COMMISSION ON ISLAMIC FINANCE

PROPOSAL

GROUP ON GOVERNING LAW

AND DISPUTE RESOLUTION

IN ISLAMIC FINANCE [©]

21 September 2009

[©] Short citations of this Proposal are permitted and should refer to the Proposal as follows : « Proposal – Group on Governing Law and Dispute Resolution in Islamic Finance », G. Affaki (Ed.), I. Fadlallah, D. Hascher, A. Pézard, F-X. Train, 21 Septembre 2009, to be published.

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In the land of Islam, arbitration has always been considered as a privileged means of dispute resolution. Specifically, it was the means chosen for the resolution of one of the most dramatic crisis in the history of Islam. Ali, the son-in-law of the Prophet, was appointed in controversial circumstances the fourth Caliph following the assassination of the Caliph Osmann. The governor of Damascus, Mouawiya, disagreed with this nomination and took up arms against the new Caliph. The two armies met at Siffin, on the Euphrates River, the first day of the month of Safar in the year 37 of Hegire (657 A.D.). After several days of combat, a truce was decided in order to submit the dispute to an arbitrator. An agreement was reached on the 13th day of Safar according to which two arbitrators, Abou Moussa al-Ash'ari, appointed by Ali, and Amr Ibn al-As, appointed by Mouawiya, were to examine, separately, the Koran in its entirety. At the end of eight months, the first day of the month of Ramadan, they were to meet at Dawmat al-Jandal, near Amman in Jordan, to render their award. The agreement stipulated that their award would be binding on the parties. Mouawiya obtained the Caliphate, and became the spiritual leader. This was the beginning of the Umayyads dynasty.

According to the Tabari Chronicle, 310 Hegire
(translated into English from the French translation of Editions de la Ruche, Paris 2003)

1. INTRODUCTION

1.1 Paris Europlace has established a commission tasked with reflecting on means of receiving Islamic finance in France. Its efforts have led to a series of tax reliefs and legislative measures aimed towards making the Paris financial market more attractive to Islamic capital.

1.2 Within the framework of its mission and as a result of its meeting on 17 December 2008, the Commission on Islamic Finance requested Georges Affaki, of BNP Paribas, to reflect on the perspectives of dispute resolution relating to Islamic finance cases that would be tried before French courts either directly or by way of recognising or enforcing a foreign judgement or an international arbitral award.

1.3 The study of applicable laws and dispute resolution relating to Islamic finance raises the following questions:

- the normativeness of the rules of *Shari'a*,
- the method used to identify the rules of *Shari'a* applicable to a given contract, and
- the compatibility of the rules of *Shari'a* with procedural and substantive French public order.

1.4 To accomplish this task, a Working Group on applicable law and dispute resolution in Islamic finance was created. Its consultations benefited from the enlightened opinions of Sheikh Nizam Yacubi (Bahrain), mufti and *Shari'a* advisor to numerous financial institutions, and of Mr. Michel Baert (France), judge of the commercial court of Paris, both of whom were auditioned by the Working Group in Paris on 23 March 2009.

The objective of this report is to present the Working Group's conclusions.

1.5 Nothing in this report must be interpreted as derogating from Paris Europlace's neutral position concerning the parties' choice of law or court jurisdiction in Islamic finance contracts. Paris Europlace does not intend to pronounce itself in favour of any of the formulas that the parties may use to express this choice, an inventory of which is listed in a descriptive manner in this report.

2. MEMBERS OF THE GROUP

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Chair

Georges Affaki, Member of the Executive Committee and Head of Structured Finance, CIB Legal, BNP Paribas.

Members

Ibrahim Fadlallah, Emeritus Professor of the Université Paris Ouest – Nanterre La Défense,
Dominique Hascher, Chief Judge of the Reims Court of Appeals and Associate Professor of the Université Paris I (Panthéon-Sorbonne),
Alice Pézard, Associate Judge of the Cour de Cassation,
François-Xavier Train, Professor of the Université Paris Ouest – Nanterre La Défense.

Secretary

Nadia Mejri, Ph.D. Candidate at the Université Paris I (Panthéon-Sorbonne).

3. EXECUTIVE SUMMARY

In this report, the Working Group on Governing Law and Dispute Resolution in Islamic Finance reached the following conclusions:

1. The rules of *Shari'a* concerning Islamic finance are rules of law. As such, they should be given effect by the French courts when *Shari'a* has been chosen by the parties to govern their international finance contract. The effectiveness of these rules relies on the principle of party autonomy which has been affirmed in a consistent body of case law typical of the French courts' liberal approach in applying non-State legal rules to international contracts.

