

What happens when Islamic Finance transactions go wrong? The use of arbitration to resolve disputes

Tom Ross: K&L Gates, London
Peter Morton: K&L Gates, London
Hussain Khan: K&L Gates, London

www.klgates.com

Sharia Compliant Finance and Applicable Law

- Huge growth in Sharia compliant products.
- Many Sharia compliant finance transactions are governed by English law or the law of another country.
- Sharia is a set of moral and religious principles rather than a codified body of laws.
- Sharia compliant transactions may involve parties from many jurisdictions.

Tendency to Favour Litigation

Historic reasons for antipathy towards arbitration:

- Scepticism towards alternative forms of dispute resolution amongst entities working in Sharia compliant finance e.g.
 - Current practice in Malaysia.
 - Aramco and experience in the Kingdom of Saudi Arabia.

Issues to Consider When Choosing Traditional Litigation

Two principal issues:

- Difficulty of reconciling English law (and the laws of other jurisdictions where the Rome Convention applies) with Sharia principles, e.g.
 - Beximco: Sharia law not capable of being a governing law.
 - Halpern: Detailed contractual provision required to incorporate Sharia principles.
 - Lack of judicial understanding of Sharia principles.
- Enforcement

Beximco

Beximco established:

- Sharia was not capable of being a governing law for the purposes of the Rome Convention.
- Sharia law was not capable of guiding the application of English law, as there were as there were too many possible interpretations of Sharia law.

Halpern

Halpern established:

- If Sharia law principles are to be contractually agreed then these need to be spelt out or “black letter” anything less is too uncertain.

Judicial Understanding of Sharia Law

"Litigation is not geared towards solving these cases. Judges often lack education in many industry principles" (Prof. Andrew White, International Islamic Law and Finance Centre, Singapore, July 2011)

"More often than not, judges have made flawed statements relating to Shariah banking and finance principles" (Nik Norzul Thani, Chairman Zaid Ibrahim & Co, Kuala Lumpur, July 2011)

Enforcement (or location, location, location)

This is a largely practical consideration:

- Choice of jurisdiction must be considered alongside choice of law to determine the likely remedies available in the event that litigation is necessary.
- Where are the assets? Need to consider where the assets of any counterparties are located and the likely ability to enforce any award by the local Court. Is security available (or appropriate)?

Traditional Litigation Can Be Suitable

- Where you have international parties with global businesses and assets in the relevant jurisdictions then traditional litigation may be appropriate.
- English law is flexible and principles can be incorporated into contracts provided that these are spelt out clearly.

But Arbitration Should be Considered ...

Arbitration can also be very well suited to Sharia compliant finance transactions and should be considered as an alternative.

GROWTH OF ARBITRATION IN FINANCE

- Establishment of Panel of Recognised International Market Experts (*PRIME*) in Finance in 2011
- New arbitration institutions / rules aimed at Islamic finance disputes e.g.,
 - Kuala Lumpur - Regional Centre for Arbitration (KLRCA) – Islamic Banking and Financial Services Arbitration Rules, 2007
 - Dubai - International Islamic Centre for Reconciliation and Arbitration (IICRA), 2005
- Inclusion of optional arbitration provision in the standard ISDA/IIFM Ta'hawwut Master Agreement, issued March 2010

IS ARBITRATION THE ANSWER? (1)

Some key features:

- Independent and impartial tribunal (normally 1 or 3 arbitrators)
- Often a neutral venue
- Private and confidential
- Often administered by an arbitration institution
- Arbitral rules provide procedural framework
- Limited grounds of appeal / challenge of the award

IS ARBITRATION THE ANSWER? (2)

Potential advantages:

- Input in selection of the arbitrator(s)
- Ability to select a neutral venue
- Procedural flexibility e.g., can agree ‘fast track’
- Absence of wide ranging ‘discovery’ exercises - IBA Rules of Evidence
- Final and binding - no endless appeals
- Privacy
- Cross-border enforcement - *New York Convention 1958*
- No real alternative?

IS ARBITRATION THE ANSWER? (3)

Potential problems:

- Can be expensive (n.b. fees of arbitrators and institution)
- Can take a long time
- Not all potential venues ('seats') are arbitration-friendly
- No default / summary judgment procedures
- No precedent value in arbitration award
- Multi-party / multi-contract situations
- Enforcement - theory vs. reality

WHY ARBITRATION FOR ISLAMIC FINANCE DISPUTES?

- Selection of decision maker
- Ability to agree on suitable procedure (e.g., KLRCA and IICRA)
- Confidentiality - “*The Sharia fraternity prefer arbitration due to confidentiality ... goodwill means an awful lot to the finance sector*”, Sundra Rajoo, Director of KLRCA
- Possible ability to have dispute decided under non-national system of law (n.b. seek advice / check)
 - e.g., England – s46 Arbitration Act 1996 – see *Sanghi Polyesters Ltd -v- International Investor KCSC* (2000) All ER 93

ALWAYS ...

