

# Resolving Islamic finance disputes through international arbitration

The number of Shariah compliant products and transactions has grown enormously over the past decade. Many of the contracts that underpin Islamic finance transactions are governed by English law or the law of another country, not by Shariah law. These types of transactions often take place on a global level, with parties originating from different regions in the world. Given the diverse backgrounds of the parties involved, the specialist nature of the agreements and the potential variety of legal jurisdictions in play, JONATHAN LAWRENCE discusses the considerable benefits in having an authoritative common platform to resolve disputes as they arise in a manner that is guided by the Shariah within a modern commercial context.

## The tendency to favor litigation

Litigation through the courts is the most well-known method of determining disputes. A recent judgment of the UK Tax Chamber of the First Tier Tribunal published on the 15<sup>th</sup> July 2013 considered arguments of religious discrimination under the Human Rights Act 1998 and the European Convention on Human Rights (the Convention). TC:02777 Project Blue Limited [2013] UKFTT 378 (TC) concerned the amount of stamp duty land tax due on a real estate transaction which was funded by an Shariah compliant bank.

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The UK tax authorities contended that such tax was payable on a higher amount than the company contended. The tribunal agreed that there was no evidence that the company was under any religious obligation to use Shariah compliant financing, such that its

decisions were purely commercial: “The motives of the Appellant in structuring the transaction in the way it did are unclear. No directors of the Appellant [...] were called to give evidence. [...] Accordingly, we have concluded that the Appellant has not established that it entered into the Shariah compliant financing for religious reasons and that, therefore it has not shown that it suffered discrimination on the basis of religion contrary to Article 14 of the Convention.”

Various other factors were not deemed sufficient to enable the company to run a religious discrimination argument: for example, the bank dealt exclusively with Shariah compliant finance; the company obtained a Fatwa to certify compliance with Islamic requirements; and there was a contractual acknowledgment in the transaction’s common terms agreement that the transaction documents were consistent with Shariah principles.

Article 14 of the Convention may offer protection from adverse taxation to persons compelled by religious reasons to use Shariah compliant finance. In order to gain this protection from the courts, the religious motivation of using such compliant finance must be evidenced, for example in the minutes of a company’s board meetings. The judgment states: “We do not accept [...] that evidence of intention can be more reliably inferred from the Appellant’s actions than from direct evidence of its directors. The board of directors will usually be the guiding mind of a limited company and the board’s intentions and purposes will usually be attributed to a company.”

So far as the English Courts are concerned: (i) the governing law of a contract has to be either English law or the law of a country; therefore, Shariah law cannot be the governing law of a contract; (ii) it may be possible to

incorporate as a term of the contract certain principles of Shariah law, provided there is certainty as to what is being incorporated, and (iii) there must be strong evidence of a counterparty’s religious motivation in order to rely on any advantages that flow from the deal structure.

The English cases demonstrate that, whilst there has been a tendency to favor court litigation as a means of resolving disputes in Islamic finance, the English courts have at times encountered difficulties in dealing with contracts where the parties have, at least to a certain extent, sought to have their dispute resolved in accordance with Shariah or other non-national laws or principles.

There may be fewer difficulties in electing to have a dispute in relation to a contract decided in accordance with Shariah law by submitting the dispute to arbitration, rather than litigation. Taking the position in England as an example, the English Arbitration Act 1996 (which applies to all arbitrations seated in England and Wales) expressly permits the arbitral tribunal to decide the dispute in accordance with the law chosen by the parties or: “If the parties so agree, in accordance with such other considerations as are agreed by them or determined by the tribunal.” (s46(1)(b)). So in English-seated arbitrations the arbitral tribunal can decide the dispute in accordance with such other considerations as are agreed by the parties, and this could include Shariah law.

## The key features and foundations of arbitration

Arbitration is a non-court alternative method of resolving disputes, where a

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‘neutral, independent arbitrator or panel of arbitrators, known as a tribunal, is appointed by the parties to make a binding decision, known as an award, from which there are very limited grounds of challenge. Arbitration may be either administered (where the arbitration is conducted under the auspices of one of several arbitral institutions) or non-administered/ad hoc (where the parties agree between themselves the rules that will apply to the arbitration, without the involvement of an institution for the arbitration).