2. Their legal character having been recognized, the rules of *Shari'a* chosen by the parties to apply to an international Islamic finance contract are expected to be given effect by the French courts if the relating dispute is directly submitted to them. In the same vein, the rules of *Shari'a* are expected to be recognized by the French courts petitioned to rule on the recognition or the enforcement of international arbitral awards and foreign judgements having applied these rules.

   This constitutes a determining advantage for the Paris financial market in comparison with competing foreign jurisdictions which would not show such openness.

3. The identification by a French court of the rules of *Shari'a* that will apply to a given situation will follow the same method currently used to identify the relevant contents of a foreign law chosen by the parties, an identification in which the parties, assisted by their experts, are expected to participate. The AAOIFI's codification of the rules of *Shari'a* that apply to Islamic finance will largely facilitate this identification process.

4. The effectiveness in the French legal system of the parties' choice of *Shari'a* for their Islamic finance dealings cannot result in evicting French mandatory rules. However, in the event of a conflict, only the rules of *Shari'a* which violate mandatory rules must be evicted, without calling into question the effectiveness of the parties' choice of *Shari'a* as the governing law or the

application by the courts of the other rules of *Shari'a* that do not contravene mandatory rules in France.

5. Upon examination, the relevant rules of *Shari'a* relating to commercial transactions (*mou'amalat*) and susceptible to govern Islamic finance does not reveal contradictions with French mandatory rules. In particular, the prohibition of charging interest, of speculating and of the uncertainty of the contract's object, the main canons of Islamic Finance, do not contradict the French mandatory rules. To the contrary, the non-recognition by a French court of one of these canons would risk disqualifying the disputed contract from being conform to *Shari'a*. Such a hypothesis would surely have a negative effect on the attractiveness of the Paris financial market for Islamic finance and investors.

4. MISSION STATEMENT

4.1 The Working Group set its mission statement as to answer the following six questions :

(1) Are the rules of *Shari'a* relating to Islamic finance rules of law?

(2) If the answer is yes, would French courts give effect to an international contract of Islamic finance, where *Shari'a* is chosen by the parties as governing law, while excluding a national law?

(3) Would the reception by the French courts of the rules of *Shari'a* relating to Islamic finance vary according to whether the parties have chosen *Shari'a* as the governing law without any other specification or rather through a combination of *Shari'a* and French law (or a foreign law)?

(4) How would the French courts identify the relevant rules of *Shari'a* for the Islamic finance case it is asked to adjudicate?

(5) The English courts have repeatedly denied effect to the parties' choice of *Shari'a* as governing law. Is a French court susceptible to have the same approach? If the parties choose arbitration in their contract, and the international award rendered according to the rules of *Shari'a*, while excluding a State law or other non-State legal rules, will the recognition or the enforcement of this award be granted by a French court?

(6) Would the parts of *Shari'a* applicable to commercial transactions (*mou'amalat*) (in opposition with those applicable to religious beliefs (*ibadat*)), contain substantive or procedural rules which would be incompatible with the French mandatory rules?

4.2 At the outset, the Working Group would like to make two preliminary remarks.

(1) This report exclusively deals with international financing and not with transactions typical of retail banking, which reflects the scope chosen by Paris Europlace's Commission on Islamic finance.

(2) The Working Group limited its mission to only examining adjudicative means in dispute resolution (litigation, arbitration), which are more likely to be submitted to French courts. However, the importance in Islam of alternative (non-adjudicative) dispute resolution should be emphasized. Indeed, the *solh* (settlement facilitated by a mediator), recommended in several surah of the Koran,[1] has an important role in dispute resolution due to the tribal organization of the society that witnessed the birth of Islam. The intervention of a mediator with recognized authority allowed for disputes between tribes to be settled rapidly and ensured a peaceful cohabitation regardless of the underlying dispute. For the entirety of the Ottoman rule, the recourse to *solh* remained largely widespread within trade guilds and urban merchants (a process generally organized under the direction of the *shahbandar*, a guild provost) as well as amongst nomad tribes in the Arabian Peninsula. It is still largely used nowadays. Like the conventional alternative means of dispute resolution, the *solh* rests on a contractual basis: the parties must have accepted, in one form or another, a mediator's intervention to settle their dispute. Often, they also accept in advance to be bound by his ruling. Initially, the tribal pressure and the importance for litigants to keep their reputation intact in the eyes of their peers played a persuasive role in ensuring the voluntary respect of the ruling. The survival of the guild mind-frame in the Muslim merchant societies ensures even now a satisfactory rate of voluntary enforcement.

