAC as the highest authority on Islamic banking and finance. In the same year of its enactment, in the case of

4 The CBA was passed by the Parliament in July 2009, received Royal Assent on 19th August 2009 and was gazetted on 3rd September 2009. It is worth noting that the CBA has jurisdiction only in matters that fall under the auspices of Bank Negara Malaysia (BNM), which therefore excludes the Shari‘ah board in the Securities Commission (SC). The SC has its own Shari‘ah board and in August 2009 it issued the Registration of Shari‘ah Adviser’s Guidelines under section 377 of the Capital Markets and Services Act 2007 that specifically provides rules and procedures for registration of Shari‘ah advisors.

Tan Sri Khalid Ibrahim v Bank Islam Malaysia Berhad, for the first time in the history of the Malaysian courts the High Court judge made reference to the SAC for confirmation of the Shari'ah status of the agreement. In pre-2008 cases, the courts had never referred to the SAC for any Shari'ah deliberation. This new approach indicated that regulatory initiatives through proper legislation and legal framework may influence the court's attitude in making decisions in resolving any Islamic finance disputes. It is imperative for the court to refer to the SAC or Shari'ah experts to decide matters related to Shari'ah issues, failing which the Islamic finance industry may be exposed to significant Shari'ah non-compliance risk.

Table 1: The Differences between Part VII, Chapter 1 of the CBA and Section 16B of the Central Bank of Malaysia (Amendment) Act 2003

Part VII, Chapter 1 of the CBA	Section 16B
It should be read together with the Shari'ah Governance Framework for IFIs 2010.	It should be read together with the Guidelines on the Governance of Shari'ah Committee for the Islamic Banks 2004 (BNM/GPS 1)
It grants authority to BNM to establish the Shari'ah Advisory Council (SAC) and to specify its functions as well as the secretariat to assist the SAC in carrying out its definitive roles. This vividly clarifies the roles and responsibilities of the SAC as the highest and sole authority in Islamic financial matters.	It provides the establishment of the SAC but does not clearly clarify the roles and responsibilities of the SAC. No provision mentioning the setting up of the SAC's secretariat.
In parallel with the status of the SAC as the highest authority, the appointment of the SAC members shall be made by the Yang di-Pertuan Agong. The SAC's remuneration and the terms of reference shall then be determined by BNM.	The appointment shall be made by the Minister on the recommendation of BNM.
It sets the minimum fit and proper criteria of the SAC members. The candidate must be at least knowledgeable and qualified in Shari'ah or have appropriate knowledge and experience in banking, finance and law. Section 53 of the CBA also allows experts in other related disciplines, as well as judges of the civil and Shari'ah courts, to be SAC members.	It has a similar provision.
No similar provision with the retired section 16B (6).	No member of the SAC shall become a member of any Shari'ah advisory body with any IFIs.
It affirms the legal status of the Shari'ah pronouncement issued by the SAC to be binding upon both the court as well as arbitration.	It merely provides that Shari'ah rulings issued by the SAC are binding upon the arbitration.
It is mandatory for the court or arbitrator to refer to the SAC for deliberation on any Shari'ah issue, as well as taking into account its existing Shari'ah rulings.	The court or arbitrator is not obligated to refer to the SAC to resolve any Shari'ah issue.
It clarifies the status of the Shari'ah rulings issued by the SAC in the event that they contradict the Shari'ah pronouncement of a Shari'ah committee at an individual IFI. The Shari'ah rulings of the SAC shall prevail and have binding force over the Shari'ah resolutions of the Shari'ah committees of IFIs.	It does not clearly stipulate the position of Shari'ah rulings in the case of conflicts with any other Shari'ah resolutions.

B. Inherent Issues in Islamic Finance Cases

The development of Islamic finance cases in Malaysia reflects the dynamic quality and reality of Islamic banking practices within the legal environment they operate in. The evolution of court cases since the implementation of Islamic banking provides an overview with regard to how numerous legal issues involved can be solved and be treated accordingly without impeding the development of the industry. To enlighten further, this section highlights several inherent issues pertaining to Islamic finance cases as mostly discussed and debated within the legal fraternity namely, courts' jurisdiction, the interpretational approach and reference to the SAC.

i. Courts' Jurisdiction

Based on the overall analysis of the court decisions, particularly in deliberating Shari'ah issues, it is observed that the judges in the civil court to a certain extent do not have the competence to deal with Shari'ah matters. This is also one of the reasons why the CBA provides specific provision on the mandatory requirement to refer to the SAC on Shari'ah matters. For instance, in the case of *Arab Malaysian Merchant Bank Bhd v Silver Concept Sdn Bhd*, the learned judge himself observed that in the civil court not every presiding judge is a Muslim and, even if so, may not be sufficiently equipped to deal with matters which Muslim jurists take years to comprehend. This issue invites the big question as to whether Islamic finance cases should be adjudged by the Shari'ah court.

In Malaysia, separate Islamic banking legislation and regulations exist side-by-side with those of the conventional banking system. Islamic banking and finance was placed under the Federal List since it involves commercial dealings, although it actually falls under the purview of Islamic law. Thus, it is the Parliament which passes any law governing the IFIs and *takāful* operators. Being so, the only avenue available to try cases or disputes on Islamic banking and *takāful* is the civil courts. This is due to the fact that Islamic banking and *takāful* cannot be interpreted under the ambit of "personal" but under the item "finance" as stipulated in Article 74 of the Federal Constitution.

