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Rethinking dispute resolution mechanisms for Islamic finance: understanding litigation and arbitration in context

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ABSTRACT

While there seems to be a growing appetite for Islamic finance products at a global level, the parties using these products do not seem to pay enough attention to how best they can resolve any disputes arising from these agreements. It is a shortfall that undermines the Islamic compliance aspect of these transactions and jeopardises their unique Islamic characteristic. This article considers ways in which English litigation can be used as an optimal mechanism to resolve Islamic finance disputes. The article particularly analyses the incorporation of international Sharia Standards in Islamic finance agreements as a way to overcome the disadvantages of ligation highlighted by a large body of case law in this context. It then argues that, while arbitration might seem on the face of it a more appropriate mechanism, it is riddled with complexities and disadvantages.

Keywords: Islamic finance disputes; English court litigation; arbitration; international standards incorporation.

INTRODUCTION

The Islamic finance industry has enjoyed significant growth, particularly in the last two decades. It is estimated that the industry is currently worth $2.2 trillion with an expected continuous growth rate in 2022/2023 of about 10 per cent. Despite the double shock from the Covid pandemic and the drop in oil price, the industry grew rapidly in 2020 albeit at a slower rate compared to 2019.[1]

The serious business credentials of the industry have allowed it to become a global rather than regional industry and to attract international investors from the entire globe. Further, it has opened up the door of some of the major financial centres in the Western world. An example in point is the United Kingdom (UK), where the Government has long taken a special interest in developing its Islamic

1 S&P Global Ratings, Islamic Finance Outlook (2022 edition) and S&P Global Ratings, Islamic Finance 2022–2023: Same Constraints, New Opportunities.

financial sector. The position of London as a world-leading financial centre has attracted Islamic financial institutions and also provided the City of London with a variety of new and innovative Islamic financial products. This mutual interest between the UK and the Islamic finance sector has been manifested in the offering of Islamic financial products by a number of high-street conventional banks, which have paved the way for the UK financial market to host a number of fully fledged Islamic banks. Further, in June 2014, the UK Government was the first one outside of the Islamic world to issue sovereignty Sukuk al-ijara worth £200 million, which matured on 22 July 2019. Given its success, the UK Government followed it in 2021 by a second sovereignty Sukuk al-ijara offering worth £500 million, which matures on 22 July 2026.[2]

This transformation from a regional to a global industry has come with some serious legal challenges. The regional familiarity and, to an extent, acceptance of the industry's legal foundation, namely Islamic law, is no longer a given. On the contrary, Islamic law, 'Sharia', is not a recognised source of law in Western jurisdictions. This, in truth, primarily stems from the nature of Islamic law in its present form, as an abstract concept. Islamic law, conceptually, is widely understood and accepted as a divine law founded in the religion of Islam. Practically, however, it lacks the systemisation and standardisation that creates structure and certainty and can be only offered by the sovereignty of a state.[3] In fact, even in a jurisdiction such as Saudi Arabia that claims to be Sharia-based, the state has not developed the essential foundations and processes to achieve the required structure and certainty for Islamic law.[4] Therefore, contemporary reference to 'Islamic law' entails the reference to a collection of principles and rules found in the Quran and Prophetic Sunnah,[5] on the one hand, and the broad scholarly work of Muslim jurists to interpret and apply these principles and rules on

2 HM Treasury, 'UK bolsters Islamic finance offering with second Sukuk' (25 March 2021).

3 Wael B Hallaq, *The Impossible State* (Columbia University Press 2013) 30–31.

4 Hossein Esmaeili, 'On a slow boat towards the rule of law: the nature of law in the Saudi Arabia legal system' (2009) 26(1) Arizona Journal of International and Comparative Law 1–47.

5 The Quran is a direct divine revelation which is believed to be the words of God '*Allah*' that were revealed to his last messenger Prophet Muhammad. It is the highest and most authenticated source of Islamic law as it was recorded in writing during the Prophet Muhammad's lifetime. The Prophetic Sunnah is the second source of divine revelation as mandated in the Quran [53:3–4]: 'Nor does he say [aught] of [his own] Desire. It is no less than revelation sent down to him.' It encompasses all the Prophetic statements and actions that were narrated by his companions, later collected, and recorded in writing by their followers.

the other.[6] This engenders variation and uncertainty in the absence of divine revelation, as there is no qualified authority to take over the divine legislative power, or to act as an authoritative interpreter in the way a final court can.

In the context of Islamic finance, there are two dimensions to this identified legal challenge; the first concerns the operations of Islamic finance in these Western global financial centres, which is primarily a regulatory challenge that the article does not address. The second concerns settling the disputes that arise from Islamic finance operations, which is the focus of this article.

As mentioned earlier, one important aspect of becoming a global industry is that Islamic finance has become a means to facilitate international investments. Parties from different jurisdictions can now agree to use an Islamic finance product to facilitate a commercial or financial transaction, which is not necessarily executed in their jurisdictions. This mandates the inclusion of a governing law clause, according to which the parties mutually choose a jurisdiction to determine their rights and obligations under the contract. In this respect, the wide interpretation of the freedom of contract principle under English law and the trustworthiness of the English judiciary have induced parties to international Islamic finance transactions to elect the English law and its court system as their choice to settle their disputes.

As this article is set to rethink the best mechanism to settle Islamic finance disputes, it is divided as follows. The next part examines the use of litigation before the English court in this respect. Drawing on a host of case law, it narrows down this challenge to two issues. First the classification of Islamic law under the English legal system and, second, the technicality of proving Islamic law before the court. Accordingly, it proposes a solution for the parties to an Islamic finance agreement to consider in advance if litigation is their preferable route to resolution while they remain committed to the Sharia integrity of their transaction. In other words, the focus is *how* best to litigate rather than *why* not litigate an Islamic finance dispute before the English court. The article then examines whether arbitration could be a more optimal alternative to litigation in the context of Islamic finance disputes. It argues that although arbitration might, at first, seem a more straightforward solution, it has its many challenges that make it far from perfect. It

6 This represents the human endeavour (*ijtihad*) to understand the divine textual sources and apply their rulings to ever-evolving circumstance by using human reasoning and logic. Although this process is governed by the rules of Islamic jurisprudence (*usul alfiqh*), it remains highly susceptive to subjectivity associated with the personal input of each and every jurist or scholar. See A K Aldohni, 'A compatibility analysis of Islamic financial disputes: English private international law and Islamic law' (2019) 14(1) Journal of Comparative Law 219–221.

is important to note that the analysis of arbitration only concerns an arbitral process where England is the seat. The final part concludes the discussion by bringing together the key arguments made in this article.

LITIGATION: FOREIGN LAWS, ISLAMIC LAW AND THE ENGLISH COURT

The English legal system has developed over the centuries its unique private international law framework. This set of rules is shaped by a historic narrative founded in the decisions of the common law courts, the adversarial character of the English legal system and international treaties. Taking into account these unique features and reflecting on a large body of case law, the below discussion demonstrates how best to litigate Islamic finance disputes before the English courts.

For historic reasons concerning the evolution of common law,[7] English law does not assume that all laws are equal partners 'in the community of law of nations'.[8] The English court's knowledge of all laws only extends to English law and excludes foreign laws.[9] Therefore, the English court will not introduce the rules of a foreign law *ex officio*.[10] This is not to suggest that the English court is not equipped to apply a foreign law, English private international law accommodates for this once two requirements are satisfied: first, that the foreign law is in itself applicable and, second, that its contents have been proved to the satisfaction of the court.

Applicable foreign law

English private international law refers to certain cases where a foreign law could be potentially applicable, provided the parties plead it: for example, tortious disputes concerning a personal injury that took place in a foreign jurisdiction (*lex delicti*); proprietary disputes concerning a property located in a foreign jurisdiction (*lex situs*); and contractual matters concerning the choice of a foreign law as the contract governing law, under which *Shamil Bank of Bahrain v Beximco Pharmaceuticals*

7 Fentiman suggests that historically common law courts had jurisdiction over domestic disputes where they applied what later became known as English common law, while any other cases with foreign elements fell within the jurisdiction of admiralty courts. This arrangement later changed as a result of the eventual dominance of the common law, English law and courts for that matter would – in principle – only recognise and apply the rules of English law to all disputes. See R Fentiman, 'Foreign law in English courts' (1992) 108(1) Law Quarterly Review 142–156.