Following the example of numerous other international contracts, Islamic finance is oriented towards integrating, in a parallel fashion or as a preliminary step of a more global jurisdiction clause, an alternative means of dispute resolution. French courts recognize the effectiveness of the parties' choice of such means of dispute resolution and mandate its respect, including

[1] Surah Al-Hojrates, verse 9, surah Al-Nissa', verse 128.

if the need be, by rejecting a petition seeking to bring a case to court without having previously gone through the agreed mediation stage.[2]

This is an additional advantage for the Paris financial market.

[2] Cour de cassation, 1st civil chamber, 9 April 2009, Petition B 08-10.866 (the petition could only be validly submitted in the event that the mediation failed or was refused. The plaintiff could not, in advance, refuse mediation proceedings which had yet to be initiated).

5. REPORT:

GOVERNING LAW AND DISPUTE RESOLUTION RELATED TO ISLAMIC FINANCE BEFORE THE FRENCH COURTS

5.1 ARE THE *SHARI'A* RULES, AS APPLICABLE TO ISLAMIC FINANCE RULES OF LAW?

5.1.1 The Working Group unanimously answered this question by the affirmative. Even though they do not constitute a law, at least in the sense of the codified corpus of law which distinguishes codes in the civil law system, the rules of *Shari'a* applicable to Islamic finance constitute a corpus of rules on social conduct that is both general and abstract, and is meant to be binding and susceptible to be sanctioned by a court of law. These rules irremediably generate legal effects which bind the persons who choose to be submitted to them. This permits to conclude that these rules are rules of law.

5.2 WOULD FRENCH COURTS GIVE EFFECT TO AN INTERNATIONAL CONTRACT OF ISLAMIC FINANCE THAT WOULD BE GOVERNED BY *SHARI'A* AS CHOSEN BY THE PARTIES BUT EXCLUDING ANY NATIONAL LAW?

5.2.1 At the outset, note that the French courts may have to rule on disputes related to international Islamic finance contracts in two situations:

- Directly, as a result of the general application of general jurisdiction rules (for example, by reason of the defendant's domicile) or special jurisdiction rules relating to the subject matter of the litigation (for example, place of performance of a contract, location of tangible assets), or even in application of a jurisdiction clause, or

- Indirectly, in the matter of the recognition or enforcement of a foreign judgement or an arbitral award rendered in connection with an international contract governed by *Shari'a*.

5.2.2 The Working Group considers that the French courts should give effect to the rules of *Shari'a* relating to Islamic finance as non-State legal rules. In doing so, the courts are expected to follow the reasoning which ultimately led to giving effect to the usages and principles of international trade (*lex mercatoria*) as non-State legal rules when they are chosen by the parties to govern their international contract.[3] The Working Group also notes that *Shari'a* may also be given effect as a state, even multi-State, law, due to the choice by the parties of one or more national laws which refer to *Shari'a* as a principle source or as an essential component, as do Saudi or Pakistani laws for example.

5.2.3 The effect expected to be given by the French courts to the parties' choice of *Shari'a* in their international contract of Islamic finance is grounded on the principle of party autonomy. This principle reaches its full capacity due to the French courts' particularly receptive and liberal case law when it comes to international contracts. This favourable reception is presented in the form of two complementary aspects: the freedom to choose a law other than domestic law, and the liberty to choose a non-State law. Indeed, Regulation (EC) No. 593/2008 on the Law Applicable to Contractual Obligations (Rome I) unrestrictively allows the parties to a contract that involves a foreign element, to submit their contract to a foreign law. In this respect, the French courts have even gone as far as to require a judge, when applying a foreign law, to identify for himself the content of this law, in order to settle the dispute accordingly.[4] Furthermore, this liberal approach is not restricted to national laws chosen by the parties to govern their contract. Responding to criticism of the Rome Convention, the new Rome I Regulation specifies in its recitals: "The Regulation does not preclude parties from incorporating by reference into their contract a non-State body of law or an international convention." The Rome I

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[3] Among the particularly abundant case law having recognized the efficiency in the parties' choice of *lex mercatoria* as the governing law, see Paris, 12 June 1980 (2nd Case), Revue de l'arbitrage 1981, p.292, note Couchez ; Civ. 9 December 1981, Revue de l'arbitrage 1982, p.183, note Couchez ; Civ. 2nd, 9 December 1981, Bulletin No. 212 ; Paris 19 December 1982 (*Norsolor*), Revue de l'arbitrage 1983, p.472, confirmed by Civ. 1st, 9 October 1984, Bull. No. 248 ; Paris 13 July 1989 (*Valenciana*), Revue de l'arbitrage 1990, p.663, note Lagarde, confirmed by Civ. 1st, 22 October1991, Journal du droit international 1992, p.177, note Goldman.

