CHAPTER 30
Dispute resolution

30.1 Introduction

From a niche subset of conventional finance to a lucrative alternative, Islamic finance has grown remarkably over the last 30 years. Muslim and non-Muslim governments, corporations and individuals are entering this market, leading to the development of new products to meet demand; economies of scale are being realised, prices are decreasing and products are becoming competitive. This has led to regulatory changes to accommodate Islamic finance with tax discretions and legal recognition of products. The trajectory of Islamic finance is thus onwards and upwards.

While this is positive, Islamic finance finds itself in a paradoxical situation. Ostensibly following the Shari'a, products are issued under a secular legal framework. In the event of a dispute, they are judged according to rules and regulations which can be contrary to the Shari'a. If this is allowed to continue, this will weaken the edifice of Islamic finance. Several commentators have added that without the establishment of a specialised body which judges Islamic finance institutions according to the Shari'a, true Islamic finance cannot be fully realised. The current practice where Islamic banking and finance disputes are heard and determined by the civil or common law courts will be counter-productive to the practice of Islamic banking and finance.

It is therefore imperative for the maturity of the Islamic finance industry to develop a dispute resolution system whereby Islamic finance transactions are judged according to the precepts of the Shari'a. The intellectual framework of Islamic finance is based upon looking at classical Islamic law, and deriving principles to be utilised for modern day financial transactions. If Islamic finance products are to work according to the Shari'a, they should be judged according to the Shari'a in the event of a dispute. Today, there is an opportunity to establish Shari'a based courts which will not be anachronistic but integrate seamlessly into the modern day legal framework: an example of legal pluralism.

30.2 The importance of a Shari'a court

The legal framework of a society is heavily based on the culture and traditions of its people, and this is important to have in mind when considering dispute resolution. It is argued that legal polities start from their dispute resolution processes from different points and have differing objectives. Broadly speaking, the differences between the western approach (the European based common and civil law systems) as compared to the Islamic approach usually revolve around the dichotomy of individualism and community. The former concentrates on the individual, whereas in an Islamic context, priority is given to ensuring congeniality in future relationships. Conflict is considered to be negative and threatening to the normative order and needs to be settled quickly or avoided altogether.

Arbitration has been seen by many as a panacea to the problem of accommodating the Shari'a into a non-Shari'a framework. In international transactions, parties can either opt to be judged according to a national court or laws and procedures that they define through the process of arbitration. Consequently, arbitration provides parties with flexibility, and freedom from the constraints of national courts.

In Malaysia and the UAE, there are Islamic finance arbitration centres, respectively The Kuala Lumpur Regional Centre for Arbitration and International Islamic Centre for Reconciliation and Commercial Arbitration for Is-

lamic Finance. The Kuala Lumpur Regional Centre for Arbitration in Malaysia came out with its Rules for Arbitration (Islamic Banking and Financial Services) in 2007. The rules closely mirror those of the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules, with modifications made only to meet the unique needs of Islamic finance in the case where the dispute arises from the Shari'a aspects of the transaction. Rule 39 of the Islamic banking rules requires the application of both Shari'a and the law chosen by the parties, while Rule 33 rules requires that opinions made on points relating to Shari'a, be referred to either the Shari'a council or a Shari'a expert.

Unfortunately, neither centre is extensively used by commercial parties. While there has been no extensive survey as to the reasons, industry experts have presumed that parties do not have confidence that arbitral awards will be enforced or that they can be circumvented. Litigation provides more certainty as the state represents the authority which will enforce a judgement. It is one of the reasons that parties are more comfortable with having English or New York law to govern the contract as opposed to Saudi Arabian or Malaysian law. Litigation also offers a beleaguered party the opportunity to enforce their rights whereas arbitration looks to reconcile parties and can derogate a party's rights in order to ensure common good. Thus, the clamour for Islamic finance arbitration rests not only on the expediency of judging according to the Shari'a, but also on the notion that antagonistic parties will be able to resolve their issues in a mutually beneficial and conciliatory manner; a process which will establish self evident truths agreed upon by all parties. But, one should not be so naive to think that commercial transactions are pervaded by communal, altruistic motives. Profit maximisation parties will seek to gain and succeed in securing their rights in the event of a dispute, and this therefore necessitates litigation processes involving the court.