8 Ibid 143.

9 R Fentiman, *Foreign Law in English Courts: Pleading, Proof and Choice of Law* (Oxford University Press 1998) 5.

10 Ibid 68.

Ltd and Others[11] and *Dubai Islamic Bank PJSC v PSI Energy Holding Company BSC*[12] fall, at least on the face of it. It is important to note that including a conclusive choice of a foreign law in the terms to govern the agreement still does not guarantee its application by the English court. As seen in *Aluminium Industrie Vaassen B V v Romalpa Aluminium Ltd*,[13] unless either of the parties were to invoke the choice of law clause, it would have no effect and English law will apply.[14]

In *Shamil Bank of Bahrain v Beximco Pharmaceuticals Ltd and Others*,[15] the parties agreed to use a *Murabaha* (mark-up) agreement as a facility for trade finance. Under this type of agreement, the Islamic financial institution buys the required goods desired by the client. Upon obtaining the goods, the bank resells the goods to the client with an added margin of profit to the original purchase price. Given that the Islamic financial institution is only paid once the goods are supplied to the client, the Islamic financial institution bears the risk of delivery failure. In theory, this genuine form of risk-sharing is what justifies the added margin of profit from an Islamic law perspective. Accordingly, Shamil Bank under a *Murabaha* agreement with the first defendant undertook to buy goods and to resell them to the first defendant for an added margin of profit. The second defendant was appointed by the Bank as its agent 'for the purchase of the goods'.[16] As for the governing law clause, the parties expressed that all legal issues 'arising out of or in connection to the agreement'[17] should be 'subject to the principles of Glorious Sharia, this agreement shall be governed by and constructed in accordance with the laws of England'.[18]

The dispute was brought before the English court because of a default in payment by the defendants, who argued that the overdue payment and any agreed compensation were not enforceable, citing the governing law clause.[19] The defendants argued that both English and Sharia laws should apply, while English law would sanction such a

11 [2003] EWHC 2118 (Comm).
12 [2013] EWHC 3186 (Comm).
13 [1976] 1 WLR 676.
14 Despite having clause 30 in the disputed agreement, which subjected the conditions of the agreement to Dutch law and gave the Amsterdam court an exclusive jurisdiction, the English court decided that English law is the applicable law. Neither the plaintiffs, a Dutch company, nor the defendants, a British company, pleaded Dutch law as the governing law of the agreement by invoking the choice of law clause *Aluminium Industrie Vaassen B V v Romalpa Aluminium Ltd* [1976] 1 WLR 676, 684. See also Fentiman (n 7 above) 149.
15 [2003] EWHC 2118 (Comm).
16 Ibid para 4.
17 Ibid cited in para 5.
18 Ibid cited in para 5.
19 Ibid cited in para 15.

payment, Sharia would prohibit it, as it constitutes the forbidden '*riba*' (interest).

While the defendants were quick to plead the application of 'glorious Sharia', which is procedurally essential, there were substantive failures in the choice of law clause that made it ineffective. First, the freedom to choose a governing law must be 'affirmatively used',[20] therefore the choice clause must be structured clearly and conclusively. The first instance court found that was not the case. Mr Justice Morison stated that 'it cannot have been the intention of the parties that it would ask this secular court to determine principles of law derived from religious writing on matters of great controversy'.[21] He found it highly improbable that the intention of the parties was to ask the English court 'to determine difficult questions of the Sharia principles',[22] which include 'conflicting pronouncements' and many of the commercial issues which are still quite debatable.[23] The fact that the court had to guess the intention demonstrates the lack of an affirmative choice of Islamic law or 'glorious Sharia'.

This leads to the second issue that is the legal classification of 'Islamic law' or 'Sharia' in light of the meaning of a valid choice of law. It has been long established under common law,[24] then the Rome Convention[25] and now the Rome I Regulation,[26] that only a national system of law, namely the law of a country, could be a valid choice

20 This requirement has long been under the Rome Convention on the Law Applicable to Contractual Obligations (Rome Convention), which came into force in the UK after its implementation by the Contract (Applicable Law) Act 1990, art 3(1), and then later in the Law Applicable to Contractual Obligations (Rome I) Regulation (EC) No 593/2008 (Rome I Regulation), art 3(1). For more discussion, see also Adrian Briggs, *The Conflicts of Law* 4th edn (Oxford University Press 2019) 214.

21 *Shamil* (n 11 above) cited in para 35.

22 Ibid cited in para 24.

23 Dr Lau's (expert witness) opinion on Sharia law: ibid para 24.

24 In *Amin Rasheed Shipping Corporation v Kuwait Insurance Co* [1984] AC 50, 61, Lord Diplock – while quoting Lord Simonds' 'pithy definition' of the proper law of contract in *John Lavington Bonython and Others v Commonwealth Australia* [1952] AC 201 – stressed that under English conflict rules the 'proper law' of contract 'is the substantive law of the country which the parties have chosen that the courts of that country might themselves apply if the matter were litigated before them'.

25 Rome Convention, art 1(1) (emphasis added): 'The rules of this Convention shall apply to contractual obligations in any situation involving a choice between the *laws of different countries*.'

26 Rome I Regulation, art 3(3) (emphasis added): 'the *country whose law has been chosen*'.

of governing law in a contract.[27] This automatically disqualifies the choice of Islamic law or any other religious law for that matter, such as 'Jewish law' in *Halpern v Halpern*,[28] as the court does not have the power to give effect to this choice. The court in the *Shamil Bank* case reached the same conclusion, citing the applicable law at the time – the Rome Convention.[29]

Dubai Islamic Bank PJSC v PSI Energy Holding Company BSC[30] has a strong sense of *déjà vu* about it. The case concerned a debit-restructuring agreement the parties reached in relation to the outstanding principal amount, which the bank gave in the course of a legitimate Sharia-compliant agency agreement, and the agreed profits. The governing law clause in the disputed debt-restructuring agreement chose English law to govern the agreement 'save in so far as inconsistent with the principles of Sharia law'.[31] The defendants argued that making the agreed payments – the principal amount and profits – would breach Sharia, and, given the governing law clause, the payment under English law was no longer enforceable. The court decided that such a 'proviso is of no effect', citing the decisions of the *Shamil bank* and *Halpern* cases, and subjected the agreement to the exclusive jurisdiction of the English court.[32]

Satisfactory proof

Although Islamic law does not qualify as a legitimate choice of governing law in a contract, in theory, nothing stops the parties to an agreement from choosing the law of a country – a national system of law – that incorporates some elements of Islamic law. The reality, however, is far from simple as such incorporation tends to be limited in its coverage and does not guarantee the Sharia compliance of the entire laws of that state. For instance, the United Arab Emirates (UAE) Civil Code, which is influenced by several civil codes in the region that are primarily based on the French Civil Code,[33] incorporates elements of

27 There could be one governing law of a particular country to ensure certainty, for detailed scholarly commentary on the case, see Jason Chuah, 'Islamic principles governing international trade financing instruments: a study of the Morabaha in English law' (2006) 27(1) Northwestern Journal of International Law and Business 137–170, 144.

28 [2008] QB 195.

29 The court stated that: 'Article 1(1) of the Rome Convention makes it clear that the reference to parties' choice of the law to govern a contract is a reference to the law of a country': *Shamil* (n 11 above) para 27.

30 [2013] EWHC 3186 (Comm).

31 Ibid para 11.

32 Ibid para 11.

33 *Glencore International AG v Metro Trading International Inc* [2001] CLC 1732, 1751.

Islamic law concerning loan (*qardh*) contracts,[34] transfer of ownership in bailment[35] and misappropriation.[36] On the other hand, the UAE Commercial Code allows for the payment of interest on commercial loans and delay interest on commercial loans and commercial obligations fixed in a sum of money.[37] Therefore, the 'law of the UAE' could be a valid choice of governing law yet it would not guarantee that 'Islamic law' exclusively governs the agreement. Further, if the law of such a country were made as an express choice of the governing law, any modifications that changed the law to non-Sharia compliant would still bind the parties.[38]

More importantly, the English court will treat the foreign law as 'a peculiar kind of fact'[39] that has to be proved to the court's satisfaction.[40] This is something that the court has dealt with on numerous occasions where the proprietary[41] or tortious[42] disputes connected the case, according to English private international law, to foreign jurisdictions that included elements of Islamic law.

In an adversarial legal system, such as the English legal system, the parties to a dispute will call their witness to give statements[43] concerning the application of the foreign law while the court is not actively involved in this fact-finding process. The court will assess the evidence provided and decide, accordingly, how the foreign law applies in the context of the case. It is the parties who appoint their expert witness rather than the court, therefore, the expert evidence is likely to conflict as each expert advocates a more favourable position of their

34 Arts 992–993.

35 Art 975.

36 Art 1326.

37 Commercial Transactions Code, arts 77, 78, 88.

38 Lord Collins of Mapesbury and J Harris (eds), *Dicey, Morris and Collins on the Conflict of Laws* 15th edn (mainwork) and 5th supp (Sweet& Maxwell 2018) vol 2 (32-058).

39 *Parkasho v Singh* [1968] P 233, 250. Sir Jocelyn made this remark while explaining that the appellate court will still have the power to interfere with the finding of the trial court concerning the question of foreign law despite being classified as a fact. The appellate court can assess whether the evidence justifies the trial court's conclusion regarding the question of foreign law, which does not normally extend to the other relevant facts in that case, and see also Fentiman (n 7 above) 145.

40 *Guaranty Trust Company of New York v Hanny & Co* [1918] 2 KB 623 and *Ertel Bieber & Co v Rio Tinto Co Ltd Dynamit AG (Vormals Alfred Nobel Co) v Rio Tinto Co Ltd Vereingte Koenigs v Rio Tinto Co Ltd* [1918] AC 260.

41 For example, *Glencore* (n 33 above).

42 For example, *Harley v Smith* [2010] CP Rep 33 and *Abdel Hadi Abdallah Al Qahtani & Sons Beverage Industry Company v Andrew Antliff* [2010] EWHC 1735 (comm), Official Transcript.