In light of the above, it is almost settled law that the jurisdiction of Islamic banking cases was placed under the auspices of civil courts. This position is clearly mentioned by the Court of Appeal in the case

of *Bank Kerjasama Rakyat Malaysia v Emcee Corporation* where the learned judge stated, “The law was mentioned at the beginning of this judgment; the facility is an Islamic banking 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 the conventional banking.” Indeed, in actual fact, the disputed cases relating to Islamic banking normally involve a mixture of issues and not Islamic law per se. Therefore, the function of the civil court in dealing with Islamic banking cases is to render a judicially considered decision on the particular facts of the specific case before it according to law. The civil court has a constitutional duty to ensure that Islamic financial instruments are within the spirit of the IBA and the BAFIA (See Backer, 2002). In the event that the court needs deliberation on Shari‘ah issues, by virtue of section 58 of the CBA, the judge should refer to the SAC and take into consideration its opinion before making any decision on Islamic finance cases.

ii. The Interpretational Approach

As a general observation on the evolution of Islamic finance cases in Malaysia, it is concluded that the courts have applied an integrated interpretational approach. At this point, the judge refers and considers the common law, equity and Shari‘ah positions before making any decision. Unlike the cases in the first phase, the courts in the phase afterwards interpreted the cases by analysing the issues involved with a proactive attitude. Interestingly, in explaining *ribā* and usury, the courts critically examined the cases by integrating the common law, equity and Shari‘ah interpretational approach.

In the case of *Arab Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors*, the learned judge interpreted the concept of usury by integrating its understanding under the common law, equity and Shari‘ah. The common law approach requires that the parties are bound by the terms of the contract regardless of whether it involves an usurious element. The equitable principle then was developed in order to remove injustice from the operation of common law. Based on the equitable principle, the court then declared that the excessive amount of profit derived from the BBA transaction was invalid and therefore the defendants would only have to pay the principal sum of the facility.

The court also made reference to the Sharī'ah position in interpreting *ribā* or usury in the context of BBA. The learned judge quoted several verses of the Qur'an from *Tafsir Pimpinan al-Rahman* and English translations of the Holy Qur'an by Abdullah Yusuf Ali, Pickthal and Shakir as well as Resolution No. 10(10/2) of the Council of the Islamic Fiqh Academy of the Organization of the Islamic Conference and the judgment on interest in the Supreme Court of Pakistan. In examining *ribā* in the actual context of BBA, the court finally decided that the profit portion of the BBA facility was unlawful and rendered the facility contrary to the IBA and the BAFIA. In justifying that the profit portion of the BBA facility was unlawful and contrary to the religion of Islam, the court arrived at its decision based on the following four main reasons, namely - deferred payment of the sale price was a loan;⁵ the issue of *'iwad* (counter-value or compensation);⁶ form against substance;⁷ and the approval by any of the recognised *madhhabs*.⁸

As the case demonstrates, there have been several attempts by the courts, particularly the High Court, to depart from the conservative interpretational approach of common law by going beyond the

5 The court considered deferred payment of the selling price as a credit or a loan and any profit claimed or charged by the bank as an addition to the facility amount as interest. The court signified that the profit derived from the BBA facility was lawful if the transaction was considered as a *bona fide* sale. Nevertheless, the BBA facility in this case abandoned the element of *bona fide* sale in which making the profit derived from it would be prohibited as *ribā*.

6 Although the court did not mention this specific issue anywhere, it is observed that the BBA facility had apparently neglected the requirement of *'iwad* where the obligation of warranty to the properties sold had been shifted to the vendor and not the plaintiffs as the sellers. Moreover, it was evident in most of the BBA legal documentation that the bank held no liability arising from all defective assets sold.

7 In this case, the court opined that the BBA facility may be classified as a pretence of sale transaction unless there was a novation agreement to make the bank a genuine seller. If this was a pretence of sale transaction the profit derived from the BBA facility was considered unlawful since there was no genuine sale transaction which had been concluded.

8 In interpreting the requirement under the IBA and the BAFIA that the financing facilities offered did not involve any element not approved by the religion of Islam, the court declared that the facility must not contain any element not approved by any of the recognised *madhhabs* unless the financing agreement specifically stated a particular *madhhab*. Since the *bay al-'inah* concept was only acceptable in the Shāfi'i *madhhab*, it failed to meet the IBA and the BAFIA's requirements and rendered the transaction null and void.

wording of the contractual agreements. These attempts nevertheless were unsuccessful as the appellate court in the appeal cases rejected such an approach. The Court of Appeal overturned the decision in the case of *Arab Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors* and then upheld the validity and enforceability of the BBA contract based on the classic common law approach as decided in the earlier cases. The Court of Appeal reminded the judges that it was wrong for the lower court to simply ignore or disregard the decisions of the Court of Appeal in the cases of *Adnan Omar v Bank Islam Malaysia Berhad* and *Datuk Haji Nik Mahmud Nik Daud v Bank Islam Malaysia Berhad* since doing so violates the doctrine of *stare decisis* or binding precedent and in fact would create inconsistency in the judicial system.

iii. Reference to the Shari'ah Advisory Council

With the understanding that judges in the civil courts are not as well-qualified to decide matters on Shari'ah issues, it is important for them to refer to the SAC or Shari'ah experts for deliberation. Judges in the civil court should not take it upon themselves to declare whether a matter is in accordance with Shari'ah or not. This needs deliberation by eminent jurists who are properly qualified in the field of Islamic jurisprudence. The court then may need to refer to the SAC or expert evidence to clarify the Shari'ah issues involved as this is the proper avenue and authority to decide matters.