Further important features of arbitration include:

1. **Arbitral rules and institutions** — the procedural framework for the arbitration is stipulated in the arbitral rules. The arbitral tribunal obtain their procedural powers from the arbitral rules which are usually much briefer than court rules, and give the tribunal discretion on many matters unless the parties agree otherwise. Parties are able to choose which institution, if any, should administer the arbitration, and therefore, which rules will be applicable to their arbitration.
  2. **Seat of arbitration** — the seat of arbitration is typically, but not always, where the arbitral hearing is held. It is usually expressed as a city. The seat is an important choice as the law of the seat will govern the arbitral procedure. As mentioned above, all English-seated arbitrations are governed by the Arbitration Act 1996. The courts of the seat will have certain powers, and the award will be treated as having been made at the seat.
  3. **Neutrality** — arbitration in a third country is often an acceptable alternative when contracting parties are not prepared to submit to the jurisdiction of its counterparty’s local court.
  4. **Finality** — unlike a court judgment, an arbitral award is generally not subject to appeal on the merits, and may only be annulled for jurisdictional grounds or on the basis of serious procedural irregularity giving rise to substantial injustice.
- Whilst this is generally the position, it is always important to check the local arbitration law and practice at the seat of the arbitration to understand the scope for an award to be set aside and the likelihood of court intervention.
5. **Procedural flexibility** — arbitral procedures can be adapted to the circumstances of the contract or matter in dispute much more readily than court procedures. For example, the parties can agree to the location of the hearings, the language of the proceedings and the number and qualifications of arbitrators. In the absence of party agreement, the arbitral tribunal usually has a great deal of discretion on procedural matters.
  6. **Privacy and confidentiality** — arbitral proceedings are generally private and parties may insert confidentiality wording in their arbitration clause (if none exist in the arbitration rules) so that the contents of the proceedings and the award are kept confidential.

### **Drafting the arbitration clause in an Islamic finance contract**

In cases where arbitration is the chosen method of dispute resolution, it will be necessary to include in the contract a suitably drafted arbitration clause. Parties and their counsel should consider carefully, as a minimum: the seat of arbitration and the laws which would be applicable due to this choice, and importantly, whether the seat of arbitration and the anticipated jurisdiction for enforcement are signatories to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

The New York Convention seeks to provide common legislative standards for the recognition of arbitration agreements and for court recognition and enforcement of foreign arbitral awards. The clause should also include the rules of any institution the parties wish to use; the categories of dispute covered; the method of appointment and number of arbitrators; the language of the arbitration; and the governing law of

the contract, which should preferably be stated outside of the arbitration clause.

Legal advice should be taken to ensure that the proposed choice of governing law will be respected in the arbitration. For example, whilst an election by the parties to have their dispute referred to arbitration and decided in accordance with Shariah law should be respected for arbitrations seated in England (per s46(1)(b) of the Arbitration Act 1996), that is not necessarily the case in all seats of arbitration.

Special care should be taken in seeking to draft arbitration clauses for multi-party arbitrations and multi-contract arbitrations. Optional provisions which may be considered for inclusion in the arbitration clause include, for example, making provision for: a specific procedure to be followed relating to the disclosure of evidence; allowing for remedial powers, such as interim relief; rights of appeal; confidentiality; and the qualifications of the tribunal.

In order to avoid ending up with an ill-suited arbitration procedure, it is very important that the arbitration clause is given careful consideration at the time of contracting, and appropriate legal advice is taken. It is unfortunately the case that all too often the arbitration clause is very much the ‘midnight clause’ thrown in at the last minute without due consideration. This can have very serious time and cost consequences if a dispute should arise and can seriously hamper a party’s ability to obtain a fair and efficient resolution of a claim.

### **Conclusion**

The Quran and Sunnah repeatedly stress the importance and benefits of settling disputes quickly and discreetly. International arbitration is a method that can be used to achieve this. When parties have carefully considered and drafted international arbitration clauses in their Islamic finance agreements, they can have greater confidence that any disputes which may arise will be handled in an equitable, confidential and most importantly, Shariah compliant manner. <sup>(f)</sup>

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