43 A A Gillespie and S Wear, *The English Legal System* 5th edn (Oxford University Press 2015) 14–15.

party.[44] This could prove particularly problematic in the context of Islamic finance disputes.

On the one hand, the issue of Sharia compliance is central to the dispute; on the other hand, the judge's use of the evidenced Islamic law is solely based on the quality of the expert's evidence statement and performance in court. These are two fundamentally different things and the high quality of the latter does not necessarily guarantee achieving the former. For instance, *Abdel Hadi Abdallah Al Qahtani & Sons Beverage Industry Co v Andrew Antliff*[45] concerned the meaning of bribery and duty to declare conflict of interests in Sharia under Saudi law. While the judge acknowledged the expertise of the claimant's expert witness as a Sharia scholar and Saudi law practitioner, he questioned his abilities to provide consistent explanations.[46] It can be suggested that such an impression by the court has its impact on the extent to which the witness statement is factored in the judge's ruling. Therefore, appointing the more convincing expert witness, who is probably the more expensive, could be a decisive factor in these cases. Further, it can be argued that fluency in the English language and the ability to explain the complicated Sharia points in question in a legal language that the court is familiar with are qualities that contribute immensely to the strength of the statement, which does not always correlate with its Sharia rigour. In other words, it is not always the case that the expert who has the Sharia training and the language skills to interrogate the vast Islamic jurisprudence literature available in Arabic also has the English language skills to convey this knowledge to the court.

An English judge cannot decide by himself or herself what the foreign law means without relying on the proof provided by the parties. In *Harley v Smith*,[47] the case concerned a tortious claim brought by three British former employees (professional divers) who were injured in Saudi territorial waters. The court considered Islamic law to decide the meaning of 'work relation' and whether the claim was time barred. The first instance court concluded that the time limitation should be interpreted in line 'with the Sharia principles of there being no limitation period (or at least none as short as one [year]) in relation to ordinary personal injury claims'.[48] The Appeal Court particularly criticised this finding as it found that there was no evidence presented to the court to support the judge's interpretation of the 'work relation'

44 T C Hartley, 'Pleading and proof of foreign law: the major European systems compared'(1996) 45(2) International and Comparative Law Quarterly 274.

45 *Abdel Hadi Abdallah Al Qahtani & Sons* (n 42 above).

46 Ibid para 29.

47 [2010] C Rep 33

48 *Harley v Smith* [2009] PIQR P11, para 82.

under Sharia. Therefore, in the absence of the required proof for this fact (ie a Sharia or Islamic law extended meaning of work relation) the judge 'decided for himself what Sharia law would require' and 'went beyond what he could properly do' in construing 'foreign legislation by applying principles of interpretation which had not been established by evidence'.[49]

Therefore, it is inherent in an adversarial legal system that the court's view of the substance of the foreign law is not established in complete isolation from the parties' influence, albeit through the legitimate means of expert witnesses. This situation can only be avoided where the judge is primarily tasked with establishing the substance of the applicable foreign law. Take for example the German legal system. Section 293 of the Code of Civil Procedure (*Zivilprozessordnung* – ZPO) requires the court to determine the substance of the foreign law using the court's own research. This may include contacting 'the competent authority in the foreign state concerned' and obtaining a legal opinion from an expert.[50] However, the use of an expert's opinion in this context is quite different from that under the English legal system. The court objectively appoints the expert based on their knowledge and practical experience of the foreign law, which prevents the parties from shopping for a favourable opinion. Accordingly, in an Islamic finance dispute this prevents a party who can afford a favourable opinion with a convincing quality – not necessarily matched with its Sharia rigour – from succeeding.

Based on the above, there are some key observations to make. First, it is well established that parties to an Islamic finance dispute are not legally entitled to ask the English court to apply a non-national system of law. Therefore, it can be suggested that the superficial use of terms such as 'Islam law' or 'Sharia' in the governing law clause is, in a way, an affirmative choice by the parties not to apply Sharia. Second, even the choice of a national system of law that includes elements of Islamic law brings a host of concerns that may undermine the Sharia compliance goal. Accordingly, the optimal solution to this problem rests on two factors: on the one hand is ensuring the certainty of the Sharia-based rules that the English court is authorised by private international law to apply; on the other is minimising the influence that the parties can exert, albeit legitimately, over the court's understating of the substance of these rules.

In this regard, it is argued that this still can be achieved in litigation before the English court through incorporating Sharia-based principles in the terms of the contract, which is not as simple as it may seem. In

49 *Harley v Smith* (n 47 above) para 50.
50 European e-Judicial Portal, 'Germany'.

order for incorporation to succeed, there are procedural and substantive matters that require careful consideration and adherence.

In English contract law, parties to a contract may elect to incorporate certain terms into their agreement as long as a number of procedural hurdles have been overcome. First, is ensuring that a notice of the term(s) in question is given before or at the time of concluding the contract: second, ensuring that the document – intended to have contractual effect – contains the incorporated term(s); third, that reasonable steps were taken to bring the term(s) to the attention of the parties;[51] and, finally, ensuring that the incorporation takes place in the actual terms (ie the operative parts) of the contract.

Islamic Investment Company of the Gulf v Symphony Gems NV & Ors[52] could be a good example of the failure to comply with the procedural requirements of incorporation. The case concerned a *Murabaha* (mark-up) agreement, in which the parties agreed, in a clear choice of law clause, that: 'this Agreement and each purchase agreement shall be governed by, and shall be constructed with, English law'. They also agreed that: 'the courts of England shall have exclusive jurisdiction to hear and determine any suit'.[53] Nevertheless, one of the recitals to the agreement stated: 'The Purchaser [Symphony Gems] wishes to deal with the Seller [IICG] for the purpose of purchasing supplies under this Agreement in accordance with the Islamic Sharia.'[54]

The case was brought to court with regard to the amount of the balance due to IICG. The defendant (Symphony Gems, ie the purchaser) argued that the payment default was due to an alleged delivery failure by the supplier, a risk that should be borne by the claimant (IIGS, ie the seller) according to Islamic law. The reference to Islamic law in this agreement was not made in the terms, rather it was in one of the recitals that could only play a role if 'the operative part' of the agreement was ambiguous.[55] Hence, it was unenforceable given that the operative parts were clear in nominating the English law as the governing law and the English court as the one with exclusive jurisdiction to settle any related disputes. Therefore, the 'Islamic Sharia' recital could not control the clear governing law term in this case.[56] The judge stated: 'it is a contract governed by English law. I must simply construe it according to its terms as an English law contract.'[57]

51 E Mckendrick, *Contract Law* 13th edn (Palgrave Macmillan 2019) 172.
52 [2002] 2 WLUK 313.
53 Cll 25–26 of the contract cited in ibid.
54 Ibid.
55 H G Beale (ed), *Chitty on Contracts* 34th edn (Sweet & Maxwell 2021) vol 1, 1149.
56 Ibid.
57 *Islamic Investment Company* (n 52 above).

This leads to the substantive requirements concerning the terms that incorporate Sharia principles in an Islamic finance agreement, which should be considered in light of English private international law. Recital 13 of the Rome I Regulation states: 'this regulation does not preclude parties from incorporating by reference into their contract a non-State body of law or an international convention'.[58] In principle, this suggests that parties to an Islamic finance agreement can elect to incorporate elements of Islamic law into the terms of their contract provided they fulfilled the earlier discussed procedural requirements. However, in order for such incorporation to take effect from a private international law perspective it must identify specific 'black letter' provisions.[59] Therefore, in a case such as *Symphony Gems*[60] the reference to 'Islamic Sharia', even if it were made in the terms of the agreement, would have been ineffective. Similarly to terms such as 'glorious Sharia' and 'Islamic law', it still lacks the certainty of sufficiently identified 'black letter' provisions.[61]

It is argued, therefore, that the Sharia Standards of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) should be used for effective contractual incorporation.[62] On the one hand, AAOIFI is the leading international not-for-profit organisation primarily responsible for developing and issuing standards for the global Islamic finance industry. It has institutional members from over 45 countries including central banks and financial regulators.[63] On the other hand, AAOIFI Sharia Standards represent a set of rules that clearly articulates the underpinning Sharia principles of a large array of Islamic finance agreements and products. These international standards have been either mandated or adopted by a number of regulatory authorities around the world.[64]

58 For detailed analysis of recital 13 and its legislative history, see Chuah (n 27 above) 195–196.

59 Collins and Harris (n 38 above) vol 2 (32-056)–(32-058); see also Chuah (n 27 above) 150–151.

60 Islamic Investment Company (n 52 above).

61 For detailed discussion on legal risk and uncertainties associated with Islamic law, please see Andrew White and Chen Mee King, 'Legal risk in Islamic finance' in Simon Archer and Rifaat Ahmed Abdel Karim (eds), *Islamic Finance: The New Regulatory Challenge* 2nd edn (Wiley 2013) 226–228.

62 Rupert Reed, 'The application of Islamic finance principles under English and DIFC Law' (2014) (Oct) Butterworths Journal of International Banking and Financial Law 574–575.