Although Islamic law is regarded as *lex loci* (local law) and this rule prevents expert evidence from being called to the court to clarify issues on Islamic law, section 58 of the CBA relaxes the said rule by specifically requiring the court to seek the opinion of the SAC. By referring to the overall arguments made by the learned judges, particularly in resolving Shari'ah issues as in the case of *Arab Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors*, *Affin Bank Berhad v Zulkifli Abdullah*, *Malayan Banking Berhad v Marilyn Ho Siok Lin* and *Malayan Banking Berhad v Yakup bin Oje & Anor*; they indicate that the SAC's deliberations or expert opinions are actually needed. There is no harm in the court seeking the SAC's view and indeed it could strengthen the court's reasoning and arguments

in making the decision.⁹ The first motion made by the learned judge in the case *Tan Sri Khalid Ibrahim v Bank Islam Malaysia Berhad* to refer to the SAC indicates a positive development of the courts' attitude towards resolving mixed legal and Shari'ah issues in Islamic finance disputes.

III. OUTLOOK ON INTERNATIONAL ISLAMIC FINANCE DISPUTES

This section reviews the court decisions on Islamic finance disputes in three additional jurisdictions where Muslims are minorities, notably the United Kingdom, India and the United States.

A. The United Kingdom

It has been a common practice for Islamic banking and finance-related transactions to be governed by English law. In fact, as part of the business strategy, many Islamic finance deals, especially those involving cross-border transactions, are governed by English law. In lieu of this, all the transaction documents, including the declaration of trust, are also subject to English law. These typical practices indicate that numerous Islamic financial transactions are governed by English law in which the courts of England have exclusive jurisdiction to settle any Islamic finance disputes under such arrangements. This section briefly discusses three landmark cases decided in the courts of England pertaining to this issue.

The case of *Investment Company Of The Gulf (Bahamas) Limited v Symphony Gems N.V. and Ors* [2002] West Law 346969, QBD

9 The Federal Court of Pakistan in the historic judgment on *ribā* cited the opinions of various experts such as Umer Chapra, Hasan-us-Zaman, Abdul Rahman Al-Jaziri, Mawlana Taqi Usmani, Ghulam Rasool Saeedi, Munawar Iqbal and Afzalur Rahman and referred to numerous views of jurists, such as al-Kāsānī, al-Zayla'ī, al-Sarkhasī, Ibn Qudāmah, Fatāwā Ālāmgir, the Council of Islamic Ideology of Pakistan, the Islamic Fiqh Academy of OIC countries, the Islamic Fiqh Academy of India and the resolution of the Seminar Indexation held at Jeddah in 1987. See Khan, (1994: 19-27).

(Comm. Ct.)¹⁰ which was decided on 13 February, 2002 was the first case in the English courts pertaining to Islamic finance. The issues involved in this case referred to the question of the validity of the *murābahah* agreement. Under this *murābahah* deal, the plaintiff agreed to finance the defendant via a revolving facility to purchase precious stones and gems. The defendant defaulted and the plaintiff brought the case to court. The main issues discussed *inter alia* in this case referred to: (i) the determination of the effect of the *murābahah* agreement on the risk of failure to deliver, (ii) the Shari'ah issue as a legal defence and (iii) the doctrine of *ultra vires*.

With regard to the first issue, the learned judge rejected the argument by the defendant on the default payment of failure of delivery. The contract clearly stated that the defendant was obligated unconditionally to purchase the gems from the plaintiff. In fact, delivery was not a prerequisite to payment by the defendant. The court referred to the relevant clause provided in the contractual agreement which clearly stated that the plaintiff would not be liable for any failure of delivery or defects or any deficiency. In essence, the court in this case chose to literally interpret the contract employing a classic common law approach by construing strictly the agreement in its terms and conditions.

In relation to the second issue, the defendant argued that the *murābahah* agreement was invalid on the ground that it contradicted Shari'ah principles. In order to determine the validity of this *murābahah* contract, two experts were called to testify, namely Dr. Yahya Al Samaan of the Saudi Law Firm of Salah Al Hejailan and Dr. Martin Lau of the School of Oriental and African Studies (Balz, 2004: 124). Interestingly, both experts said that the underlying contract was not based on an actual *murābahah* transaction. While the court agreed to hear the experts' views on the *murābahah* issue, it nevertheless at the end held that the contract was vividly valid from the English law point of view and dismissed the argument of Shari'ah non-compliance.

10 See also *Investment Company of the Gulf (Bahamas) Ltd v Symphony Gems NV & Ors* [2008] EWCA Civ 389 (11 March 2008) ([2008] EWCA Civ 389, from England and Wales Court of Appeal (Civil Division) Decisions; 31 KB).

Pertaining to the final issue, the court also rejected the defendant's argument in claiming the common law doctrine of *ultra vires* upon Symphony Gems, which was incorporated under the law of Bahamas. Although a clause in the agreement stated that the defendant had to pay the plaintiff under any circumstances, which was against the Sharī'ah principles, the court viewed that the doctrine of *ultra vires* was not relevant (See Aldohni, 2009: 350-356). After analysing the *ultra vires* law of the Bahamas, the court took the view that the plaintiff was not subject to the *ultra vires* doctrine (Moghul and Ahmed, 2003-2004: 188). The court ordered the defendant to pay the total amount of USD 10,060,354.28, inclusive of both principal and the compensation for late payments.

Another landmark case in the English courts related to Islamic finance was the case of *Shamil Bank of Bahrain v Beximco Pharmaceuticals Limited and Others* [2004] 1 Lloyd's Rep 1 28. In this case the defendant Beximco Pharmaceuticals Ltd and the other borrowers entered into a *murābahah* agreement with the plaintiff in 1995. The defendants defaulted and after a series of various termination events under the agreements, the plaintiff finally brought the case to court and made an application for summary judgment.