[4] Cour de cassation, 1st civil chamber, 18 September 2002, Bulletin 2002, I, No. 202. It is up to the judge ruling on the application of a foreign law to proceed in its implementation and especially, to research its contents in order to render a decision according to this law.

Regulation therefore embraces the French case law which had already welcomed the choice by the parties of non-State legal rules to govern their international contract.[5]

The efficiency in the French legal system of *Shari'a* as the parties' choice to govern their international contract of Islamic finance offers a considerable advantage for the Paris financial market in comparison with competing foreign market places whose courts have not proven to be as receptive.

5.3 WOULD THE RECEPTION BY THE FRENCH COURTS OF THE RULES OF *SHARI'A* RELATING TO ISLAMIC FINANCE VARY ACCORDING TO WHETHER THE PARTIES HAVE CHOSEN *SHARI'A* AS THE GOVERNING LAW WITHOUT ANY OTHER SPECIFICATION OR INSTEAD HAVE CHOSEN A COMBINATION OF *SHARI'A* AND FRENCH LAW (OR A FOREIGN LAW)?

5.3.1 The Working Group has identified several types of governing law clauses which are susceptible to be incorporated into Islamic finance contracts. These clauses consist of the following :

5.3.2 <u>The unitary clauses:</u>

> *"This agreement shall be governed by the principles of* Shari'a*"*,
>
> or
>
> *"This agreement shall be governed by the principles of* Shari'a *as they are codified in the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) standards according to the version in effect on the date of the contract's signature."*

5.3.3 <u>The dual clauses:</u>

> *" Subject to the principles of the Glorious* Shari'a*, this agreement shall be governed by and construed in accordance with the laws of France ,"*[6]

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[5] See note 3, *supra.*

[6] See *Shamil Bank of Bahrein EC v Beximco Pharmaceuticals Ltd and others* [2004] EWCA Civ.19, [2004] 4 All ER 1072.

or

" This dispute shall be governed by the laws of France except to the extent it may conflict with Islamic Shari'a*, which shall prevail*".[7]

5.3.4 <u>*Common Trunc* clauses</u>

"This contract is governed by the principles which are common to French law and Shari'a."[8]

5.3.5 Among the clauses previously listed, the most frequently used are those which submit the contracts of Islamic finance to national laws subject to *Shari'a*. Those are also the clauses that gave way in England to critical decisions such as *Beximco*[9] which testifies to the confoundedness of British judges when confronted which such duality. One of the consequences of the *Beximco* decision in denying effect to the choice of *Shari'a* as governing law was the considerable increase of clauses which submitted Islamic financing solely to English law, without making any reference to *Shari'a* whatsoever. It is difficult to see how in such a case the disputed contract could be considered as being *Shari'a* compliant. Such a restrictive approach would surely constitute a major handicap for any jurisdiction looking to attract Islamic funds.

5.3.6 It should be specified that Islamic finance in its contemporary financial applications has given way to very few court decisions. Other than four decisions rendered by the English courts,[10] the Malaysian courts, belonging to a non-sectarian legal system albeit located in a Muslim country, were also led to settle disputes related to Islamic

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[7] See *Sanghi Polyesters Ltd (India) v The International Investor KCSC (Kuwait)* [2001] Vol 1 Lloyd's LR 480.

[8] The members of the group have not found an example of this type of clause. It however should not be excluded given precedents in international contracts dealing with the joint choice of two national laws or state and non-State rules of law.

[9] Court of appeal (Civil division), *Shamil Bank of Bahrein EC v Beximco Pharmaceuticals Ltd and others* [2004] EWCA Civ.19, [2004] 4 All ER 1072. See G. Affaki, *L'accueil de la finance islamique en droit français : essai sur le transfert d'un système normatif*, « La finance islamique à la française », J. Laramée (Ed.) Bruno Leprince, 2008, p.164.