63 AAOIFI, 'About AAOIFI'.

64 For example, from 1 September 2018 the UAE Central Bank required that all fully fledged Islamic banks, Islamic windows of conventional banks, and finance companies offering Sharia compliant products and services in UAE must comply with the AAOIFI Standards. AAOIFI, 'AAOIFI welcomes UAE's adoption of its Standards'.

The incorporation of these Sharia Standards in the terms of an Islamic finance agreement would certainly fulfil the earlier identified requirement for effective incorporation. In addition to having the required international recognition and authority, these standards have 'black letter' provisions that are published by AAOIFI in clear and understandable English. For example, AAOIFI's Sharia Standard No 8 provides clear and precise Sharia provisions regarding a number of questionable issues in the practice of a *Murabaha* (mark-up) agreement, a widely used agreement by Islamic financial institutions. Some of these issues were disputed in both the *Shamil Bank* and *Symphony Gems* cases in the context of Sharia compliance.[65] This includes the requirement that the Islamic financial institution 'must assume the risk of the item it intends to sell',[66] which encompasses any risks associated with the delivery and possession of the item.[67] In addition, it prohibits the seller from subsequently demanding an extra payment in consideration for delay in payment.[68] Unfortunately, the terms of the agreements in the *Shamil Bank* and *Symphony Gems* cases[69] were in clear contradiction to the provisions of AAOIFI Sharia Standard No 8 and the superficial reference to 'glorious Sharia' and 'Islamic law' had no effect.

Although the use of incorporation of international standards has not been tested in the context of Islamic finance disputes litigation before the English court, there are many examples of incorporated international commercial standards, especially in the context of arbitration, in which the English court upheld its implementation. For instance, in *Econet Satellite Services Ltd v Vee Networks Ltd*[70] the parties signed a number of agreements, including 'the Main Contract', concerning the supply of satellite equipment and technology. Later, they signed a further agreement, the Voice Traffic Termination Rate Agreement (VTTRA), in which they included a governing law clause choosing 'the substantive internal laws of the United Kingdom applicable to contracts executed and to be ... interpreted in accordance with the UNIDROIT Principles of International Commercial Contracts'.[71] More importantly, the VTTRA included an arbitration clause that incorporated the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules.[72]

65 *Shamil* (n 11 above) and *Islamic Investment Company* (n 52 above).
66 AAOIFI, Sharia Standard No 8 3/1/1.
67 Ibid 2/5/2.
68 Ibid 4/8.
69 *Shamil* (n 11 above) and *Islamic Investment Company* (n 52 above).
70 [2006] 2 CLC 488.
71 S 15(1) cited in ibid para 5.
72 S 16(1) cited in Ibid.

The VTTRA was disputed in relation to unpaid invoices, therefore, an arbitration began in which the party owing the payment admitted the sum claimed but by a way of defence made a counter-claim of set-off arising out of 'the Main Contract' and not the VTTRA. The arbitrators decided that article 19(3) of the UNCITRAL Arbitration Rules[73] incorporated in the VTTRA would only allow a set-off based on a counter-claim arising out of the *same* contract in question: that is only out of VTTRA. This arbitral award was challenged before the English court on a point of law under section 69 of the Arbitration Act 1996 (discussed in detail in the next section) given that the chosen governing law was the laws of the UK. The court confirmed that 'the meaning and effect of Article 19 (3) is clear',[74] therefore, the arbitral tribunal was right not to allow a set-off counter-claim. In the court's opinion, the parties agreed to the effect of article 19(3) by signing up to the incorporation clause in the VTTRA.[75]

It is argued, therefore, that the incorporation of AAOIFI Sharia Standards provides the clarity and certainty that allow the court to deal effectively with highly contested Sharia matters and it demonstrates the parties' true commitment to Sharia compliance. In addition, it is the judge who interprets these terms as terms of an English contract. And given that they are published in English in a precise, 'black letter', form, it is suggested that the Sharia compliance of the agreement will be certainly far more observed by the incorporation of these standards. This is because the earlier identified challenges associated with the use of expert witnesses in the context of applying a foreign law will no longer be a matter of concern.

ARBITRATION AND ISLAMIC FINANCE DISPUTES

It is well established that arbitration provides an effective alternative mechanism to resolve commercial and financial disputes. In this respect, the concept of arbitration is deeply rooted in the primary sources of Islamic law, the Quran and the Sunnah, as a recommended form to resolve disputes in general without specific reference to commercial disputes. For example, the breach of the Quranic prohibition of hunting during the pilgrimage period would result in a fine which the Quran requires to be estimated by a just arbitrator.[76] In the context

73 UNCITRAL Arbitration Rules, art19(3): '3. In his statement of defence, or at a later stage in the arbitral proceedings if the arbitral tribunal decides that the delay was justified under the circumstances, the respondent may make a counter-claim arising out of the same contract or rely on a claim arising out of the same contract for the purpose of a set-off.'

74 *Econet* (n 70 above) para 21.

75 Ibid para 21.

76 Quran, verse [5:95].

of domestic disputes, the Quran also requests the husband and wife to resort to arbitration.[77] Further, the Prophetic Sunnah includes a number of references to the Prophet's use of arbitration in numerous warfare-related events to settle arising disputes.[78]

This is not to suggest that the permissibility of arbitration in the commercial and financial context is contentious. On the contrary, the Council of *Fiqh* Academy–the Organisation of the Islamic Conference has generally accepted the permissibility of arbitration in commercial and financial disputes. It has also defined arbitration as 'an agreement between the disputing parties to appoint an arbitrator to settle the disputed matter with a binding decision that applies the principles of Islamic law'.[79]

This definition suggests that Islamic arbitration is not different from conventional arbitration as they both recognise the contractual basis of this dispute resolution mechanism. Therefore, the consent of the contracting parties, whether as a clause in the original contract or in a separate agreement, is the prime reason not only for the parties' engagement with the process but also for the binding character of the award.[80] Further, given the private nature of this mechanism, they both acknowledge that arbitrators are not judges. Yet they are always expected to be impartial, fair-minded, reasonable and knowledgeable with particular emphasis on their knowledge of Islamic law in the case of Islamic arbitration.[81] Finally, they both allow the parties to choose the law governing the disputes, which in the case of Islamic arbitration is Islamic law.

On the face of it, arbitration may seem an ideal mechanism to settle Islamic finance disputes; however, the reality is quite the opposite. It is argued that it would be a gross simplification to suggest that arbitration is a less complicated and more appropriate mechanism than litigation to resolve Islamic finance disputes. This argument is articulated in the context of England being the seat of arbitration.

In arbitration, the choice of law is not as straightforward as it may seem because there could be three types of law which are described as the applicable laws. First, is the curial law (*lex arbitri*) that applies to the arbitration procedures; second, the law governing the actual arbitration

77 Ibid verse [3:35] states: 'if you fear dissension between the two, send an arbitrator from his people and an arbitrator from her people'.

78 Wahba Al-Zuhayli, *Encyclopaedia of Islamic Jurisprudence and Contemporary Issues* vol 12 (Dar Al-Fikr 2012) 714.

79 Council of Fiqh Academy–Organisation of the Islamic Conference, Decision No 95/8/D9. Cited in Al-Zuhayli (n 78 above) vol 9, 611–612.

80 M L Moses, *The Principle and Practice of International Commercial Arbitration* 2nd edn (Cambridge University Press 2012) 2. Al- Zuhayli (n 78 above) vol 12, 731.

81 *Moses* (n 80 above) 2 and *Al- Zuhayli* (n 78 above) vol 12, 721.

clause or agreement in terms of its validity, scope and interpretation; and, third, the substantive law that governs the actual subject matter that is being arbitrated. It has been suggested that 'occasionally, but rarely' the curial law differs from the law governing the arbitration clause or agreement, while 'often' the substantive law differs from the first two.[82] This inherently creates a level of uncertainty and may open up the process in general, and the award for that matter, to a number of challenges. If the parties to an Islamic finance agreement choose England as the seat for arbitration, English law will apply and the main piece of legislation to consult in this respect is the Arbitration Act 1996.[83]

The curial law

Where parties have chosen England as the seat of arbitration, section 2(1) of the 1996 Act makes the provisions of part I of the 1996 Act applicable whether they explicitly chose English law as curial law or not. Part I includes the provisions that regulate the internal procedures of the arbitration (commencement of arbitral proceedings ss 12–14, the arbitral tribunal ss 15–29 and the arbitral proceedings ss 33–41, the award proceedings and rules ss 46–58) and the court's supervisory role at different stages of the arbitration (the court's power with regard to arbitral proceedings ss 42–45 and the court's power in relation to award ss 66–71).[84] Parties to an Islamic finance agreement may choose institutional arbitration where the conduct of the arbitration is supervised by a well-known international organisation that has its own set of procedural rules.[85] Yet, the parties still need to connect the conduct of the arbitral proceedings to a national legal system, such as English law (ie the 1996 Act). This is essential with regard to issues such as the extent of powers the parties have in selecting the arbitral procedures and the compulsory ones that the parties must adhere to, the national courts' involvement in the arbitration procedures and the review of awards.[86]

82 *European Film Bonds A/S v Lotus Holdings LLC* [2019] EWHC 2116 (Ch), para 136.

