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INSIGHT

24 January 2015

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ICC France International Banking Summit, "Trade Finance Today : Dispute Management And Innovations". 18 November 2015, Paris.

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IBA Annual Conference, « Resolving Commercial Disputes in the Arab Region — The State of Arbitration, Litigation, Mediation, and Enforcement in the Middle East", 5 October 2015, Vienna.

October 2015 *click here to view*

ICC Switzerland Conference on International Arbitration and Economic Sanctions, 24 September 2015, Zurich.

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ICC Austria 10th Global Conference on Bank Guarantees, 8 June 2015, Vienna.

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Arbitration in Islamic Finance

Whether consisting of straightforward murabaha or more complex tawarruq or Tahawwut, contracts of Islamic fiqh used in modern finance raise a difficult question: which law should be chosen to govern the contract with a view to achieving both legal certainty and consistency with the ethics of Islam that drove the investor into the transaction in the first place?

Almost all international contracts of Islamic finance refer to a national law as governing law. And this law is seldom that of a State whose law is Shari'a, such as Saudi Arabia or Afghanistan. Often financial institutions involved in Islamic finance choose to submit their contracts to English law. Before the Beximco decision of the Court of Appeal of England, [2004] EWCA Civ 19, references were sometimes made to Shari'a as governing law alongside English law, e.g. "subject to the principles of Shari'a, this contract is governed by English law". In Beximco, the court considered that the reference to Shari'a must be construed as a reference to the bank's ethical principles in doing business rather than to a system of law. It went on to surmise that it would be improbable for the parties to intend that the English court should apply Shari'a in relation to enforcing the contract obligations. Some commentators (including the author of this note) consider that Beximco is case-specific given (a) the concession made by the defendant that the murabaha contract in dispute is governed by English law alone and (b) the rendering of the decision under the Rome Convention on the Law Applicable to Contractual Obligations 1980 which only refers to the parties' choice of "law" (the succeeding Rome I Regulation of 2008 refers to "rules of law"). Yet, the majority of subsequent contracts in Islamic finance were drafted to refer only to a national law with no longer a reference to Shari'a in the governing law clause.

In fact, there was never a debate properly speaking before a court as to the normative nature of the rules of Shari'a as they apply to transactions of Islamic finance (the mu'amalat part, as opposed to the ibadat that relate to faith). This is all the more regrettable when there is a broad consensus that the Shari'a mu'amalat rules are indeed rules of law, albeit non-statutory ones. They apply to regulate the parties' behavior, rights and obligations in transactions and are considered as being binding by the parties which choose to refer to those rules. In a great number of countries, parties to an international contract are free to opt out of a national legal system to have their contract governed by a non-national legal system such as trade usages or the general principles of law. The Shari'a mu'amalat rules share with those two legal systems the same nature and casuistic method of identification of the proper rule.

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And here is where international arbitration could offer an interesting alternative to courts of law in Islamic finance. The legal nature of lex mercatoria was upheld in the 80' due to a consistent line of arbitral awards considering that the arbitrators' application of trade usages is an application of rules of law and that international contracts governed by trade usages cannot be avoided on the ground of being drawn in a legal vaccum. In the same vein, an international arbitral award enforcing the parties' choice of Shari'a as governing law without an additional reference to a national law should likewise be recognized and enforced under the New York Convention, barring one of the exhaustively-listed causes for rejection of exequatur. Recourse to arbitration could therefore offer investors committed to acting in accordance with Shari'a both legal certainty and consistency with their commitment. A similar reasoning brought the International Swaps and Derivatives Association (ISDA) in 2010 to issue its Islamic derivative master agreement with an ICC arbitration clause. This is all the more compelling when knowing that arbitration is enshrined in Islam and has helped averting a major crisis in the earlier days of the new nation when the followers of Ali and those of Muawiyya disputed the caliphate.

So the question arises as to which arbitration to choose? All the major arbitral institutions administer disputes that refer to Shari'a as governing law, whether or not in duality with a national law. In addition, some arbitral institutions were created specifically to administer Islamic finance disputes, such as the International Islamic Center for Reconciliation and Arbitration (IICRA). Other institutions have developed specific sets of rules for Islamic finance disputes (see the KLRCA i-Arbitration rules). This adds obviously to the possibility for the parties to choose non-administered (ad hoc) arbitration. Rather than engaging in a vacuous exercise of listing the advantages and limits of each option, a broad consultation is recommended, one that transcends national, sectorial and cultural cleavages to take stock of existing arbitral initiatives available for Islamic finance disputes, build on the wealth of experiences accumulated by arbitrators, counsel and parties to disputes in relation to Islamic finance and issue a white paper with recommendations for the most efficient dispute resolution system: one that does not oblige parties to choose between legal certainty ex ante and their ethical standards.

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