

# ISLAMIC LAW IN SECULAR COURTS (AGAIN): TEACHABLE MOMENTS FROM THE JOURNEY

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## Introduction

A trio of English Court cases illustrates some of the issues and complications that arise when secular courts are asked to resolve disputes involving Islamic law, Muslim litigants and Islamic financial institutions. These cases also demonstrate the need for the further clarification and harmonization of Islamic law, particularly in banking and finance. The relevant and dispositive portions of these cases are discussed in Part I of this Section. Part II discusses the lessons and applicability of these cases, and humbly suggests steps that should be considered to promote clarity and predictability in Islamic banking and finance.

## Part I: Case Summaries

### Jivraj v. Hashwani, [2009] All E.R. (D) 272 (Jun)

In *Jivraj v. Hashwani*, the Court was faced with the issue of whether an arbitration clause requiring that "[a]ll arbitrators . . . be respected members of the [Islamic] Ismaili community" violated English anti-discrimination laws or public policy. The Court enforced the arbitration clause.

The parties, Jivraj and Hashwani, were London residents and members of the Ismaili Muslim community. Ismaili Muslims are members of the *Shia* sect of Islam. In 1981, the parties entered into a joint venture agreement for the development of real estate (the "**JVA**"). The disputed arbitration clause (quoted in part above) was contained in the JVA.

Differences arose between the parties and they submitted their disputes for settlement by Ismaili Muslims in accordance with the JVA. After two rounds of arbitration/conciliation, issues between them remained unresolved. In July 2008, Hashwani asserted a claim against Jivraj for a sum certain plus interest compounded quarterly over a period of approximately 14 years. (It is assumed that a claim for compound interest would not have gone very far before a panel of members of the Ismaili community.) Hashwani also applied to the Court for an order appointing an arbitrator, Sir Anthony Colman, pursuant to the arbitration clause of the JVA. The parties stipulated that Colman was not a member of the Ismaili community.

Jivraj sought a court declaration that Colman's appointment was invalid under the JVA. Hashwani demurred, arguing that the arbitration clause was discriminatory, in violation of the Employment Equality (Religion or Belief) Regulations 2003 (the "**EER**"), the Human Rights Act 1998, and public policy. The Court held that the EER, which prohibit religious discrimination in employment, did not apply. The EER applied to

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"employment" relationships having certain characteristics, including employment at fixed places and times, significant accountability to employers, remuneration in exchange for services, relative flexibility in termination, and vicarious liability. In contrast to employees, arbitrators are autonomous, not remunerated as a rule, and removable only by Court order. The arbitrator-litigant relationship lacked the indicia of an employment relationship protected under the EER, and was outside of the EER's proscriptive ambit.

Even if the EER had applied, the challenged discrimination would have been permitted under the EER's "genuine occupational requirement" exception, which applies where "being of a particular religion or belief is a genuine and determining occupational requirement." Jivraj submitted evidence of the religious importance to Ismaili Muslims of dispute resolution, including the Ismaili Constitution, which promotes dispute resolution among its adherents. On the strength of the evidence, the Court concluded that "one of the more significant and characteristic spirits of the Ismaili sect is an enthusiasm for dispute resolution", which constituted an "ethos based on religion."

The Human Rights Act, which prohibits discrimination by "public authorities" (including courts and "tribunals"), was inapplicable as neither Jivraj nor Hashwani was a public authority, and the parties had removed themselves from the Act's reach by contracting for arbitration. The Court rejected Hashwani's public policy challenge on structural grounds, namely that it is not the role of courts to fill real or perceived gaps in legislation "under the guise of public policy."

### **Musawi v. R.E. International (UK) Ltd., [2007] All E.R. (D) 222 (Dec)**

On application for enforcement of an arbitration award, the England and Wales High Court of Justice was required to decide whether an English arbitration award decided under Shia *Shari`ah* was enforceable. The Court held that it was.

In 1987, the Claimant, Sayyed Mohammed Musawi, entered into an agreement with Dr. Sayyed Mohammed Ali Shahrestani for the joint acquisition, development and ownership of a plot of land adjoining Wembley Stadium in London (the "**1987 Agreement**"). At the time, Musawi, a Shia theologian, was the leader of the Shia Muslim community in India and wanted to invest that community's funds to yield income for charitable uses. Shahrestani, also a Shia Muslim, was an architect and engineer with business interests that included construction. Shahrestani was well-known and respected in the Shia community in India. Shahrestani and the two other individual defendants (his nephews) were beneficial owners of the named defendant.