The central issue raised in this case referred to a construction of the governing law clause. The *murābahah* agreements contained the following governing law clause: "*Subject to the principles of the Glorious Sharī'ah, this Agreement shall be governed by and construed in accordance with the laws of England.*" Based on this clause, the defendants argued that the *murābahah* agreements were invalid and unenforceable because they were in truth disguised loans charging interest. It was further argued that the *murābahah* agreements were then unenforceable due to Sharī'ah non-compliance.

Both the High Court and the Court of Appeal dismissed the arguments put forward by the defendants and finally granted summary judgment to the plaintiff on its claims. The court held that the principles of Sharī'ah did not apply to the *murābahah* agreements. The reference to the Sharī'ah in the governing law clause was not meant to replace the English law as the governing law but merely intended to reflect the plaintiff's nature of business. The learned judge further stated that there could not be two separate systems of law governing a contract. In this regard, the court referred to the Rome Convention whereby the interpretation on the reference to a choice of law was to the law of a country and not to a non-national system

of law such as the Sharī'ah.¹¹ The court rejected the arguments put forward by the defendant and noted that the Sharī'ah defence elicited in this case was merely “*a lawyer's construct*” and this would defeat the commercial purpose of the transactions.

In the case of *Investment Dar Co KSSC v Blom Developments Bank Sal [2009] All ER (D) 145*, the Investment Dar (TID) was an investment company registered in Kuwait and the Blom Developments Bank (BDB) was a bank incorporated in Lebanon. Both parties nevertheless agreed that the *wakālah* agreement entered into would be governed by the English law. When TID failed to perform its obligation under the *wakālah* agreement, the BDB sued them in the High Court of England and applied for summary judgment on the grounds of default in payment and the deposits held on trust.

In response to the claim made by the plaintiff, TID raised the defence of *ultra vires* to defy payment of an obligation under the *wakālah* deal. Ironically, TID argued that the *wakālah* agreement which was approved by its own Sharī'ah board did not comply with the Sharī'ah and was therefore void because it was against TID's constitutional documents. On the other hand, the BDB argued that the transaction was Sharī'ah compliant and in fact was duly certified by TID's own Sharī'ah board and any argument of the invalidity of such a deal was therefore void.

Unlike in the *Investment Company of The Gulf (Bahamas) Limited v Symphony Gems*, the court in this case allowed the appeal and held that there was a triable issue on both claims. The learned judge agreed that the issue of Sharī'ah compliance needed to go to trial for proper deliberation, but considering the deposit, TID still had to pay the amount deposited of USD 10,733,292.55 to the BDB. Due to various reasons, TID finally withdrew the case.

On a brief analysis, the three important cases above indicate the consistency of the practice of English law in the tendency towards a literal interpretation of commercial agreements. Two cases involved issues on *murābahah* agreement and one case referred to a *wakālah* contract. Unlike the 2004 and 2009 cases, the court referred to expert

11 The United Kingdom is a signatory to the Rome Convention 32 and with regard to any questions arising from a choice of law clause or applicability of an alien law, the United Kingdom would enforce the Convention as applied in English law by way of the Contracts (Applicable) Act 1990 (Tabari, 2010: 249).

views on the validity of the *murābahah* agreement in the case of *Investment Company of The Gulf (Bahamas) Limited v Symphony Gems N.V. and Ors.* The courts nevertheless ignored the expert views and decided based on the literal interpretation of the wording contained in the contractual agreement. The courts were also consistent in their decisions whereby a general referral to the applicability of Sharī'ah in the contractual agreements did not suffice for the English courts to regard it as the governing law of any Islamic financial transactions.

B. India

While Islamic finance cases in the English courts mainly discussed the issue of governing laws and Sharī'ah as a legal defence, the case in India involved constitutional issues. Since Islamic finance is relatively new in India, it has not been welcomed by some parties and organisations. They tend to think that the implementation of Islamic finance in India constitutes violation of the secular characteristics of the Constitution. To date, there is only one case which has been decided upon pertaining to Islamic finance. This case is very important with regard to the future of Islamic finance in India as it will be the leading case or precedent to any further disputes on Sharī'ah-compliant financing.

In the case of *Dr. Surbahmaniam Swamy v State of Kerala WP (C) No. 35180 of 2009 (S)*,¹² the petitioner, Surbahmaniam Swamy, challenged the legality of the implementation of Islamic finance in the state of Kerala. Being pro-Hindu, the petitioner raised the constitutional issue in the court of whether Kerala State Industrial Development Corporation's (KSIDC) 11% equity in Al Barakh Financial Services Ltd., committed to offering Sharī'ah-compliant financial services, constituted "*undue association with a religious activity amounting to State favoring or promoting a religion*" which is against Article 27 of the Indian Constitution. The central issue involved in this case therefore was whether the decision of the State of Kerala and the KSIDC to associate themselves with Islamic finance

12 Full judgment can be downloaded at: https://docs.google.com/viewer?a=v&pid=explorer&chrome=true&srcid=0B6hXZkfsIpLQN2UzZGJIYjgtN2MwNi00ODhmLTgyMzYtZjhhN2Y1YWZhNTUw&hl=en_GB&authkey=CluTgpAH.

business was contrary to the constitutional requirement that the State should be a secular state.