83 The focus of the analysis in this part of the article is England as the seat for arbitration. However, for some broad overview of arbitration practices in different countries, see Julio C Colon, 'Choice of law and Islamic finance' (2011) 46(2) Texas International Law Journal 411–436.

84 On the contrary, parties who choose to arbitrate in another country cannot, according to the 1996 Act, choose English law as the curial law, therefore, the provisions in part I of the 1996 Act will not apply: Arbitration Act 1996, s 2; see J Hill, 'Some private international law aspects of the Arbitration Act 1996' (1997) 46(2) International and Comparative Law Quarterly 295.

85 Such as the ICC Court of Arbitration or the London Court of International Arbitration.

86 Collins and Harris (n 38 above) vol 1, 16-009.

A close examination of what the 1996 Act is offering procedurally to the parties to an Islamic finance dispute demonstrates how disadvantaged this mechanism is compared to litigation.

First, the 1996 Act does not provide summary procedures where it imposes a duty on the arbitration tribunal to give each party 'a reasonable opportunity of putting his case and dealing with that of his opponent'.[87] While this clearly prevents the court's 'encroachment on the principle of party autonomy ... if the parties have agreed to arbitrate their dispute',[88] it reduces the efficiency of this mechanism and allows parties to play for time. For example, where the respondent does not have a real prospect of successfully defending their claim the claimant cannot have a summary decision in their favour.[89] Further, where one of the parties is a recalcitrant absentee from the hearing in arbitration, unlike litigation, a judgment in default of defence may not be entered into as of right without any examination of the merits.[90] Another example, where there is no genuine dispute to submit to arbitration, section 9 of the 1996 Act does not allow the parties to a disputed contract with an arbitration clause to obtain a summary judgment from the English court preventing the reference to arbitration.[91] It is worth noting that section 9 is mandatory: parties to an arbitration clause or agreement cannot contract themselves out of this provision.[92] Therefore, the lack of these summary procedures may unnecessarily prolong the process and allows either of the parties to use arbitration for tactical reasons.

Second, as for interim remedies or injunctions, in principle, these are designed to require one of the parties to act or refrain from acting in certain ways, which is central to the protection of the other party's rights. Given the sense of urgency that is associated with the use of these injunctions, their effectiveness depends on the following four factors: the breadth of these injunctions; their binding authority; the time needed to enforce; and the parties that they can be enforced against.

Section 38(1) of the 1996 Act deals with arbitral interim injunctions. It is not a mandatory section, therefore, parties can agree broad

87 Arbitration Act 1996, s 33(1)(a).

88 Lord Saville, 'The Denning Lecture 1995: arbitration and the court' (1995) 61(3) Arbitration 161.

89 D St J Sutton, J Gill and M Gearing, *Russell on Arbitration* 24th edn (Sweet & Maxwell 2015) 1-031.

90 R Merkin and L Flannery, *Merkin and Flannery on Arbitration Act 1996* 6th edn (Routledge 2020) 373. See also Arbitration Act 1996, s 33.

91 Arbitration Act 1996, s 9: see Lord Saville (n 88 above) 161 and N Blackaby, C Partasides with A Redfern and M Hunter, *Redfern and Hunter on International Arbitration* 6th edn (Oxford University Press 2015) 19.

92 Arbitration Act 1996, sch 1, Mandatory Provisions of pt I.

powers for the arbitral tribunal to grant interim injunctions or they can restrict these powers. However, if there is no agreement, then the 1996 Act provides default provisions, which are very limited, and the 1996 Act does not in any of its parts explicitly allow the court to interfere in the exercise of these powers.[93] These limited interim remedies include injunctions in relation to security of cost, preservation of property and preservation of evidence.[94] The limitation in the breadth of these default interim injunctions can be seen in relation to the preservation of property injunction. This injunction is of particular significance to Islamic finance agreements and any possible disputes arising. According to Islamic finance principles, money itself is not a commodity, and investing the capital in real property/assets is central to generating litigate profits, which makes the property/assets an integral component of any Islamic finance agreement.[95]

In this respect, it has been argued that the default preservation of property injunction is much narrower than that granted by the court as it only concerns a property subject to the proceeding and owned or possessed by a party to the proceeding.[96] This falls short of a court interim freezing injunction that covers assets/property not directly concerned with the proceedings and in control, rather than owned or possessed, by a party to the proceeding.[97]

Further limitations can be identified regarding the binding authority of the preservation of property injunctions, and the other default interim injunctions for that matter. They are granted in the form of orders or directions, therefore, the arbitral tribunal cannot compel compliance as it lacks the coercive power of the court, despite the urgency associated with their use.[98] Although they can be granted in the form of a peremptory order,[99] which can be enforced by the court under section 42 of the 1996 Act,[100] this requires time that defies the urgent nature of these interim injunctions. The party would first need to fail to comply with the interim injunction without showing sufficient cause, and only then could the tribunal issue the injunction

93 Merkin and Flannery (n 90 above) 398. See also Arbitration Act 1996, s 38.

94 Arbitration Act 1996, s 38(3), (4) and (6); see Sutton et al (n 89 above) 5-080, 5-081.

95 This can be seen in commercial agency agreement (*Wakalah*) and also mark-up agreement (*Murabaha*).

96 Arbitration Act 1996, s 38(4), and see also Merkin and Flannery (n 90 above) 404.

97 Pt 25 of the Civil Procedures Rules does not include these limitations. See further, Merkin and Flannery (n 90 above) 405.

98 Sutton et al (n 89 above) 5-082, 5-083.

99 Arbitration Act 1996, s 41.

100 Ibid s 42; Sutton et al (n 89 above) 5-083.

as a peremptory order.[101] This is not to suggest that the court does not have any powers in relation to interim injunctions in arbitration. Parties can seek urgent interim relief to preserve assets/property from the court under section 44(2)(e) and (3) of the 1996 Act.[102] However, on the one hand, the party seeking the relief will have to demonstrate its urgency in addition to the fact that the court's involvement would undermine the privacy and confidentiality advantage of arbitration.[103] On the other hand, similar to section 42 of the 1996 Act, section 44 is non-mandatory, which means parties to an arbitral clause or agreement can contract out of these sections.

It is worth noting that there is an argument for the use of section 39 of the 1996 Act to grant interim injunctions in the form of provisional awards. Section 39 empowers the tribunal to order on 'a provisional basis any relief which it would have power to grant in a final award', including, for instance, order for payment or the disposition of property between the parties.[104] However, there are a few issues concerning the use of section 39 in this context.

First, there is some doubt as to the interpretation of this section, given that only the title refers to the provisional measure as an 'award' while the section uses the term 'order'. This casts uncertainty in terms of the enforceability of the measure, given the difference in this respect between an 'order' and an 'award' albeit provisional.[105] Second, section 39 does not provide a more advanced interim injunction to preserve property than that available under section 38, as it does not allow the tribunal to grant interim freezing injunctions. Although there is no unanimity, a significant volume of the academic commentary on section 39 takes the view that a freezing order cannot be granted, as of right, in the form of a provisional award because it is not a relief the tribunal is empowered to grant in a final award under section 48 despite the broad wording of this section.[106] Rix LJ noted this view in the Court of Appeal decision of *Kastner v Jason*,[107] although it was

101 Arbitration Act 1996, s 42(3) and (4) and see also Sutton et al (n 89 above) 5-186.

102 Sutton et al (n 89 above) 5-083.

103 Merkin and Flannery (n 90 above) 470.

104 Arbitration Act 1996, s 39(2).

105 Especially in the context of domestic arbitration where orders can be granted in the form of a peremptory order (s 41) and enforced by the court (s 42) while an award albeit provisional can only be enforced under s 66. See Merkin and Flannery (n 90 above) 409.

106 Rix LJ in the Court of Appeal decision of *Kastner v Jason* [2004] EWCA Civ 1599, para (16), cited a number of academic sources, among which Sir M J Mustill and S C Boyd, *Mustill & Boyd, Commercial Arbitration* (LexisNexis 2001) 315, and Sutton et al (n 89 above) 6-020.

107 *Kastner* (n 106 above) paras 16–19.

'not the direct subject matter of any issue in this appeal'.[108] Third, and most importantly, this section needs to be agreed by the parties in the first place, as the 1996 Act does not set this power as a default option subject to contrary agreement.

As for the last indicator of the effectiveness of the arbitral interim measures, it is the parties that they can bind. In this regard, these interim injunctions can only bind parties to an arbitral clause or agreement, which excludes third parties. This is particularly disadvantageous in Islamic finance disputes as the majority of Islamic finance agreements involve a third party who would either sell or purchase the property/asset that is central to the finance agreement. Take, for example, a mark-up agreement (*Murabaha*) where the Islamic finance institution would buy a specific asset from a third party to resell it to the client at a mark-up price or appoint an agent to purchase the assets, as seen in the *Shamil Bank* case.[109] The third party in these examples could be in control of the asset/property and is not bound by the arbitral interim injunctions.[110]

The governing law of the arbitration agreement

It is more common for the agreement to arbitrate to be found as a clause in the main contract than as a submission agreement or a compromis.[111] In any case, identifying the law governing the arbitration agreement is a matter of significant importance as it decides on the 'validity, scope and interpretation of an arbitration agreement'.[112] Any successful challenge to any of these issues would adversely affect the validity and recognition of the final arbitral award and render it unenforceable.