Currently, most Islamic finance contracts are governed by non-Shari'a laws. International commercial parties have, broadly speaking, resorted to English or New York law to govern Islamic finance contracts. Both systems of law are respected, time tested, efficient and provide effective enforcement procedures. The product maybe Shari'a-compliant, but in the event of a dispute, courts will judge according to these 'secular' based laws. This poses an immediate contradiction and one which brings a series of problems to the fore. Firstly, the philosophy of judging according to the Shari'a as opposed to judging according to a secular based law differs, and this is bound to affect the quality of the judgement. Secular courts will not understand the finer details and nuances of Islamic law; secondly, with respect to judgement outcomes, Islamic law differs from secular law in terms of recouping damages due to the prohibition of gharar and riba; and finally, there is an opportunity for parties to evade Islamic law in a secular court if judgements go against them.

These are considerable problems which have, by and large, been avoided as there have been few Islamic finance cases which have gone to a secular court. However, of the few that have gone to court, the aforementioned problems have arisen. In English courts, judges have conceded that it is not expected, nor should it be expected, that they should judge the case from a Shari'a standpoint. English law therefore triumphs over Shari'a law, and consequently disputes shall be judged according to English legal principles and the facts at hand. References to Shari'a only indicate that the transaction will follow Shari'a precepts, but this did not elevate it to the governing law of the contract. According to the seminal UK case of Beximco Pharmaceuticals Ltd v Shamil Bank of Bahrain ('Beximco), courts will judge according to the literal meaning of the words within the contract, without having recourse to the Shari'a.

A worrying trend in the few Islamic finance cases heard has been for disputants to claim that the contract was not valid according to Shari'a: we see this argument being used in Beximco and in the more recent case, Investment Dar v Blom Bank. In the former, the judge regarded this argument as a 'lawyers construct', highlighting the subtle problems that may arise through representative advocacy and the adversarial process. As a side point, it is interesting to note a hadith from the Prophet, who states 'You bring me lawsuits to decide, and perhaps one of you is more skilled in presenting his plea than the other, and so I judge in his favour according to what I hear'. Unfortunately, by arguing that a contract is not Shari'a-compliant, after it has been given the rubber stamp by the Shari'a Supervisory Board serves to weaken the veracity of Islamic finance.

In Muslim countries, analysing the courts approach to Islamic finance contracts is laden with difficulty. The transparency of the court systems in most Muslim countries is poor and thus information is thin. It would be reasonable to assume that Saudi Arabia, whose legal system is based on the Shari'a (more specifically the Hanbali school of thought), would offer an appropriate choice of law for Islamic finance contracts. Unfortunately, Saudi Arabia's court system is hampered by bureaucracy, delays and a lack of enforcement of judgements, which deters commercial parties. The international community do not feel comfortable with the Saudi legal system. Iran and Malaysia are also viewed adversely, though Malaysia's legal system does not claim to be based on the Shari'a.

Thus, considering the legal differences between civil/common law and the Shari'a, it is imperative for a Shari'a court to be established. Unfortunately, with the failings of the legal systems in Muslim countries, there does not seem to be space for this to be achieved. However, the flexible and fluid international legal system presents other opportunities for realisation of a court.

30.3 Legal pluralism

The problem that confronts us is broadly speaking a geographical and contextual one. Each country has its own legal system, one which is conducive to the culture and needs of that particular country. The imposition of a Shari'a court would be anachronistic within a certain system which has its own specific laws and processes. Consequently, it may be worth considering an international Shari'a court, one which has a codified set of rules and with acceptance across the globe, rather than a na-

tional Shari'a court.

This may not be as bold a suggestion as it seems at first glance. Legal pluralism, where different systems can coexist together is a staple feature of all legal systems. According to legal scholar John Griffiths,[2] legal centralism – the idea that there is only one type of law, namely that enacted by the state - is a myth and that legal plurality is evident in all social arenas. A legal system is pluralistic when the sovereign tolerates the application of different legal systems for different groups.