After analysing the arguments put forward by the petitioners and the respondent, the Kerala High Court finally declared that the promotion of Islamic banking by the government had not violated the constitutional provisions. In their judgments, both judges, J. Chelameswar and P. R. Ramachandra Menon, agreed that any commercial activity for the purpose of development did not tantamount to the maintenance or promotion of religion which was prohibited by the Constitution. The Constitution itself granted minorities the right to administer educational institutions and association of the State with religious institutions was ordinarily permissible, as well in education. In fact, Article 298 of the Constitution granted broad executive authority to the State to engage in commercial interactions with no mention of any exception against involvement with religious denominations.

The judgment in the Kerala High Court is very significant to the future of Islamic finance in India. It is fortunate that the judges in this case applied a constructive approach in their interpretation. In fact, the learned judges indirectly recognised the practice of Islamic finance by declaring that any engagement with Sharī'ah-compliant financing would not violate the secular characteristics of the Constitution. The decision in this landmark case at least has resolved the issue of legality of Islamic finance business vis-a-vis the constitutional provisions and it will be a precedent for any further Islamic finance disputes in India.

C. The United States

There are two celebrated cases pertaining to Islamic finance in the United States. The first case refers to the petition made by Kevin J. Murray upon the constitutional validity of the government's bailout of AIG while the second case relates to bankruptcy proceedings involving East Cameron Partners. Both cases are imperative to the Islamic finance industry as they demonstrate the United States courts' attitudes towards cases involving Islamic finance disputes.

In the case of *Kevin J. Murray v Henry M. Paulson Jr.* No. 2:08-cv-15147 in the United States District Court for the Eastern District

of Michigan Case,¹³ the petition was brought by the Thomas More Law Center (TMLC), on behalf of Kevin Murray, a retired navy and veteran of the Iraqi War. This was the first time a federal court in the United States had considered cases pertaining to Islamic finance. The federal lawsuit was filed against the Secretary of the Treasury, Timothy Geithner and the Board of Governors of the Federal Reserve System. The petition challenged the validity of the government's bailout to the AIG on the ground of constitutional violation. They also challenged the legality of the Emergency Economic Stabilization Act of 2008 (EESA) that appropriated USD 70 billion of taxpayer money to financially support the AIG.

The chief issue involved in this case was whether the usage of federal tax money to bail out the AIG constituted a violation of the Constitution. According to the lawsuit, the petitioners claimed that the government's bailout to the AIG constituted violation of the Establishment Clause of the First Amendment to the United States Constitution. They argued that the government's aid to the AIG, which had a significant portion of its business as Shari'ah compliant, was considered support to Islamic religious indoctrination through the funding and promotion of Islamic finance. Moreover, the petitioners also made the allegation that the promotion of Islamic finance as in the case of AIG may lead to the destruction of Western civilization and the United States (Thomas More Law Center, 2011).

After hearing the arguments put forward by the petitioners and the respondents, on 14 January 2011, a federal district court judge in Michigan, Lawrence P. Zatkoff, dismissed the petition and rejected the argument on a constitutional challenge. The court held that merely rescuing AIG through bailout did not violate any constitutional provision. Involvement in any business activity for commercial purposes did not amount to the act of indoctrination of religion. In fact, the petitioners had failed to provide any evidence to prove that the government had assisted the AIG for the purpose of religious indoctrination. Dissatisfied with the decision, the petitioner filed an appeal to the 6th U.S. Circuit Court of Appeals in order to overturn the Federal District Court ruling (Gordon, 2011).

13 The full version of the petition can be downloaded at: http://204.96.138.161/upload/wysiwyg/article%20pdfs/Murray/031-1_Motion%20to%20Compel.pdf.

Unlike the AIG case, the case of *East Cameron Partners* (see Sapp and Harley, 2010) is less sensational. It refers to the issue of bankruptcy laws. In 2006, East Cameron Partners issued the first US-originated *ṣukūk* based on *mushārah*.¹⁴ Due to *force majeure* in Louisiana, which badly affected the company financially and physically, they filed for bankruptcy protection under Chapter 11 in the United States Bankruptcy Court. Based on the bankruptcy proceedings, the issue involved in this case was whether the *ṣukūk*-holders actually owned a portion of East Cameron Partners' oil and gas royalties. This was a crucial test to Islamic finance, particularly involving *ṣukūk*, as the court would determine whether the securitisation of assets under the *ṣukūk* arrangement was legally recognised as well as whether it was substantively distinct from an interest-bearing debt.

In its claim, East Cameron Partners argued that there had been no transfer of ownership of royalties into the Cayman Islands-domiciled SPV to issue the *ṣukūk*. They claimed that the transaction was a loan secured on those royalties in which all the *ṣukūk*-holders would have to share the royalties with other creditors in the event of liquidation. The bankruptcy court appears to have rejected this argument and requested East Cameron Partners to advance additional arguments to support its case, impliedly indicating the recognition of the validity of the *ṣukūk*-holders' ownership. The bankruptcy court then entered a preliminary injunction prohibiting the purchaser SPV (Louisiana Offshore Holding LLC), the issuer SPV (East Cameron Gas Co. *ṣukūk* Trust) and the collateral agent from exercising any remedies on the oil and gas royalties (Ryan and Elmalki, 2010). The case is still pending in the United States Bankruptcy Court.

Islamic finance is a small but growing industry in the United States. To maintain its sustainability and viability, over and above Sharī'ah requirements, Islamic finance must be able to accommodate itself to state and federal legislation and regulations. As both cases demonstrate, there are uncertainties in the legal position of Islamic finance under the existing United States law. Unlike in the United Kingdom, which proactively facilitates the implementation of

14 The *ṣukūk* was structured under the *mushārah* contract for the purpose of fund capital expenditure and working capital between East Cameron and the SPV in the United States, to which it sold oil and gas royalty rights. The sale was funded by *ṣukūk* investors who purchased *ṣukūk* certificates from a Cayman Islands-domiciled SPV (Goud, 2010).