[10] Chancery division, *Musawi v R E International (UK) Ltd and others*, *per* David Richards J 14 Décembre 2007, [2007] EWHC 2981 (Ch), [2007] All ER (D) 222 (Dec); Court of appeal (Civil division), *Shamil Bank of Bahrein EC v Beximco Pharmaceuticals Ltd and others* [2004] EWCA Civ.19, [2004] 4 All ER 1072; Queen's Bench division (Commercial Court), *Islamic Investment company of the Gulf (Bahamas) Ltd v Symphony Gems NV and others* [2002] EWHC 1; *Sanghi Polyesters Ltd (India) v The International Investor KCSC (Kuwait)* [2001] Vol 1 Lloyd's LR 480. On these decisions, see G. Affaki, *L'accueil de la finance islamique en droit français : essai sur le transfert d'un système normatif, op.cit*., p.163.

finance.[11] The scarceness of these cases does not enable the Working Group to identify with certainty the type of disputes resulting from Islamic finance that the French courts could be confronted with. However, in examining these few reported decisions the Working Group can speculate that the likely object of potential disputes will probably concern the interpretation of the contract's terms and determining the duties that arise thereof. It is very unlikely that a French court would in addition have to decide on the religious normative character of the rules of *Shari'a*. This was confirmed by Sheikh Nizam Yacubi during his audition by the Working Group on 23 March 2009.

5.4 HOW WOULD A FRENCH JUDGE IDENTIFY THE RULES OF *SHARI'A* THAT ARE RELEVANT TO THE CASE THAT IS PENDING BEFORE THE COURT?

5.4.1 At the outset, the Working Group acknowledges that, as in common law and *lex mercatoria*, *Shari'a* must not be seen as a body of pre-existing rules, exhaustively codified and applied abstractly. The application of *Shari'a* essentially consists of a method that ensures, by a casuistic approach using the various sources of *Shari'a*, the identification of rules that respond to particular situations.

5.4.2 The sources of the rules of *Shari'a*'s that govern financial contracts are diverse. The Koran is the fundamental source for the rules of Islam. The *Sunna* is the second source for *Shari'a*. It transcribes the Prophet's Tradition, meaning his speeches, acts and explicit and implied approbations relating to practices that existed during his time. *Shari'a*'s casuistic approach mandates that the relevant rule be extracted from the general principles of the Koran and the *Sunna*. This process, called *ijtihad*, allows competent scholars to use analogical or deductive reasoning such as *qiyas*, *istihsan* and *istislah* to identify the solution to a given problem. The rules thus extracted will have a heightened normative nature were they to benefit in addition from *ijma'*, the *Shari'a* scholars' consensus.

[11] *Affin Bank Berhad v Zulkifli Abdullah*, [2006] 1 CLJ 438, A.H. Buang. See G. Affaki, *L'accueil de la finance islamique en droit français : essai sur le transfert d'un système normatif, op.cit*., p.168.

5.4.3 Whether the *Shari'a* clause is unitary or dual, the Working Group considers that for the rules of *Shari'a* relevant to a given financing to be identified, judges or arbitrators must follow the same approach as used to determine the relevant content of a foreign law or a transnational body of legal rules such as *lex mercatoria*, a process in which the parties and their experts play a determining role. This was confirmed by Judge Michel Baert during his audition by the Working Group on 23 March 2009.

5.4.4 The useful contributions of the *Takhayour* doctrine should be added to this method. Indeed, *Shari'a* admits that the determination of an applicable rule may be done within the terms of a casuistic and syncretistic approach which allows the parties and the judge to choose the rules set by one of the schools of Islamic case law (*fiqh*), which would validate the contract, and if the need be in using *dépeçage* for the different contractual obligations.

5.4.5 The work of the arbitrators and judges in determining the relevant rules of *Shari'a* will without a doubt be facilitated by the codification of *Shari'a*'s legal and financial norms undertaken by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).[12] Through this codification, the relevant rules of *Shari'a* for Islamic finance have acquired a larger accessibility and visibility. This codification may even eventually play the same systematizing and harmonizing role as the Unidroit Principles on international commercial contracts did in relation to *lex mercatoria*. In addition, the methodological and consensual process that was chosen by the AAOIFI in codifying *Shari'a*'s financial norms reinforces their authority. The successive drafts had, in fact, been submitted to the vetting of different committees of the AAOIFI which transcended the rifts among Islamic *fiqh* schools and, hence, met the cardinal test of representativeness, both from a doctrinal as well as geographical standpoint. The *Shari'a* financial norms synthesized by the AAOIFI

[12] The AAOIFI's codification is not the first attempt to compile in a coherent body the rules of *Shari'a* applicable to civil and commercial transactions. In 1863, the Ottoman Empire had promulgated *Majallat al-ahkam al-adlyiyah*, a veritable civil code, according to the *Hanafi* school case law. On the reasons why the *Majalla* was not used as a basis for modern codifications on the applications of *Shari'a* for financial transactions, see G. Affaki, *L'accueil de la finance islamique en droit français : essai sur le transfert d'un système normatif, op.cit*., p.156, foot note 39.

may be incorporated into contracts by a contractual reference[13] or be cited by judges and arbitrators as a persuasive authority in support of their decisions.