Ido Shahar (2008)[1] divides legal pluralism into two categories:

1.) Legal pluralism in the strong sense – An agent can appeal to more than one tribunal of law

2.) Legal pluralism in the weak sense – The legal system assigns specific tribunals to specific categories of the population.

Leaving aside the latter, we see examples of strong legal pluralism in the western legal frameworks, especially in the sphere of alternative dispute resolution processes. Arbitration is become increasingly popular amongst commercial parties and is regulated by a number of domestic and international laws. The New York Convention provides a legal framework for international commercial arbitration which offers two crucial features in ensuring strong legal pluralism. The first is the autonomy given to parties to design dispute resolution procedures which includes choosing, if desired, the law by which the arbitration should be judged by. The second is that arbitral awards is recognised and enforced in by signatories to the convention which include many of the world's commercial hubs.

Not all parties will be keen on arbitration, and undoubtedly commercial litigation using the courts of a country will be used. Notwithstanding this, international law has provided the avenue whereby the judgements of the courts of a sovereign nation can be recognised, once again strengthening the idea that western legal frameworks have a place for pluralism. As noted above, western court systems do not recognise Shari'a. However, European law has granted courts within the EU the power to recognise foreign judgments. Article 3 of Regulation No 593/2008 of the European Parliament states 'A contract shall be governed by the law chosen by the parties'. However, 'the law' is understood to be the law of a sovereign country. This point was raised in Beximco case in which the Court of Appeal stated 'The doctrine of incorporation (of another law besides English law) can only sensibly operate where the parties have by the terms of their contract, sufficiently identified specific 'black letter' provisions of a foreign law or an international code or set of rules apt to be incorporated as terms of the relevant contract such as a particular article or articles of the French Civil Code or the Hague Rules'. The problem for the litigants was that there has been no codification of the Shari'a.

It would therefore be beneficial for the Islamic finance industry to codify the Shari'a. Unfortunately, as most Islamic finance practitioners would attest, the Shari'a is not a fixed set of laws. The Shari'a is the cumulative attempts of Islamic scholars to define laws based on several sources, the key being the Quran. In this regard, there is a diversity of opinions in the Shari'a. In a modern day context, the differences of opinion have been seen as an obstacle to the development of Islamic finance. There have been calls for standardisation of contracts in order to provide certainty. Others have disagreed with standardisation, arguing that this goes against the ethos of Islamic law which promotes diversity of thought. However, a platform on which this diversity can coexist while facilitating certainty in transactions would reconcile the conflict. This is not out of the realms of possibility and in fact we have evidence from history where it has worked successfully.

30.4 Legal pluralism in the Shari'a

While in the seats of power a certain school of thought would be encouraged, it was difficult to ensure that all citizens followed the same school. Standardisation was difficult to achieve. Therefore within a single jurisdiction, the four schools would co-exist though not at all times harmoniously. It was a concern for Sultan Baybars (1260 – 1277) who saw how, by allowing the courts to be under the jurisdiction of one school of thought, namely the Shafi school, other schools were being shunned and strict opinions of the Shafi school were being utilised at the expense of its citizens. In 1265, Sultan Baybar appointed four judges in Cairo, one to represent each of the four schools of thought in Sunni Islam, to judge according to the jurisprudence of their respective school. The judiciary of Damascus was similarly reformed the following year. Over the next century four judges were appointed in other towns and cities. By the latter half of the fourteenth century, Aleppo, Tripoli, Hama, Safed, Jerusalem and Gaza each had its own quadruple judicial system.

The appointment of judges from one of the four schools continued up to the Ottoman conquest at the beginning of the sixteenth century. Scholars believe that the establishment of the quadruple judge system was to restore flexibility in the legal system which had become rigid. It was recognised that certain acts were permissible under certain schools, whilst prohibited by other schools. By having a coexistence of the four schools, individuals had the opportunity to go to a judge who offered an opinion which would be aligned to their requirements. This did not contravene the broad desire by the state and the judiciary, that the schools of thought should retain uniformity in jurisprudence. It was important in maintaining rule of law. Therefore, while there were different schools of thought coexisting as laws of the state, the schools themselves continued to follow the principles of law that defined them. This adherence is known as taqlid.