Islamic finance with a sound legal infrastructure, there are numerous loopholes in the United States legal framework for Islamic finance. In fact, the battle on the constitutional challenge in the case of *Kevin J. Murray v Henry M. Paulson Jr.* is still ongoing in the Court of Appeals. This remains one of the hurdles and legal conundrums of Islamic finance in the United States.

IV. CRITICAL OBSERVATIONS

Under this section, the different positions and distinctive approaches of the courts in resolving Islamic finance disputes are examined and critically reviewed.

A. The Polemics of Governing Laws

In practice, many Islamic finance transactions are governed by English law. In fact, numerous international Islamic finance disputes are subject to the jurisdiction of foreign courts. Balz (2008: 10) expresses his view on the tendency of the Islamic finance industry towards reception of the English common law, which may lead to the issue of the polemics of governing laws. This trend indicates that the foreign courts, particularly the courts of England, may have exclusive jurisdiction in many Islamic finance disputes.

The attitude of English courts so far has ignored the element of Sharī'ah and in fact they do not recognise the Sharī'ah as an applicable law. A general referral to the applicability of the Sharī'ah will not suffice for the English court to regard it as the governing law of the underlying transaction (See Tabari, 2010: 249). In the case of *Shamil Bank of Bahrain v Beximco Pharmaceuticals Limited and Others*, the English court strictly applied the provision in the Rome Convention on the reference to a choice of law, which rejected Sharī'ah as the recognised law.

Another crucial issue in this matter refers to the question of enforceability of the contracts. Although in practice, Islamic contractual agreements provide a clause that the contract shall be governed or subject to the glorious Sharī'ah principles, it is questionable whether such a choice of law provision is enforceable in Western courts (Balz, 2004: 124). This matter is further complicated where there are no bilateral treaties for reciprocal

enforcement of judgments between foreign jurisdictions. Even if judgment is obtained in the United Kingdom for instance, there may be additional hurdles to be overcome to have those judgments enforced in foreign jurisdictions. The attitude of the English courts, which have been unwilling to apply the Shari'ah in commercial disputes, further complicates these matters (See Ercanbrack, 2011: 69).

Based on the foregoing discussion, the current practice of choosing English law as the governing law needs to be revisited and reconsidered. This is because the choice of parties to be adjudicated by a non-Islamic court in a non-Islamic jurisdiction shows that due recognition is not given to the validity and the principles of Shari'ah. Even though the contract was deemed as being non-compliant with the Shari'ah, the court still validated the transaction based on normal contracts and made it enforceable. This decision may be harmful to the Islamic finance industry as its aims to comply with Shari'ah are seemingly being defeated. Furthermore, this case could easily be used as a precedent in future disputes whereby the Shari'ah rulings would be abandoned in favour of prevailing English law.

B. Shari'ah Issues as a Legal Defence

It is very interesting to note that most of the cases in Islamic finance delve into the defence of non-compliance when the party or the defendant fails to comply with the contract or, in other words, fails to pay. This indicates that the competence and integrity of Islamic financial contracts have been called into question. There are two important points in this issue. Firstly, it invites ethical issues that play a major role in Islamic finance, where the parties argue the validity of a Shari'ah contract.¹⁵ Secondly, allowing companies to argue that a deal is non-compliant will finally negatively impact the image of the Islamic finance industry. Investors will be wary of dealing with IFIs and any companies that offer Shari'ah-compliant products and services.

15 It is worthwhile to refer to Rohana Yusof J. in *Tan Sri Abdul Khalid bin Ibrahim v BIMB and Another* [2009] 6 MLJ 416, who said "*Questioning of the validity of an agreement after benefiting from it and upon default, in itself lacks bona fide as the plaintiff was in the position to obtain any Shari'ah or legal advice at the time he entered into the agreements with the bank. To turn around and challenge the validity of an agreement entered voluntarily after reaping the benefit under it appeared to be a mere afterthought.*"

As a general observation, the majority of the court decisions used a literal approach or classic common law interpretational approach to resolve Islamic finance cases. In the English courts, the issue of Shari'ah as a legal defence was rejected upfront. Using a literal approach in interpreting the contractual agreements, Shari'ah validity is not considered relevant as the English court will not bother to determine whether the contract is valid or not from an Islamic law point of view. This is in fact appropriate because IFIs have their own Shari'ah board that actually makes decisions on the aspects of Shari'ah. It is well-known that the English courts tend towards literal interpretation of commercial agreements by strictly construing the wording of the contracts and not the actual intention of the parties (Balz, 2004: 125). The contract is construed as commercial in nature, regardless of having a Shari'ah-compliant financing character. This is affirmed in the case of *Investment Company of The Gulf (Bahamas) Limited v Symphony Gems N.V. and Ors* where the court clearly stated that the Shari'ah expert's view on deliberating the validity of the *murabahah* agreement was unnecessary as the contract must be construed to its terms and governed by the English law (Moghul and Ahmed, 2003-2004: 187).