5.4.6 In addition, the *fatawa* handed down by *Shari'a Boards*, which are composed of scholars who are competent in financial transactions, will constitute precedents susceptible to be applied to ongoing disputes.

5.5 CONFRONTED WITH APPLYING *SHARI'A* TO ISLAMIC FINANCE, ENGLISH COURTS HAVE DENIED THE PARTIES' CHOICE OF *SHARI'A* FROM BEING EFFECTIVE. IS A FRENCH JUDGE SUSCEPTIBLE TO MAKE THE SAME FINDING? IF THE PARTIES CHOOSE ARBITRATION IN THEIR CONTRACT, AND THE INTERNATIONAL AWARD RENDERED UNDER THE RULES OF *SHARI'A*, WHILE EXCLUDING A STATE LAW OR OTHER NON-STATE LEGAL RULES, WILL THE RECOGNITION OR THE ENFORCEMENT OF THIS AWARD BE GRANTED BY A FRENCH COURT?

5.5.1 The conclusion in this report pertaining to the legal nature of the rules of *Shari'a* applicable to Islamic finance should ensure avoiding decisions from French courts which would track the critical *Beximco* decision. In this decision, the English Court of Appeals saw in *Shari'a* nothing more than religious rules and refused to see its normative character.[14] It grounded its decision on the fact that, when the decision was rendered, only the Rome Convention (and not the Regulation) was applicable and that articles 1(1) and 3(1) of this Convention were generally held as solely

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[13] See. § No.5.3.1 *supra.* Today, thirty norms are published by the AAOIFI in Arabic and in English. Ten additional norms are currently being finalized and will soon be published. A draft of a translation of these norms is currently underway.

[14] Court of appeal (Civil division), *Shamil Bank of Bahrein EC v Beximco Pharmaceuticals Ltd and others* [2004] EWCA Civ.19, [2004] 4 All ER 1072, particularly in No.54 seq. p. 1087. The *Beximco* brings into memory three arbitral awards from the last century in which arbitrators refused to apply *Shari'a* as an essential component of the disputed laws of Abu Dhabi, Qatar and Saudi Arabia due to its alleged absence of legal nature. See, *Sheikh Abu Dhabi v Petroleum Development Ltd* (ICLQ 1952. 247), *Ruler of Qatar v International Marine Oil Company Ltd* (Int. Law Rep. No.20, p534), and *Aramco v Government of Saudi Arabia* (RCDIP 1963, p.272). For an overview of these awards and the errors in reasoning that the courts uphold against *Shari'a*, see I. Fadlallah, *Arbitration facing conflicts of culture*, conference delivered on 4 December 2008 at the Annual School of International Arbitration Lecture.

allowing the parties to choose a State law but not non-State rules of law.[15] In virtue of this argument, the Court in *Beximco* refused to give effect to the parties' choice of *Shari'a* in the contract, a choice that was, in this specific instance, expressed in ambiguous terms while simultaneously choosing English law.

5.5.2 This said, we cannot rule out the possibility of a contention amongst expert opinions concerning the content of the relevant rules of *Shari'a.* The casuistic approach in *Shari'a* leaves large room for the subjective interpretation of the *mufti*. Yet, nothing in this aspect of *Shari'a* will distinguish the approach to be followed in a trial involving rules of *Shari'a* from other approaches followed by trial judges which imply a necessary appraisal for which they have discretion in their role as judges of facts. The judge is expected to render his decision on the basis of factual elements presented to him by the parties and their experts to determine the relevant rules of *Shari'a*. This process will take place without the judge having to query if the rules of *Shari'a* have a normative nature, since such a question remains a question of law for which the answer has already been settled in case law as indicated earlier in this report.

5.5.3 Certain members of the Working Group have expressed more confidence in the recognition of the effectiveness of the parties' choice of *Shari'a* in international contracts of Islamic finance if these contracts provide arbitration clauses. In examining case law from the English courts, one notices in fact the contrast between the effectiveness granted to the parties' choice of *Shari'a* when the dispute is submitted to arbitration[16] and the failure of this same choice and its being replaced by English law where the dispute was adjudicated directly by the courts.[17]

5.5.4 After deliberation, however, the Working Group concluded that the rules of *Shari'a* applicable to international Islamic finance are expected to be recognized as effective in the French legal system, whether it be before an arbitrator or a judge.