Within the quadruple judiciary in Sultan Baybar's Cairo, the Shafi chief judge retained overall responsibility for the proper functioning of the system as a whole. One of his tasks was to ensure that non-shafi judges did not deviate from the doctrines of their respective schools.

[1] Shahar, Ido (2008) "Legal Pluralism and the Study of Shari'a Courts" Islamic Law and Society, Volume 15, Number 1, 2008 , pp. 112-141.

[2] Griffiths, John (1986) "What is Legal Pluralism?", Journal of Legal Pluralism and Unofficial Law, Volume 24 , pp 1-55.

Bound by the regime of taqlid, shafi judges sometimes would transfer certain cases to judges from other schools, when their school could not offer a favourable decision. In 17th Century Cairo, there is evidence of merchants attending to the judge of the school of thought he felt would accept a particular transaction. Transactions deemed contrary to the principles of a certain school, may have had acceptability at another school and therefore merchants would constitute deeds according to that particular school. 'Forum shopping' was thus identifiable in pre-modern Islamic courts and represents an example of strong legal pluralism.
In the early days of Islamic law, people would trust the opinions of those who had contact with the companions of the Prophet. As the Islamic empire grew, it was necessary to have a trusted system in place to derive legal rulings. The rise of the now well established four schools of thought in Sunnism – when once there were multitudes of legal schools – is the end product of centuries of legal reasoning amongst scholars. Scholars slowly derived a fixed methodology in deriving legal rulings. Beginning in the twelfth century, treatises devoted to Islamic jurisprudence started to assert the right and duty of muftis and judges to follow the opinions of past authorities in their school of law rather than apply their own independent legal reasoning. Mohammad Fadel (1996) argues that this shift from independent legal reason (ijtihad) to following past authority (taqlid) was primarily motivated by the desire to limit the discretionary power of legal officials through the creation of uniform rules. Taqlid allows jurists to work under the purview of a fixed body of laws and therefore follow a 'rule of law': the ideal that officials are bound by prexisting laws. By the 13th Century, scholars from the various schools of thought had created books of law which articulated the position of the school in a particular situation – the mukhtasar. It was imperative to concretise these rules in order to achieve uniformity and certainty. Scholars within their respective schools were required to follow these rules and only scholars who had reached the intellectual summit of their school could change legal doctrine in situations that demanded it. Fadel believes this system had the hallmarks of the modern day common law system

The approach of Sultan Bayber offers a pragmatic way forward. His reforms established a platform on which the four schools could coexist, while at the same time ensuring that the jurisprudential edifice on which the school premised itself remained intact. With the mukhatasar, each school had recourse to a quasi statute book providing certainty for all concerned. A case with no precedent would be judged by judges through legal reasoning with the assistance of higher members in the school. But what is important is that they followed an agreed upon methodology. In the modern day Islamic finance industry, this is what is needed. There are a slew of divergent opinions; the formulation of which is not systematic and arguably does not often follow the established methodologies of the classical Islamic legal schools. A recognised system in deriving law needs to be adopted and it would make sense to adopt the principles and methodology of the accepted schools of thought. If states recognises their methodologies and codifies their rulings in Islamic finance, only then could a Shari'a court flourish.

It has to be emphasised at this point that the key problem that needs to be addressed in the Islamic finance industry, is not the rulings that are issued by the Shari'a scholars and banks but rather the method by which they reached their conclusion. The Islamic legal schools that have been established have a defined methodology, which has historicity. In the Shari'a courts of yesteryear, judges would seek the advice of those bellwether scholars (Muftis) within their school to ensure that they are following the schools methodology and precedents in issuing judgement. Consequently, it is expeditious for rulings to be underpinned by a particular school, as it will make facile the judgement process in a Shari'a court. Not only can the court decide on whether there has been a contravention of the contractual clause, but also assess if the fatwa was formed using the correct methodology. This will increase credibility, transparency and effectiveness of the fatwa making process.

Moving to the present day, the OIC Fiqh Academy has been active in issuing rulings on Islamic finance products using a defined methodology. In terms of codification, AAOIFI and the IFSB have been especially prominent in issuing standards and codifying them. Recently, Malaysian based research institute, ISRA, teamed up with Kuwait Finance House to translate their Shari'a rulings and Shaykh Yusuf De Lorenzo has translated a series of rulings by Gulf banks.