Further, in the context of international commercial arbitration, identifying the law governing the arbitration agreement could also be a significant challenge where the parties have not made an express choice of law with specific reference to the arbitration agreement. The Rome I Regulation does not apply in this context;[113] therefore, where England is the arbitration seat, any questions arising before the English court concerning the governing law of the arbitration agreement will be

108 Ibid para (19). The first instance judge Mr Justice Lightman considered *obiter* that s 39 could be used to grant a freezing order where the parties conferred such powers in the tribunal on a final award, although in this case 'the arbitration agreement does not expressly grant to the Beth Din jurisdiction to grant a freezing direction in its final award': see *Kastner* (n 106 above), paras 27–28, and see also Merkin and Flannery (n 90 above) 410.

109 *Shamil* (n 11 above). The appeal decision is reported in [2004] 2 Lloyd's Rep 1.

110 In order for interim injunctions to bind third parties an application must be made to the court. Sutton et al (n 89 above) 5-080

111 Collins and Harris (n 38 above) vol 1 16-008.

112 Ibid 16R-001.

113 Art 1(2)(e) states that the Regulation does not apply to 'arbitration agreements'.

subject to English common law and the choice of law rules. This means that the court will decide whether the parties to arbitration made an implied choice, where there is no express choice, of the law governing the arbitration agreement and give effect to the parties' choice.[114] In the absence of such a choice, it is the law that is most closely connected to the arbitration agreement which would 'generally' be the law of the seat where the parties had chosen a seat of arbitration.[115] However, the application of these rules is not straightforward. The English court has taken different approaches. In some decisions the court has opted for the law governing the main contract chosen (expressly or impliedly) by the parties,[116] while in other decisions the court has opted for the law of the arbitration seat.[117] Further, views also differed as to whether either approach reflected the parties' implied choice or the closest connection test.[118]

This remained an area of uncertainty until the UK Supreme Court decision in *Enka Insaat ve Sanayi AS v ooo Insurance Company Chubb*.[119] The Supreme Court decided that in the absence of an express choice of law for the arbitration agreement the law chosen to govern the whole contract will apply to the arbitration agreement,[120] and where there is not such a choice then the law of the arbitration seat will apply to the arbitration agreement as the most closely connected to it.[121]

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114 *European Film Bonds A/S v Lotus Holdings LLC* [2019] EWHC 2116 (Ch), para 142; see also Collins and Harris (n 38 above) vol 1 16R-001.

115 *Enka Insaat ve Sanayi AS v ooo Insurance Company Chubb* [2020] Bus LR 2242, 2293; and see also Collins and Harris (n 38 above) vol 1, 16R-001, fn 1 cites a large volume of case law decisions to this effect.

116 *Sulamérica Cia Nacional de Seguros SA v Enesa Engelharia SA* [2012] EWCA Civ 638; [2013] 1 WLR 102: see also *Black Clawson International Ltd v Papierwerke Waldhof-Aschaffenburg AG* [1981] 2 Lloyd's Rep 446, 456; *Channel Tunnel Group Ltd v Balfour Beatty Construction Ltd* [1993] AC 334, 357; *Arsanovia Ltd v Cruz City 1 Mauritius Holdings* [2012] EWHC 3702 (Comm) and *Habas Sinai Ve Tibbi Gazlar Istihsal Endustrisi AS v VSC Steel Co Ltd* [2013] EWHC 4071 (Comm) cited in fn 5 in Mark Campbell, 'How to determine the law governing an arbitration agreement: direction form the Supreme Court' (2021) 24(1) International Arbitration Law Review 29.

117 *Enak v Chubb* [2020] EWCA Civ 574. See also: *XL Insurance Ltd v Owens Corning* [2001] 1 All ER (Comm) 530; *C v D* [2007] EWCA Civ 1282 cited in fn 6 in Campbell (n 116 above). See also, William Day, 'Applicable law and arbitration agreements' (2021) 80(2) Cambridge Law Journal 239; see also Myron Phua and Matthew Chan, 'Persistent questions after Enka v Chubb' (2021) 137(Apr) Law Quarterly Review 217.

118 Day (n 117 above).

119 *Enka Insaat* (n 115 above).

120 Ibid 2292.

121 Ibid 2293.

Accordingly, in the context of Islamic finance disputes, where English law is identified as the governing law of the arbitration agreement, there are two issues that parties should take note of. First, the interpretation of the arbitration agreement and its scope are among the key areas that will be governed by common law, more specifically the general principles of contract law.[122] As seen in *Enka*,[123] in deciding that English law was the governing law of the arbitration agreement, that the arbitration clause was valid and that the claim fell within the scope of the arbitration agreement,[124] the Supreme Court engaged with some key common law contractual interpretation principles, such as the separability principle and validation principle.[125] Second, the Arbitration Act 1996 would also apply, as part of English law, to issues cornering formal validity of the arbitration agreement.[126] More importantly, the 1996 Act provides the arbitral tribunal with the freedom to determine its jurisdiction (s 30) and limits the court's power to determine the jurisdiction of an arbitral tribunal (s 32).[127] Yet section 67 still provides a route to challenge an award on jurisdiction in the English court.[128] While the 1996 Act does not dictate how the tribunal interprets these matters, it remains central to the parties to Islamic finance disputes to understand the powers given the tribunal in this respect, the challenges associated with them, and the routes to review these decisions by the English court.

The 1996 Act under section 30 empowers the arbitration tribunal, unless agreed otherwise, to rule on its own 'substantive jurisdiction'.[129] This includes the validity of the arbitration agreement, the constitution of the arbitration tribunal and the matters that fall within the arbitration agreement.[130] It has been suggested that this section is one of the most important sections of the 1996 Act as it deals with the difficult concept of 'substantive jurisdiction' and its categories.[131] In principle, this concept concerns the legal right or competence of the tribunal to

122 Campbell (n 116 above) 35.

123 *Enka* (n 115 above).

124 Ibid 2296.

125 Ibid 2256, 2261–2262, 2271–2276, see Campbell (n 116 above) 31–33. For more on the separability principle and construction of an arbitration clause, see also *Trust v Privalov* [2007] UKHL 40.

126 Arbitration Act 1996, s 5: see Collins and Harris (n 38 above) vol 1, 16-023–16-026.

127 Collins and Harris (n 38 above) vol 1, 16-013, and the source expands on this point in fn 29.

128 Ibid.

129 Arbitration Act 1996, s 30(1).

130 Ibid, s 30(1)(a), (b), (c).

131 Merkin and Flannery (n 90 above) 318.

decide over the matters put to it by the parties.[132] In practice, however, the concept of substantive jurisdiction remains elusive and has often been confused with the concepts of admissibility[133] and authority.[134] Even the categories identified by section 30(1)(a)–(c), especially the 'validity' of the agreement and the 'matters' submitted to arbitration, have been criticised for being either limited in coverage regarding the former or lacking clarity in relation to the latter.

The significance of the distinction between a jurisdictional and non-jurisdictional claim is that the former is subject to the English court review, and where the challenge is successful the award is rendered unenforceable. There are two sections under the 1996 Act, section 32 and section 67, which provide the route to the court review of jurisdictional challenges, and both sections are mandatory.[135]

As explained earlier, subject to parties' contrary agreement, the arbitral tribunal has the competence to decide on a question of its substantive jurisdiction. The decision of the tribunal under section 31(4), which is also a mandatory section, could be in a preliminary award, concerning only the jurisdictional issue, or in its final award, when deciding on the merits. The parties to arbitration are entitled to agree which course the tribunal should take in deciding on this issue.[136] Whether the jurisdictional question is decided by the tribunal in a preliminary or final award can be challenged before the English court under section 67.[137] Further, section 32 provides an alternative route to question the substantive jurisdiction of the arbitral tribunal before the court. This is not a form of appeal from an arbitral award on jurisdiction, but rather it is a substitute to that type of award.[138] The court can make a binding ruling on a jurisdictional matter if the application was made either with the agreement in writing of the parties,[139] or if it was permitted by the tribunal and the court is satisfied that this is likely to make substantial savings in costs, there

132 Ibid.

133 The best example is whether the time limit on claiming arbitration is a question that concerns the jurisdiction or the admissibility. If it concerns admissibility then it falls within the jurisdictional authority of the tribunal, therefore, it is not itself a jurisdictional issue that can be reviewed by the court and if successful annul the award. See Merkin and Flannery (n 90 above) 319–320.

134 Also acting within authority is not a jurisdictional matter that can be challenged before the court. However, in this case there is the argument of serious irregularity that can open it up to court review under s 68.

135 Arbitration Act 1996, sch 1, Mandatory Provisions of part I

136 Ibid s 31(4).

137 Ibid s 67(1)(a) in relation to an award confined to the jurisdictional matter or s 67(1)(b) in relation to a final award.