The parties intended the 1987 Agreement to be "Islamically binding." They described the joint venture as a *Mudaraba*. Musawi, as *rabb ul-maal*, was to arrange and provide capital. Shahrestani, the *mudarib*, would contribute know-how, management and other services. They agreed to divide net profits equally.

The parties purchased the Wembley land in 1988, but did not develop the land as planned. Subsequently, they held discussions and exchanged correspondence (the binding effect of which was in

dispute) to determine their respective ownership interests in the Wembley land. Having failed to agree, in September 2003 they agreed to arbitration and entered into an arbitration agreement by which they elected "Islamic legal standards" as governing, and appointed an ayatollah "as arbitrator and Islamic legal judge." The arbitrator issued an award in June 2004. The defendants challenged enforcement of the award on a number of grounds, and asserted a counterclaim. The Court was required to decide whether, *inter alia*, Shia *Shari`ah* was valid governing law in an English arbitration conducted in England.

The Court held that Shia *Shari`ah* was valid governing law, by virtue of the English Arbitration Act 1996, which provides that "[t]he arbitral tribunal shall decide the dispute. . . if the parties so agree, in accordance with such other considerations as are agreed by them or determined by the tribunal." "Other considerations", the Court found, included *Shari`ah* or other non-national law.

**Shamil Bank of Bahrain EC v. Beximco Pharmaceuticals Ltd., [2004] All E.R. 1072; Shamil Bank of Bahrain v. Beximco Pharmaceuticals Ltd., [2003] All E.R. (Comm) 849.**

*\* Note: The following discussion refers to and relies upon both the trial and appellate court decisions in Shamil.*

At issue in *Shamil* was the proper construction and effect to be given under English law to a governing law clause which provided that: "Subject to the principles of the Glorious Sharia'a, this agreement shall be governed by and construed in accordance with the laws of England." The issue arose on appeal from a USD 49.7 million judgment for the plaintiff-appellee, Shamil Bank of Bahrain EC (Islamic bankers), a Bahraini bank. The five defendants-appellants were two Bangladeshi companies, Beximco Pharmaceuticals Ltd. and an affiliate, two directors of those companies, and the companies' parent.

The *Shamil* dispute arose out of two tripartite "*Murabaha*" transactions between the Bank and both the first defendant ("D1") and second defendant ("D2") in 1995 and 1996. In 1995, the Bank advanced to D2, the Bank's agent pursuant to an agency agreement, USD 15 million for the purpose of purchasing goods for immediate onward sale to D1, at a pre-agreed price and on a deferred credit basis. The pre-agreed price comprised the ostensible cost of the goods, USD 15 million, plus the mark-up, which apparently was USD 2,585,583. Payments and re-payments were to commence in March 1996, with a final payment of USD 15,323,322 due on December 28, 1997. The 1996 transaction was identical to the first, except that D2 was the purchaser and D1 was the Bank's agent.

The defendants defaulted on their obligations under the 1995 and 1996 agreements. Negotiations ensued and resulted in two "exchange and satisfaction and user agreements" between the Bank and D1 and D2 (the "**Exchange Agreements**"). The Exchange Agreements purported to discharge the indebtedness under the *Murabaha* agreements (the indebtedness was the unpaid "cost-plus" amount and curiously termed "accrued compensation" claimed by the Bank). In consideration of the debt forgiveness, the Bank obtained "unencumbered title to certain assets" of the first two defendants. The Bank then leased the assets to the defendants in exchange for "user fees" payable in installments. The latter arrangement was

styled an *Ijara*. The remaining defendants guaranteed the obligations of D1 and D2 under the Exchange Agreements. The Bank's *Shari`ah* Board certified for 1995 and 1996, that "all the bank's business throughout the said . . . [period], including investment activities and banking services, were in full compliance with Glorious Islamic Sharia'a." It was not clear from the testimony if the Bank's *Shari`ah* Board had reviewed the disputed agreements.

At trial, it was "common ground . . . [between the parties] that . . . when . . . [they] entered into the Morabaha agreements and subsequently, neither side was under any illusion as to the commercial realities of the transactions, namely the provision by the bank of working capital on terms providing for long term repayment." The defendants argued that the disputed agreements were interest-bearing loans "dressed up" in Islamic garb, and therefore were invalid under Islamic Law, which categorically prohibits the payment and collection of interest. The question was whether the contractual proviso that English law governed, "subject to the principles of the Glorious Sharia'a", had the effect of rendering *Shari`ah* the governing law (by itself or with English law) or incorporating *Shari`ah* as a contractual term of reference. The proviso had neither effect, the Court held.