In Malaysia, the courts' attitude towards the Shari'ah as a legal defence can be divided into three phases. In the first phase, the courts tended to adopt the English courts' approach by strictly construing the contractual agreements. The trend differed in the second phase whereby the judges seemed to consider an integrated approach to resolve any issues involved in Islamic finance disputes. The courts achieved a stage of maturity in understanding Islamic finance in the third phase in which they considered Shari'ah issues as a legal defence and in fact proactively interpreted the contractual agreements by taking into consideration the elements of common law, equitable principles as well as the Shari'ah. To complement this development, the regulatory authority finally introduced the CBA which clarifies legal uncertainties in Islamic finance. As a result, it is incumbent upon the courts to refer to the SAC for Shari'ah deliberation.

C. Constitutional Issue

The majority of the cases discussed in this article relate to the issue of governing laws and the determination of the validity of contractual agreements from the Shari'ah perspective in the civil courts. Only in the case of *Kevin J. Murray v Henry M. Paulson Jr* in the United

States and *Dr. Surbahmaniam Swamy v State of Kerala* in India, did the courts resolve the issue of constitutional validity. Both cases referred to the issue of use of public money by companies having Sharī'ah-compliant businesses, which was alleged to be in violation of the Constitution as being secular in character.

The courts' decisions in these cases are very significant to the Islamic finance industry as they will be precedents for the implementation of Sharī'ah-compliant businesses in these respective jurisdictions. At this point of time, it is fortunate that the courts are in favour of Islamic finance. The courts' attitude towards recognising Islamic finance as legitimate business transactions will not be left unchallenged in the future. Since most of the constitutions in numerous jurisdictions are characterised as secular, whereby Islamic finance is regarded as an act of religious indoctrination, it is presumed that lawsuits on the ground of constitutional validity are likely to occur in the future.

Overall, it is trite law that the Constitution is the paramount or highest law in any legal system in the world. When the constitutional issue has been raised to challenge the legality of Islamic finance implementation, it will potentially expose the industry to significant legal risks as the Constitution will prevail over any other law, including Sharī'ah rules and principles. In this regard, continuous efforts to foster awareness and understanding of Islamic finance should be extensively carried out. Islamic finance should not be presented as purely religious but rather as an industry that offers attractive financial products and services which are fair and just. In the context of legal awareness, the Islamic finance legal fraternity should lead such an initiative.

D. Islamic Financial Instruments in Disputes

Most cases reported were in relation to debt-based financing, namely *murābahah*, BBA and *bay' al-īnah*, except cases in the United States and India. This position affirms the trend of Islamic finance, which is dominated by debt-based financing products and services. It is worthwhile to note that the Islamic financial products involved in the existing cases were simple and not complex. Only in the case of *East Cameron Partners*, were *shukūk*-related issues involved. The rest of the Islamic finance cases referred to straightforward Islamic financial contracts such as *murābahah*, BBA, *bay' al-īnah*, *istiṣnā'*, *ijārah* and *wakālah*.

With innovative financial engineering and significant growth of *ṣukūk* issuance in various structures, including the increase of cross-border transactions in different jurisdictions, it is expected that issues involved in Islamic finance cases in the future will also be more complex. Severe criticisms of the existing structures of *ṣukūk* for instance may result in disputes in the courts of law. The statement of 85% of potential Sharī'ah non-compliant *ṣukūk* in the Gulf by Shaykh Muhammad Taqi Usmani has negated in some way public confidence in the legitimacy and "Islamicity" of *ṣukūk*. This poses a great challenge to the Islamic finance industry to ensure its sustainability within the existing legal regimes in respective jurisdictions.

E. Judges' Awareness and Understanding of Islamic Finance

Despite the strong language used by some judges, the courts still upheld the contractual nature of Islamic financial transactions. The courts recognised the transactions were in principle Islamic in nature but they construed them as commercial in character and therefore subject to the general principles of contract law as applicable in English law. Since the majority of the judges are trained in English law, their decisions in Islamic finance cases are also heavily influenced by their understanding of the common law approach.

Of all of the cases listed in this article, none of the judges, except in the cases of *Tan Sri Khalid Ibrahim v BIMB* in Malaysia and *Investment Company of The Gulf (Bahamas) Limited v Symphony Gems N.V. and Ors* in the United Kingdom, have referred to expert opinions for Sharī'ah deliberation. The passive attitude by the courts towards referring to Sharī'ah experts to resolve Sharī'ah issues indicates to a certain extent their uneasiness in accepting Sharī'ah as one of the sources of law.

This situation is different in Malaysia, after the introduction of the CBA in 2009. To date, the SAC's rulings are binding on the courts and arbitration in Malaysia. This referral system preserves the sanctity of Sharī'ah rulings and consistency in the interpretation and application of Sharī'ah principles in Islamic finance transactions in Malaysia. For adjudication purposes, a dedicated judge in the commercial division of the High Court has been assigned to preside over litigated cases on matters relating to Islamic finance. Those judges shall refer to the SAC for questions or rulings relating to the Sharī'ah and these rulings are binding. Malaysian courts therefore are well equipped to uphold the sanctity of Islamic financial contracts as they have the avenue to

make references. They have the capability to preside over such cases and give firm, consistent decisions with the backing of the SAC's rulings.

F. Competency of Lawyers

Based on the overall observation of the legal defence raised by the lawyers in Islamic finance cases, the Sharī'ah defence was found to be merely a lawyer's construct. Most of the Sharī'ah issues argued in the Islamic finance disputes were constructed by the lawyers' understanding of principles of *fiqh al-mu'āmalāt* in which some of them had limited knowledge. Moreover, most of the contractual agreements in Islamic financial contracts are drafted by lawyers that are heavily influenced by the English legal drafting techniques (Balz, 2004: 132). This leads to the conclusion that Islamic finance faces a serious problem of lack of legal expertise in both Islamic and conventional finance. The trend of merely arguing the cases on the ground of Sharī'ah non-compliance to a certain extent is unethical, such as in the case of *Investment Dar Co KSSC v Blom Developments Bank Sal*. It would have been manifestly unjust for the customers or Islamic banks to avoid their liability by raising the Sharī'ah defence whereas having previously agreed on the form of the agreements and Sharī'ah validity.