138 Merkin and Flannery (n 90 above) 359.

139 Arbitration Act 1996, s 32(2)(a).

was no delay in applying, and there was a good reason for referring the matter to the court.[140]

Given the earlier highlighted uncertainties associated with the concept of substantive jurisdiction and the unenforceability of an award in the case of a successful court challenge, it is argued that the parties to an arbitral Islamic finance dispute should always agree that the tribunal should decide the jurisdictional objection in an early ruling.[141] This is to save on time and costs that parties would incur if the jurisdictional objection was decided with the merits in the final award that later was successfully challenged before the court on a jurisdictional ground. For the same reason, parties also should always agree to stay the arbitral proceedings if an application to court was made under section 32. This is particularly important given that the default setting under the 1996 Act is that the arbitral tribunal 'may continue the arbitral proceedings' while an application under section 32 is pending.[142]

A case in point is *Al Midani & Another v Al Midani & Others*.[143] Although the case was decided according to the old arbitration laws, it remains a clear illustration of the significant impact that a successful court challenge to the jurisdiction of the arbitral tribunal will have on the enforceability of the award. It can be suggested that the case deals with a number of jurisdictional matters to which the court applied English law.

Article 7 of the arbitration agreement stated that any dispute arising from the arbitral decision concerning the distribution of the inheritance should be decided by 'an Islamic judicial body' appointed by the Trusteeship Council without the involvement of the heirs.[144] The Trusteeship Council invoked this article and appointed the Islamic Sharia Council in London to decide on the disputed arbitral decision. The claimants, two of the heirs, challenged the jurisdiction of the Islamic Sharia Council. The court in its decision dealt with a number of jurisdictional issues. First, was the constitution of the arbitral tribunal. The court found that the Islamic Sharia Council in London was neither a national court nor an arbitration tribunal, therefore, did not fall with the concept of 'an Islamic judicial body' as stated in article 7 of the arbitration agreement.[145] Second, was the validity of article 7 as an arbitration clause: the court found that article 7 was not an 'arbitral clause' or providing for a 'second tier of arbitration'.[146] Finally, even

140 Ibid s 32(2)(b)(i)–(iii).
141 Ibid s 31(4).
142 Ibid s 32(4).
143 [1999] CLC 904.
144 Ibid 906.
145 *Al Midani* (n 143 above) 906, 913.
146 Ibid 913.

if article 7 was an arbitration clause and the Islamic Sharia Council was an arbitral tribunal, the court found that it had no jurisdiction over the claimants. This is because only parties to the arbitration agreement (ie the heirs) can invoke the reference to 'an Islamic judicial body', which a representative of Trusteeship Council invoked in this case.[147] Accordingly, the decision of the Islamic Sharia Council was unenforceable.

The substantive law

In the years preceding the 1996 Act, the English court questioned, in the *dicta* of a couple of cases,[148] whether the rule that the substantive issues in an arbitration should be governed by the law of a country remained 'good law'.[149] The 1996 Act decisively settled this issue under section 46(1). It states that:

> the arbitral tribunal shall decide the dispute: (a) in accordance with the law chosen by the parties as applicable to the substance of the dispute, or (b) if the parties so agree, in accordance *with such other considerations* as are agreed by them or determined by the tribunal.[150]

The use of the term 'other considerations' by the 1996 Act in the context of the substantive law choice enables the parties to arbitration to choose the principles of a non-national system of law to govern the substance of their arbitrated dispute.[151] Therefore, parties to an Islamic finance arbitration can choose Islamic law to govern the substantive matters of their dispute.

Further, the 1996 Act allows mixing the principles of a non-national system of law with the principles of a national system of law.[152]

S*anghi Polyesters Ltd (India) v The International Investor KCFC*[153] put the application of section 46 to the test. Sanghi Polyesters Ltd (SPL), an Indian company, obtained finance (US$5 million) from the International Investor KCFC (TII) by using an Islamic finance agreement known as an '*Istisna*' or manufacturing agreement.[154]

147 Ibid 913–914.

148 *Lloyd LJ in Home and Overseas Insurance Co Ltd v Mentor Insurance Co* [1990] 1 WLR 153, 166; and *Deutsche Schachtbau Tiefbohr-Gesellschaft MBH v Shell International Petroleum Co Ltd* [1990] 1 AC 295, 315, cited in *Sayyed Mohammed Musawi v RE International (UK) Ltd* [2007] EWHC 2981 (Ch), para 21.

149 *Sayyed Mohammed Musawi* (n 148 above) para 21.

150 Arbitration Act 1996, s 46 (emphasis added).

151 Collins and Harris (n 38 above) vol 1, 16-053.

152 Hill (n 84 above) 300.

153 [2001] CLC 748.

154 Manufacturing agreement where the finance provider is contracted to manufacture the required product and then sells to the client (buyer) with an added margin of profit.

The contract of *Istisna* set a 9 per cent annual profit rate expected on this investment by TII. SPL defaulted on its agreed payments and TII claimed the repayment of US$5 million and the outstanding profits of US$230,417.

The parties agreed to an institutional arbitration (International Chamber of Commerce (ICC) arbitration) and chose London as the seat of arbitration. This meant that, in conjunction with the ICC rules, part I of the 1996 Act was applied as the curial law. The parties also provided that the substantive issue in the arbitration should be governed by 'the laws of England except to the extent it may conflict with Islamic Sharia, which shall prevail',[155] which makes Islamic law as the prevailing substantive governing law of the dispute. The agreement allowed TII to appoint a Sharia expert to advise the arbitrator on issues concerning Islamic law, whose advice would be binding on TII, SPL and the arbitrator. TII chose the appointed sole arbitrator Mr Samir Saleh, an experienced lawyer and a Sharia expert, to act in this capacity, a choice that was endorsed by SPL.[156]

The sole arbitrator decided that according to the substantive governing law, 'Islamic Sharia', TII was entitled to their principal and the outstanding agreed profits but he disallowed the payment of US$600,000 in damages as this would be Sharia non-compliant.[157]

SPL challenged the arbitral award before the English court 'on point of law' under section 69 and on the basis of 'serious irregularity' under section 68 of the 1996 Act.

First, as for the application of section 69, the court found that 'virtually all the issues of law complained of by SPL touch on the arbitrator's approach to Sharia law'.[158] Therefore, the court concluded that it has no jurisdiction to decide on matters related to 'Islamic Sharia', as according to section 82 and section 69 of the 1996 Act the court will only have jurisdiction with regard to questions of English

155 *Sanghi* (n 153 above) 750.

156 Ibid 750.

157 Ibid 749

158 The issues that SPL raised primarily concerned the legal nature and validity of the contract ibid 751–752.

law.[159] This demonstrates the English court's acceptance of Islamic law, a non-national system of law, as the substantive governing law upon which the arbitration award was based, without questioning its validity as a choice of law. The judge clearly stated that there was no 'need to characterise Sharia as a foreign law or code, or set of customs … whatever Sharia may be it is not the law of England and Wales'.[160]

It is worth noting that this also applies to other religious laws. In *Schwebel v Schwebel*,[161] the parties agreed to refer their dispute, concerning the distribution of inherence, to the Beth Din, the Court of the Chief Rabbi in London, where the substantive applicable law is Jewish law. The award was later appealed against before the English court in pursuance of section 69 of the 1996 Act. The court did not question the validity of Jewish law as a governing law and found that the arbitrators had applied Jewish law and that the court would only allow an appeal on a question of English law, which was not the case here.[162]

Second, with regard to the challenge of 'serious irregularity' under section 68 in *Sanghi Polyesters Ltd (India) v The International Investor KCFC*,[163] in principle, the English court repeatedly stressed that section 68 should not be used as a 'backdoor'[164] to question the

159 It is worth noting that the English court acceptance of a 'non-national system' to apply to an arbitral dispute was seen on occasions even before the 1996 Act in relation to other religious laws, such as Jewish law. The case of *Soleimany v Soleimany* [1999] QB 785 concerned an illegal contract to export Iranian carpets in contravention of Iranian revenue laws and export controls. A dispute arose in relation to the proceeds of a sale of illegally exported quantities of carpets from Iran. The parties signed an arbitration agreement to settle this dispute before the Beth Din in accordance with Jewish law. The case was brought before the English court with regard to the enforcement of this arbitral award in England. The key point to make is that the High Court did not question the validity of such an award, which was made on the basis of Jewish law, and granted leave to enforce the award. However, the Court of Appeal refused to enforce the award, not because of the invalidity of the choice of Jewish law, but because of the illegality of the disputed agreement in the first place, ie illegally exporting these carpets from Iran to be sold in the UK and elsewhere.

160 *Sanghi* (n 153 above) 751. It is worth noting that this also applies to cases where a foreign law is as the substantive governing law in arbitration. In *Egmatra AG v Marco Trading Corporation* [1998] CLC1552, 1552–1553, Swiss law was the governing law of the substance of the disputed matters. Therefore, the court dismissed the claim under s 69 as the question of law was not of the law of England and Wales.

161 [2010] EWHC 3280 (TCC).

162 Ibid para 14.

163 *Sanghi* (n 153 above).