At English common law and under the Contracts (Applicable Law) Act 1990, the "proper" law of a contract must be English law or the law of another country, and not a "non-national system of law, such as . . . lex mercatoria, or 'general principles of law', or . . . the law of Sharia'a." Therefore, *Shari`ah*, a non-national system of law, could not be governing law, alone or with English law. English law permits the application of only one system of law to govern an issue. Had the parties selected two national systems of law, only one would have applied.

Conceding the points of law made by the Court, the defendants advanced an alternative construction, that the *Shari`ah* proviso should be construed and given the effect of incorporating *Shari`ah* as a contractual term of reference. But the *Shamil* governing law clause, on its face, was insufficiently specific to achieve incorporation. "The doctrine of incorporation 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 . . . set of rules to be incorporated as terms of the relevant contract such as a particular article . . . of the French Civil Code."

The vagueness of the governing law clause was particularly problematic in light of disagreement between the parties' expert witnesses as to the substance and applicability of *Shari`ah* with respect to the disputed agreements, and Islamic banking and finance generally. The Islamic bank's expert, testified, as paraphrased by the Court, "that the precise scope and content of Islamic law in general, and Islamic banking in particular, are marked by a degree of controversy within the Islamic world, best exemplified by the fact that the actual practice of Islamic banking differs widely within the Islamic world." Had the disputed agreements in *Shamil* effectively identified specific *Shari`ah* rules or principles as contractual terms of reference, then the outcome likely would have been different. As the appellate court itself observed, given the "general consensus upon the proscription of . . . [interest] and the essentials of a valid Morabaha agreement . . . the defendants would have been likely to succeed" had *Shari`ah* been incorporated.

## Part II: Lessons and Suggestions

### A. Lessons

The *Jivraj*, *Muswai* and *Shamil* decisions yield readily applicable practical lessons. Some are discussed briefly below.

#### ***Appointment of Muslim Arbitrators***

*Jivraj* is clear that, in English arbitration, parties wishing to appoint arbitrators having specific religious beliefs or affiliations must demonstrate a *bona fide* need for the requirement. The evidence in *Jivraj* of the religious significance of dispute resolution in the Ismaili community was pivotal. It unclear if a *bona fide* need to discriminate can be easily established by others, including other Muslims. The Ismailis involved in *Jivraj* were part of a tightly-knit community whose religious values were reflected in the Ismaili Constitution and other evidence submitted to the Court. Members of other Muslim groups likely would have difficulty making a similar case so compellingly, as the majority of Muslims are not socially organized around a constitution or other contemporary expatiations of community values based on Islam. While *Jivraj* likely could be helpfully invoked in similar cases, it should not be assumed that future challenges will equally withstand scrutiny under English law, based on precedent.

#### ***Forum Selection, Governing Law and Incorporation of Contractual Terms of Reference***

Three important lessons on forum selection, governing law and the doctrine of incorporation emerge from the *Shamil* and *Musawi* decisions. First, parties litigating in England and wishing to apply *Shari`ah* as the substantive law of decision should opt for arbitration under the Arbitration Act 1996. Second, English courts will apply only English law or other national law (including choice of law rules) as the substantive law of decision, and *Shari`ah* is excluded from these categories. Third, parties should identify in Islamic contracts or in arbitration agreements the specific *Shari`ah* rules and principles by which they intend to be bound before English Courts or in English arbitration. Such specific rules and principles might include *Qur`anic* chapters (*suwar*) or verses (*ayat*), or contemporary interpretations of Islamic banking and finance law, including AAOFI standards, *fatawas* issued by the *Shari`ah* Boards of Islamic financial institutions (e.g., the Dallah Al-Baraka Group's compilation of its *Shari`ah* Opinions on *Murabaha*), or resolutions of the Fiqh Academy of the Organisation of the Islamic Conference.

### B. Suggestions

The *Jivraj*, *Musawi* and *Shamil* cases are not the first, and will not be the last, of their kind. Secular courts in England, the United States, Canada and other jurisdictions have been, and will continue to be, presented with disputes that involve Islamic law, Muslim litigants and Islamic institutions. As secular courts decline to apply and interpret Islamic law, or apply Islamic law in limited fashion with the assistance of experts, the further development and clarification of Islamic banking and finance law will be curtailed,

unnecessarily. The Islamic banking and finance industry, like conventional banking and finance, must offer transparency and predictability. Predictability will not result from cases like *Shamil*.

Given the diverse and democratic nature of Islam, it would be neither realistic nor appropriate to expect that Islamic banking and finance law will be completely harmonized across the jurisprudential schools (*madhahib*), sects (*e.g.*, Sunni and Shia), and geographically and culturally diverse constituencies of the Faith. Nevertheless, substantive harmonization, clarity and predictability can be facilitated by non-controversial industry-wide and institution-specific procedural norms, and through specialized dispute resolution. Such procedural measures also would curb the complications that present when Islamic disputes come before secular courts. A few suggestions, inspired by the lessons of *Jivraj*, *Musawi* and *Shamil*, are offered briefly below.