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[15] Idem, No.48, p. 1086. Beximco's counsel indicated that the Court of Appeals would have likely given effect to the choice of *Shari'a* if it had taken the form of a national law that applies *Shari'a* or a body of rules that codified *Shari'a* and which was incorporated by the parties by contractual reference, such as the AAOIFI rules (interview with Antony Dutton Esq., on file with the Chair of the Working Group).

[16] *Sanghi Polyesters Ltd (India) v The International Investor KCSC (Kuwait)* [2001] Vol. 1 Lloyd's LR 480.

[17] *Shamil Bank of Bahrein EC v Beximco Pharmaceuticals Ltd and others* [2004] EWCA Civ.19, [2004] 4 All ER 1072.

5.6 WOULD *SHARI'A*, IN ITS PART ON COMMERCIAL TRANSACTIONS (*MOU'AMALAT*) RELATING TO ISLAMIC FINANCE (IN OPPOSITION WITH THAT APPLICABLE TO RELIGIOUS BELIEFS (*IBADAT*)), CONTAIN SUBSTANTIVE OR PROCEDURAL RULES WHICH WOULD VIOLATE THE FRENCH MANDATORY RULES?

5.6.1 The application of the rules of *Shari'a* to international contracts of Islamic finance which are meant to have legal effect in France may raise questions as to its interaction with the fundamental concepts of French public order. The case may arise where, under a financing contract governed by French law as well as by the principles of *Shari'a* a party invokes its choice of *Shari'a* to avoid the application of French mandatory rules.

In the French Legal system, mandatory rules are imperative laws, the respect of which is considered crucial to preserve public interest, to the point of requiring their application to every situation that falls within their scope, whatever the contract's governing law may be.[18]

5.6.2 However, the fact that the French courts have the duty to apply the mandatory rules of the French legal system (and under certain conditions, those of foreign legal systems as well) does not mean that they must deny effect to those principles of *Shari'a* that were chosen by the parties and which do not contradict French mandatory rules. In fact, in an Islamic financing governed by French law, the will of the parties is indeed to have their contract be subject to French law while respecting the relevant principles of *Shari'a*.

5.6.3 In particular, the Working Group considers that a dual clause[19] (and, by a stronger reason, a unitary clause) must not be interpreted as mandating the judge or the arbitrator only to apply the rules which are common to the two systems. A dual clause must rather be interpreted as expressing the will of the parties to have a

[18] Regulation Rome I, Article 9.

[19] See § No.5.3.1 *supra*.

national law govern their contract, with the exception of those parts of the law that would not be consistent with *Shari'a* principles.[20] For example, in the event that French law would be chosen by the parties to govern a loan agreement, which would also be governed by *Shari'a*, the articles in the Civil Code concerning the award of interest – not being part of mandatory laws in France – should be evicted as not being consistent with *Shari'a* principles. Inversely, the reference to *Shari'a* in such a loan should not lead to evicting the mandatory rules relating to bank licensing. Indeed, the choice of *Shari'a* as a governing law may not evict the mandatory rules of the host country where this contract is to have effect.

5.6.4 In any event, if a conflict were to arise between a rule of *Shari'a* and a mandatory national statutory provision, only the conflicting rule of *Shari'a* shall be evicted without having the effectiveness of the parties' choice of the rules of *Shari'a* being questioned. In tandem, the very principle of the disputed contract being subject to *Shari'a* will be even less questioned since this would amount to denying the normative nature of these rules.

5.6.5 Hypotheses of the parts of *Shari'a* governing Islamic finance violating both national and international public order, whether substantive and procedural, turn out upon scrutiny to be rather limited. Indeed, whether one considers a unitary or dual governing law clause, only a few rules of *Shari'a* may be identified as potentially contradicting French public order. Thus, in procedural matters, among the rules of *Shari'a* which are susceptible to contradict public order are :

(i) the legal authority of a woman's testimony. A text from the Koran (Surat *Al-baqara* 282) equates the legal authority of a man's testimony with that of two women's (except for matters which are purely feminine, such as birth, where the testimony of one woman is sufficient, and which are outside of the scope of this study);

(ii) doubts on the jurisdiction of a non-Muslim over a Muslim. These doubts are not based on a text from the Koran, but stem from the *Hannafi*, *Maliki*

[20] *Sanghi Polyesters Ltd (India) v The International Investor KCSC (Kuwait)* [2001] Vol 1 Lloyd's LR 480.

and *Shafi'i* teachings, which prohibit non-Muslims from having jurisdiction over Muslims;[21] and