164 *Warborough Investments Ltd v S Robinson & Sons (Holdings) Ltd* [2002] EWHC 2502 (Ch), para 4.

factual findings of the arbitral award,[165] whether the substantive applicable law is English, foreign laws or other considerations. Therefore, the test to apply this section sets the bar high where the irregularity must be 'serious' and 'has caused or will cause substantial injustice'. For example, the court in *JD Wetherspoon plc v Jay Mar Estates*[166] found that even if there was serious irregularity it had not in this case given rise to substantial injustice.[167] As in the case of *Sanghi Polyesters Ltd (India) v The International Investor KCFC*,[168] SPL's substantial ground of claim under section 68 was that the arbitrator in the award cited a few sources of Islamic law, which were never drawn to the attention of the parties before the award was delivered. The court found that there was no irregularity because, on the one hand, the fact that the parties agreed to give the sole arbitrator 'additional expert powers' to decide Sharia matters meant that the parties were 'clearly giving him more scope for individual initiative than is usual'.[169] More importantly, on the other hand, there was no injustice caused by the arbitrator to SPL.[170]

Based on the above, there are some key observations to make. First, the 1996 Act does not only validate the choice of a non-national system of law as the substantive governing law but it also protects the enforceability of the award based upon it. The court demonstrated that section 69 could only be used to question the award on a point of English law, which categorically excludes religious laws. Second, the court, time after time, rejected the use of section 68 as a backdoor to question the factual findings of the arbitrators. In other words, stopping any attempt to use 'serious irregularity' to involve the court in questioning how the arbitrator interpreted and applied the substantive law, which could be a non-national system of law, to the facts.

Having said that, there remains a major concern that stems from the nature of Islamic law, in its abstract concept, namely its certainty. Although the court's acceptance of Islamic law, as the substantive governing law, honours the autonomy of the arbitrating parties, which is the essence of arbitration, it does not add to the certainty of its application. As seen in *Sanghi Polyesters Ltd (India) v The International Investor KCFC*,[171] SPL questioned the validity of the

165 *Schwebel v Schwebel* (n 161 above) para 20, and see also *Lesotho Highlands Development Authority v Impregilo ApA* [2005] UKHL 43 (cited in ibid para 20).

166 [2007] EWHC 856 (TCC).

167 Ibid para 35. For more detailed commentary on s 68, see Merkin and Flannery (n 90 above) 693–730.

168 *Sanghi* (n 153 above).

169 Ibid 754.

170 Ibid.

171 Ibid.

underlying agreement as a genuine *Istisna*, and the parties' choice of 'Islamic Sharia' left it entirely to the arbitrator to decide what this meant. The court was in no position to assess the agreement's Sharia compliance nor was it able to displace Sharia and apply English law as it did in some of the litigated disputes discussed earlier. It can be suggested that the arbitrating parties would have improved the certainty of their choice if they added that the arbitrator's interpretation of Islamic Sharia, concerning the validity of the *Istisna* agreement, should be guided by AAOIFI Sharia Standard No 11,[172] as this standard provides parameters of a Sharia-compliant *Istisna* agreement. This is a clear point of reference that both parties know what to expect once applied.

Further, while the court expects the arbitrators' compliance with their duties under section 33 of the 1996 Act, there is no obligation on arbitrators to 'imitate the usual practice of an English judge'.[173] This has been demonstrated in the high threshold set by the court to successfully challenge an award on the basis of 'serious irregularity'. Therefore, parties who choose arbitration and Islamic law to govern the substance of the dispute should accept that arbitrators, while finding the facts, could not be held to the high standards expected of an English judge in litigation.

The final issue to consider in this context is the enforceability of an arbitral award based on Islamic law as the substantive law of the arbitration. In this regard, it has been suggested that 'arbitration is likely to afford the parties broad enforceability under the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards',[174] to which 169 countries have signed up.[175] However, there remains the question whether such an award could be challenged on the basis of public policy.[176] Given the focus of the article on English law, this issue will be considered in the context of the English court.

Article V(2)(b) of the New York Convention allows the court in the country where the recognition and enforcement is sought to set aside the award where it is contrary to the public policy in that country. The UK Arbitration Act 1996 (ss 100–103) re-enacts provisions from

172 AAOIFI, Sharia Standard No 11 (*Istisna* and parallel *Istisna*). See also White and King (n 61 above) 232.

173 Sanghi (n 153 above) 754.

174 White and King (n 61 above) 231.

175 New York Convention Contracting States as of 11 April 2022.

176 The interaction between Sharia and the concept of public policy has been examined in the literature in different contexts. Chuah, for example, analyses the enforcement of a foreign judgment where Sharia is a matter of public policy. See Chuah (n 27 above) 200–202.

previous legislation that implemented the New York Convention.[177] Accordingly, section 103(3) of the Arbitration Act 1996 makes public policy a ground to refuse recognition or enforcement of a New York Convention arbitral award.[178]

While all legal systems recognise the concept of public policy in the context of private international law,[179] the 'proper limits of the qualification of public policy remain elusive'.[180] However, Carter's analysis of when the English court invoked public policy in English private international law (conflict of laws system and enforcement of foreign judgments) drew some useful parameters for the concept of public policy. It has been suggested that public policy is fundamentally found on general principles of morality[181] where the court would refuse to apply a rule of a foreign law where it is 'unacceptably repugnant'.[182] Further, other grounds were found to be 'substantial justice' and the national and international interest of the UK.[183]

As for the meaning of public policy in international commercial arbitration, it has been suggested that what is relevant to the English court is the 'domestic' English concept of public policy.[184] Therefore, when it comes to the enforcement of a New York Convention arbitral award the concept of public policy encompasses 'the fundamental conceptions of morality and justice'.[185]

Accordingly, it is difficult to see how the enforcement of an arbitration award in an Islamic finance dispute that is based on Islamic law, as its substantive law, could be refused by the English court on a public policy ground. In *Sanghi Polyesters Ltd (India) v The International Investor KCFC*[186] the court enforced the arbitral award that according to Islamic law disallowed the payment of US$600,000 in damages to

177 Sutton et al (n 89 above) 8-025.

178 S 103(3) Arbitration Act 1996 states: 'Recognition or enforcement of the award may also be refused if the award is in respect of a matter which is not capable of settlement by arbitration, or if it would be contrary to public policy to recognise or enforce the award.'

179 Javier C De Enterria, 'The role of public policy in international commercial arbitration' (1990) 21(3) Law and Policy in International Business 390.

180 William E Holder, 'Public policy and national preferences: the exclusion of foreign law in English private international law' (1968) 17(4) International Comparative Law Quarterly 928–929.

181 P B Carter, 'The role of public policy in English private international law' (1993) 42 International and Comparative Law Quarterly 1–7.

182 Ibid 3.

183 Ibid 4.

184 Sir Jack Beatson, 'International arbitration, public policy, considerations, and conflicts of law: the perspectives of reviewing and enforcing courts' (2017) 33 Arbitration International 190.

185 Sutton et al (n 89 above) 8-050: fn 233 cites a large number of cases to this effect.

186 *Sanghi* (n 153 above).

prevent the circumvention of the prohibition of *riba*. Clearly the court did not find the award morally repugnant or in breach of substantial justice. On the other hand, *Soleimany v Soleimany*,[187] the dispute that concerned the proceeds of a sale of illegally imported quantities of carpets from Iran, was the subject of Beth Din arbitration, thereby, effectively Jewish law governed the substance of this dispute. The court refused to enforce the award, on a public policy ground, because of the illegality of the disputed agreement in the first place, namely illegally importing these carpets from Iran to be sold in the UK and elsewhere.[188] It is worth nothing that, although both cases did not concern New York Convention awards, they remain important in this context as both arbitral awards were based on religious laws as their substantive law, and the English court was asked to enforce the awards. Finally, the court repeatedly stressed that the use of public policy as a ground to refuse the enforcement of a New York Convention arbitral award should be used with 'extreme caution' as it was not intended to 'create an escape route'.[189]

CONCLUSION

When it comes to settling Islamic finance disputes, there is no binary choice to make between litigation and arbitration, where the latter is the optimal choice. On the contrary, arbitration is a complicated process that entails the application of multiple laws. As argued earlier, where the arbitration seat is England, the1996 Act does not provide the parties with the interim measures that are critical to protect the interests of the parties to a disputed Islamic finance agreement. Further, the question of the 'substantive jurisdiction' of the arbitrators remains a serious threat to the enforceability of the award. Finally, although the 1996 Act allows the choice of Islamic law, a non-national system of law, as the substantive governing law, this does not resolve a bigger problem concerning the certainty of its interpretation. The mere choice of an arbitrator who is expert in Islamic law does not necessarily guarantee a mutually accepted interpretation of Islamic law by all parties.

As for litigation, it is clear that English law is the most effective choice of governing law before the English court, which is not always equipped to serve the Sharia aspect of the disputed agreement. Nevertheless, this article has demonstrated that there is a way forward under the English private international law framework that allows the parties to benefit from the high standards of the English judiciary, its

187 *Soleimany v Soleimany* (n 159 above).

188 Ibid.

189 Sutton et al (n 89 above) 8-050: fn 232 cites a number of cases to this effect.

interim measures and enforceability of its decisions while remaining true to the Sharia essence of their agreement. The incorporation of the internationally accepted AAOIFI Sharia Standards in the terms of the agreement provides the court with a 'black letter' point of reference that the court can apply impartially.

Having said that, the extent to which such a solution can be utilised depends entirely on whether the parties are genuinely interested in the Sharia compliance of their agreement, and any arising disputes, or just the façade of it.