At this juncture, the expansion of the human capital development initiative, particularly in lawyers, judges and any individual or institutions in the legal fraternity is a necessity. There must be appropriate and sufficient measures to ensure that players within the legal fraternity are properly trained in Islamic finance. Islamic financial contracts should be prepared, documented and examined not only within the context of the law of national and international finance but also within the Sharī'ah rules and principles. Considering the trend of lawyers in preparing legal documentation by mimicking the practices of conventional finance, it is imperative for them to change this attitude and to adopt a more innovative approach which lays emphasis on the substance of Sharī'ah principles.

G. Sharī'ah Governance

Islamic finance disputes have potentially exposed the Islamic finance industry to significant Sharī'ah non-compliance risks. In the case of *Investment Company of the Gulf (Bahamas) Limited*

v Symphony Gems N.V. and Ors, Dr. Yahya Al Samaan and Dr. Martin Lau as the Sharī'ah experts have questioned the validity of *murābahah* agreements. Similarly in the case of *Arab Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors*, where the court itself declared the invalidity of the BBA financial transaction. In addition, disputes on the compliance of the *wakālah* agreement in the case of *Investment Dar Co KSSC v Blom Developments Bank Sal* have indicated the importance of strengthening Sharī'ah governance by empowering the roles of the Sharī'ah board, Sharī'ah review and Sharī'ah audit functions.

With the assumption that Islamic finance cases are likely to increase in the future in parallel with the significant growth of this industry, the risk of Sharī'ah non-compliance then should be mitigated through having a sound Sharī'ah governance framework. The regulatory authorities should then give due attention to the suitability and procedures of Sharī'ah governance, particularly the legal status of Sharī'ah resolution, legal avenues for disputes involving Sharī'ah issues and mechanisms of monitoring and supervising Sharī'ah compliance. At this juncture, the Malaysian approach of Sharī'ah governance by establishing a centralised and highest Sharī'ah authority for reference in the matter of Sharī'ah may be a good model for possible adaptation. In fact, the Malaysian regulator has further enhanced the quality of Sharī'ah governance in the Islamic financial services sector by reviewing the existing Guidelines on the Governance of Sharī'ah Committee for the Islamic Banks 2004 (BNM/GPS 1) and replacing it with a more comprehensive guideline, namely the Sharī'ah Governance Framework for IFIs 2010.

V. CONCLUDING REMARKS

This paper has examined the development of Islamic finance cases in four different jurisdictions. Following on from the analysis in the preceding discussion, this paper suggests that a jurisdiction with a flexible and comprehensive regulatory framework with proper legal infrastructure to support the implementation of Islamic finance provides a better environment for the development and sustainability of the industry. This is actually supported by the report of the governors of the central banks of the OIC countries in 1981 on the "Promotion, Regulation and Supervision of Islamic Banks" (Chapra

and Ahmed, 2002: 76), as well as by the World Bank Note on Risk Analysis for IFIs (Greuning and Iqbal, 2008: 193). Dating from the earlier court cases on Islamic finance until today as discussed in this paper, it is observed that the courts' attitudes and approaches towards Islamic finance disputes have also evolved along with the development of the industry.

Considering the continuous legal uncertainties, the polemics of governing laws, the distinct interpretational approach and the different positions on the status of Islamic law as a recognised law of the land as argued and debated in the courts, it is important to have a proper, sound and clear legal environment to support the implementation of Islamic finance. In order to mitigate any sort of legal risk as well as Shari'ah non-compliance risks which are most likely to be disputed in courts, the ideal legal framework for Islamic finance must be characterised at least by four important features. Firstly, in order to foster confidence in investors and consumers, there must be an enabling environment that accommodates and facilitates its implementation. Secondly, the enabling legal environment must be supported by a clear and efficient system that guarantees the enforceability of Islamic financial contracts. Thirdly, Islamic finance needs a credible and reliable legal avenue for settlement of legal disputes arising from Islamic finance transactions. At this point, alternative dispute resolution seems to be the best alternative to court proceedings which can streamline the resolution of disputes and avoid the need for court proceedings. Finally, a sound legal framework is dependent on the instrumental function of its legal fraternity. Lawyers, judges, legal advisors, Shari'ah scholars and other professionals in Islamic finance should acquire sufficient knowledge on the traditional Islamic legal concepts and be able to apply them in the context of modern finance and the law of international finance. All of these features are the prerequisites of a sound legal framework for the Islamic finance industry.

As has been seen through the preceding court cases, there are some similarities and differences between the legal and Shari'ah issues involved. The level of complexity and seriousness of the issues is also different. As Islamic finance grows towards market maturity and product sophistication, more disputes and lawsuits are also likely to occur and this will be a greater challenge to the industry. Yet, until Islamic finance is fully developed, the courts will continue to rule and make decisions on Islamic finance cases. At this juncture, the support of the Islamic finance legal fraternity has been

important in the advancement and significant growth of Islamic finance. The existence of appropriate laws and well-developed related institutional infrastructure has been fundamental to the orderly and sound development of Islamic finance. This triggers the need for extensive research and specific study on an ideal and sound legal regime for Islamic finance disputes and litigation.

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