Consider, and take advice as necessary, regarding

- (i) arbitration law and practice at the seat; and
- (ii) the enforcement regime at the likely place of enforcement

Drafting an effective arbitration clause

The perennial problem

- Often treated as a standard boilerplate provision
- Given little attention
- Insufficient care in drafting
- “Cut and paste”
- Relevant factors not considered
- Not tailored to the dispute

Benefits in having a considered and drafted arbitration clause

- Targeted, swiftly and amicably resolve disputes
- Expedite resolution of disputes
- Avoid lengthy expensive diversions
- Avoid ill suited procedure and unintended results

Essential elements

- Agreement to arbitrate
- Type of arbitration
- Scope of the arbitration
- Method of appointment of arbitrators
- Number of arbitrators
- Place or “seat” of arbitration
- Language of the arbitration
- Governing law of the contract
- Sharia Compliant

Essential element

Agreement to arbitrate

- Key element
- Omission can be fatal to the arbitration proceeding

Essential element

Type of arbitration

- Administered or “institutional”
 - Supervised by an arbitral institution
 - Institution provides procedural rules
 - Assists with appointment of arbitrators
 - Institution may charge fees
- “Ad hoc”
 - Parties decide their own rules and procedure
 - Frequently refer to UNCITRAL Arbitration Rules
 - Difficulties can arise

Arbitral Institutions

UAE

- Dubai International Arbitration Centre (DIAC)
- DIFC LCIA Arbitration Centre
- Abu Dhabi Chamber of Commerce & Industry
- International Islamic Centre for Reconciliation and Arbitration (IICRA)

Qatar

- Qatar International Centre for Commercial Arbitration (QICCA)
- Qatar Financial Centre (QFC)

Egypt

- Cairo Regional Centre for International Commercial Arbitration (CRCICA)

Malaysia

- Kuala Lumpur Regional Centre for Arbitration (KLRCA)

Hong Kong

- International Islamic Mediation & Arbitration Centre (IMAC)

Singapore

- Singapore International Arbitration Centre (SIAC)

Essential element

Scope of the arbitration

- The categories of dispute covered
- Clarity is paramount

Essential element

Method of appointment of arbitrators

- Generally covered in institutionally administered arbitration
- In ad hoc arbitration the procedure should be covered in the clause or by reference to another set of Rules (e.g. UNCITRAL)

Essential element

Number of arbitrators

- Sole arbitrator
- Three person tribunal

Essential element

Place or “seat” of arbitration

- Practical convenience
- Neutrality
- Legal factors
 - Scope for court interference
 - Scope for challenge to the award
 - Ease of enforcement

Essential element

Language of the arbitration

- Ordinarily follow the language of the contract
- Carefully consider cost implications
- Impact on the pool of arbitrators, counsel and experts

Essential element

Governing law of the contract

- Preferably separate from the arbitration clause

Essential element

Sharia compliant

- Take advice on the requirements of the seat
- Having a Muslim arbitrator in a Muslim country
- Minimise risk of award not being enforced

Optional elements

- Procedure
- Remedial powers
- Qualifications of the tribunal
- Confidentiality
- Rights of appeal
- Waiver of sovereign immunity

Common mistakes

No unequivocal choice of arbitration

*“English law – arbitration, **if any**, London according to ICC Rules”*

*“In event of a dispute the parties **undertake to submit** to arbitration, **but in the event of litigation** the Tribunal of Helsinki shall have authority”*

*“Any dispute relating to the Agreement **may** be referred to arbitration. The arbitration will take place in Brussels under ICC rules”*

Common mistakes

Stipulate the seat and institution correctly

*“Any dispute arising under this agreement shall be resolved by arbitration at the **ICC of Zurich**”*

*“Any dispute...between the Parties arising out of or relating to this Agreement which cannot be settled amicably shall be referred to and determined by arbitration in the Hague under the **International Arbitration Rules**”*

Common mistakes

Other errors

“Any dispute arising out of this contract shall be referred to Mr X who shall act as a sole arbitrator”

“Disputes arising in connection with the agreement shall be determined by a single arbitrator to be appointed by the Director General of the World Health Organization”

“Any dispute relating to this agreement shall be submitted to arbitration...the tribunal shall publish its award within 2 months of the terms of reference”

General comments

- Advisable to use short model clauses recommended by the leading arbitration institutions – “tried and tested”
- Depart from model wording with great care
- Don't over prescribe – “less is more”
- Ensure that all of the essential elements are covered
- Not all seats are the same, take local advice as necessary
- Make sure the arbitration clause is Sharia compliant