(iii) doubts on a woman having jurisdiction over a man, but in this matter too there is no basis for any such prohibition in the Koran nor is there a consensus between the different *fiqh* schools. For example, the *Hannafi* accept that a woman has jurisdiction except in criminal law, while the *Shafi'i* schools seem to refuse this.[22]

5.6.6 Questioned by the Working Group during his audition on 23 March 2009, Sheikh Nizam Yacubi indicated that these discriminatory rules are not meant to apply to Islamic finance and that in a number of States with a large Muslim population, including Bahrain, women are regularly named to magistrate positions. The Working Group also notes that in 2008, a female civil judge was nominated in Egypt. Other female judges have already been appointed in other Muslim predominant countries such as Tunisia, Algeria, Morocco and Syria.

5.6.7 While taking into account the testimony of Sheikh Nizam Yacubi, the Working Group concluded that none of the discriminatory rules could be given effect by a French court ruling on Islamic finance. Concerning the possible application of these rules by an arbitral tribunal, it risks annulling the award by contradicting the public policy of the domestic jurisdiction if its recognition or the enforcement of such award were to be sought in France. Arbitrators should therefore refrain from applying these discriminatory rules since it is their duty to ensure the effectiveness of their awards. In addition, the procedural rules which apply to disputes concerning Islamic finance are those of the domestic jurisdiction chosen by the parties in their contract; *Shari'a* would only apply to the substance of the dispute itself.

5.6.8 Concerning the substance of an international contract of International finance, the rules of *Shari'a*, in their financial applications (*mou'amalat*), should be compatible with French public order. In fact, the prohibition of interest (*Riba*), of uncertainty (*Gharar*) or even of speculation (*Maysser*) do not contradict French public policy,

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[21] Relevant extracts of the *fiqh* literature on file with the Working Group's Chair.

[22] *Ibidem*. There is no support for a contrary reasoning that the surat that indicates that men shall prevail over women (surat *Al-Nissa'*, verse 34) is to be read as prohibiting women from having jurisdiction over men.

and in this respect, are not susceptible to constitute a motive to refuse the recognition or enforcement of an international arbitral award or a foreign judgement in France.

5.6.9 However, caution must be used concerning an arbitral award or a foreign judgement's compatibility with international public policy if it were to recognize the *Ijara* transaction carried out by a non-licensed financial institution. If such a transaction were to be qualified as leasing,[23] and if done regularly, the mandatory statutory provisions governing the banking monopoly could be held as applicable. This could lead to the violation of this monopoly being invoked to justify refusing the recognition or the enforcement of an arbitral award or a foreign judgement which would have validated the *Ijara*. Indeed, article L. 512-2 of the French Monetary and Financial Code specifies that "leasing transactions mentioned in article L. 313-7 may only be done regularly by accredited commercial companies licensed as a credit institution." This section is a mandatory rule.

5.6.10 Finally, the Working Group queried if, inversely, there may be a provision in French law which, when applied by a judge or an arbitrator, would be susceptible to disqualify the *Shari'a* compliant character of the contract. After having auditioned Sheikh Nizam Yacubi, the Working Group concluded that it is, above all, the rule prohibiting interest that must be respected by the French courts. It being questioned by the French courts could constitute an obstacle to promoting the Paris financial market as a hub for Islamic financing and investment.

[23] A *Ijara* transaction could take the form of either a leasing agreement or a lease with an option to buy under French law.

6. RECOMMENDATIONS

The effectiveness in the French legal system of *Shari'a* as the parties' choice of governing law in Islamic finance and investments should not give rise to a conflict with French public policy. This effectiveness will be all the more facilitated since it takes place in the matter of international contracts.

A real need for information and training exists however. The Working Group recommends that the Paris Europlace Commission on Islamic Finance considers in its action plan an appropriate communication particularly geared towards magistrates and judges that would reproduce the findings of this report. It should underscore the legal nature of the *Shari'a* rules applicable to Islamic finance, the method to be used for the identification of the relevant rule to the situation at hand, the experience of the courts in other jurisdictions on disputes relating to Islamic finance, as well as an overview of the main contracts of Islamic finance. Such a didactic approach would have the merit of evicting any debate on the fictitiousness of the considered transaction or its economic rationale.

This information effort would be followed, if the need be, by training sessions that would have to be adapted to the various stages of the French magistrate's training courses.

By way of their case law, which favourably receives non-State rules of law in international contracts, the French courts must be considered as a key advantage that the Paris financial market offers Islamic capital providers and a considerable asset in comparison with competing foreign markets where the courts have not proved to be as welcoming.

This is one of France's most significant assets.