While these are steps in the right direction, without state recognition, an element of arbitrariness will resonate though Islamic finance rulings. It is important therefore for the state to support and ensure judicial recognition. In this regard, only Malaysia is making any real progress. The approach of Malaysian courts to Islamic finance contracts has evolved since the early 90s. As a common law jurisdiction, Malaysian courts were initially unwilling to judge according to the Shari'a. However, recently there has been a greater willingness by judges to address Shari'a issues though they still remain untrained on Shari'a law. Furthermore, Malaysia is making great strides in reforming their legal system to accommodate and judge Islamic finance contracts according to Shari'a precepts. The law of choice harmonisation committee, constituted in 2010, and referred in an earlier chapter, represents a fledgling attempt to bring the Shari'a precepts into the common law.

Yet there is a conflict between Middle Eastern institutions and Malaysia in regards to Islamic finance rulings. Malaysia is regarded as being too liberal; the Middle East is regarded as being too conservative. It is difficult for them to reconcile, but as mentioned above this is not necessarily a problem provided there is acceptance of the methodology utilised in deriving the rulings.

30.5 Conclusion

Critics argue that the common law system of England and Wales has the tools to deal with Islamic finance issues; if not from a Shari'a perspective, certainly from a commercial one. This is exactly the problem. The Shari'a, while compromising a spectrum of views and opinions, is based on two key sources which define its legal framework and more specifically its philoso-

phy: the Quran and the Sunnah (acts and sayings of the Prophet Muhammed.) The premises of these two are not similar to the premises of English law (or any other non-Shari'a jurisdictions), and therefore its approach to adjudicating on Islamic finance disputes will certainly be different.

This is important to remember, especially when considering the authenticity of Islamic finance. Many believe that Islamic finance is not Islamic - though mainly from an ethical standpoint. The premise will be reinforced if Shari'a principles are judged from a non-Shari'a perspective, and by judges without the requisite training in Shari'a. It should not be expected that those who have not had the training should judge according to the Shari'a just as it should not be expected that someone with Shari'a training should judge according to a system law he/she has had no experience in.

Therefore, the creation of a Shari'a court provides the avenue for adjudication based on Shari'a law. It was hoped that arbitration would fulfil this need but it has not appeared particularly successful, possibly due to the informality of arbitration. It would therefore be favourable for a state to create the legal framework for the Shari'a approach to be manifested. Malaysia is certainly on this path forward.

But Malaysia will adopt an idiosyncratic approach to integrating the Shari'a, as do other countries that purportedly base their legal system on the Shari'a, such as Saudi Arabia and Iran. Additionally, Islamic law is a composite of many different opinions, which at often times are similar, but occasionally contrary. The differences of opinions have been problematic in stimulating certainty in the industry. However, this can be resolved by taking lessons from the actions of Mamluk Sultan Baybar, in the 13th century, who instituted the quadruple judiciary, where the four schools of legal thought in Sunni Islam were allowed to coexist. An example of strong legal pluralism, parties had the option of choosing a particular school by which their commercial transaction would be underpinned.

However, in the modern day context, the methodology used to derive rulings has to be uniform according to a particular school and that a school's rulings should be codified and recognised. The Hague rules, is an international treaty on the carriage of goods by sea. This is globally recognised and accepted in courts of law throughout the world. Similarly, the various established schools of law under Islamic should also be codified and recognised.

Once achieved, it will allow the creation of an international Shari'a court – similar to the International Courts of Justice which works outside of state authority. The creation of an International Shari'a court in Islamic finance may be idealistic. Currently, there is no real support for it and countries such Malaysia and Bahrain are moving forward independently, changing regulations, and creating a system which supports and encourages the progress of Islamic finance. But it is an idealism that will strengthen Islamic finance, and more specifically the judgement of commercial disputes between parties transacting on the basis of the Shari'a.

[i] IMF (2009)

[ii] Van Den Berghe (2009)

[iii] Becht 2009:2.

[iv] Kirkpatrick(2009)

[v] Edelman (2009)

[vi] IMF (2009)

[vii] IMF(2009)