### ***Enhancement of the Role of Shari`ah Boards in Governance***

Cases like *Shamil* unavoidably raise questions about the efficacy of *Shari`ah* compliance measures employed by Islamic banks that undertake, or appear to undertake, transactions that are designed to be, have the effect of being, or are perceived as non-compliant with *Shari`ah*. Because the authority to formulate the *Shari`ah* standards of most Islamic financial institutions resides exclusively with *Shari`ah* Boards, those Boards should have a heightened role in ensuring compliance with the standards that they set and best understand. It is well known that the demand for *Shari`ah* scholars exceeds their supply, and the demands on their limited time are many.

For practical and structural (governance) reasons, *Shari`ah* Boards cannot immerse themselves in day-to-day *Shari`ah* compliance control. But they can be empowered to more effectively perform their *Shari`ah* compliance auditing functions, without upsetting governance structures or placing undue demands on their already limited time. One way to empower *Shari`ah* Boards is to provide them with dedicated legal counsel and/or compliance officers, with responsibility for reviewing transaction and business documentation. *Shari`ah* Board lawyers, compliance officers or other dedicated employees would operate independently of the executive management and executive directors of Islamic banks, and would report to and consult with *Shari`ah* Boards. This would strengthen internal *Shari`ah* compliance.

### ***Publication of the Fatawas of Islamic Financial Institutions***

As *Shamil* demonstrates, the dearth of accessible evidence of Islamic banking and finance law cultivates fertile ground for confusion and unchecked interpretations. To help fill this void, Islamic financial institutions (particularly larger banks) should publish their *fatawas* (in Arabic, with English translations subject to translation standards), on a regular and industry-wide basis and in conformity with agreed standards (*e.g.*, the posting of *fatawas* on bank websites and/or to a central website). This straightforward step would educate, and promote transparency, accountability and predictability.

### ***Regulation of Islamic Law Experts***

English and other secular courts are not equipped to interpret Islamic law. As Islamic banking and finance grows, so will the number of disputes and the need for experts. The Islamic banking and finance

industry has a vested interest in ensuring that persons acting as Islamic banking and finance experts before courts and in other fora, are sufficiently qualified to do so. Some regulation is warranted. For example, the establishment of a roll of experts certified (after testing or other appropriate qualification) by one or more entities, should be considered. Of course, measures would be necessary to ensure that such regulation would not have the undesirable effect of excluding *Shari`ah* interpretations or points of view. Courts, litigants and others would not be required to select experts from this roll, and non-listed parties would not be prohibited from acting as experts. That said, the existence of such a list of experts (or other evidence of their qualification) would introduce standards, raise visibility and encourage consistency and quality.

### ***Specialized Dispute Resolution Forum***

All commercial systems depend on courts and legal processes that provide transparency, fairness and predictability, to grow and thrive. Islamic banking and finance is no exception. Islamic banking and finance has a wide geographic reach, and crosses national, legal and political boundaries. Parties to cross-border Islamic finance agreements, like others engaged in international commercial activities, make governing law and forum selections based on their desire for predictability. As the appellate court in *Shamil* aptly observed, “English law is a law commonly adopted internationally as the governing law for banking and commercial contracts, having a well-known and well-developed jurisprudence . . . which is not open to doubt or disputation on the basis of religious or philosophical principle.” Indeed, the frequency of selection of English and other secular laws and fora by parties to Islamic contracts bears this out.

There is a clear need for a specialized forum for the resolution of Islamic banking and finance disputes, to accommodate parties and facilitate the further development, documentation and publication of Islamic banking and finance law, as practiced currently. Such a forum must offer the same transparency and predictability that is provided by English and other preferred systems, with the much needed added benefit of expertise. This type of forum should be non-governmental (except to the extent that government-owned financial institutions participate in its funding), and its jurisdiction should be based on consent, including the standing consent of Islamic financial institutions to the forum’s jurisdiction. The forum could be funded by participating Islamic financial institutions (assuming adequate conflicts protocols), the fees it collects, and other financial support. As to location, the forum could be housed in one or more Islamic financial centers, and provision should be made for the conduct of non-judicial proceedings (*e.g.*, arbitration) at locations chosen by litigants. These thoughts on how a specialized forum might be organized, financed and located are very preliminary and are intended to illustrate, with broad strokes, what a specialized forum might look like. What is clear now is the need for specialized dispute resolution for Islamic banking and finance. Further discussion is required.