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Methods of Dispute Resolution for Islamic Finance: Litigation and Arbitration

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Methods of Dispute Resolution for Islamic Finance: Litigation and Arbitration

Anthony Connerty[1]

This article sets out the view of an English lawyer on aspects of Islamic Finance

1. Introduction

The global Islamic Finance industry can be valued in trillions of United States dollars. One reason for the growth of Islamic banking may be due to the fact that it is seen as having two advantages over conventional banking. First, that Islamic banks are bound to a higher moral standard in that they will not contemplate irresponsible risks. Second, that earnings come from identifiable assets and are not based on concepts such as derivatives. In that respect, it is noticeable that Islamic banking avoided much of the damage suffered by the conventional banking sector as a result of the sub-prime crisis.[2]

Prohibition of *riba* (usury) and *gharar* (uncertainty in a contract – thus excluding short selling, for example) has led to the creation of Sharia-compliant banking, using in particular the *sukuk*: a fixed income investment product similar to a conventional bond paying a fixed yield. Various types of *sukuk* are in use. One is the *sukuk al mudaraba,* comprising an investment partnership under which investors place money with a manager who invests the capital to produce a return. A variation is the *musharaka*: again, investors pool their money, but with no party assigned to manage the venture. Profits are split according to an agreed formula and losses are borne in accordance with the amount of capital invested. Another is the *sukuk al ijara:* a lease contract.

The basic types of contract allowable in Islamic commercial law-

> …are categorised according to their purpose: contracts of exchange such as a simple sale and purchase agreement, or a lease contract; contracts of investment to permit profit for partners in a venture, which may involve the investment of either capital or labour; contracts of charity such as donations or interest- free loans, such contracts

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He has acted as Counsel in arbitration- related litigation.
His areas of experience include multi-million U.S. dollar cases involving general commercial disputes; banking; oil and gas; metals; cotton; online dispute resolution; art law.
He has been involved in the Middle East for over 15 years. He has been a member of arbitral and mediation panels in Abu Dhabi, Dubai, Egypt, Iran, Kuala Lumpur and Nigeria, and is a member of the Arab Bankers Association.
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[2] On the Sub-Prime Crisis see: "The Credit Crunch- the Collapse of Lehman Brothers", Anthony Connerty: Amicus Curiae, Issue 83, Autumn 2010, pp 9-14.

> entered into for the sake of pleasing Allah, and which have no conditions attached, being a unilateral transfer of wealth; contracts of security that create rights over an asset, such as a mortgage over property or a guarantee of a debt; and agency and trust contracts that fall into a miscellaneous category.
>
> …the prohibitions…are the fundamental things you cannot do in Islamic commercial and financial transactions.[3]

Disputes relating to Islamic Finance transactions seem inevitable. Resolution by litigation is one option: examples of cases decided by Courts in the financial centres of London and New York are considered. However, arbitration may be looked at as a preferable alternative for the resolution of Islamic Finance disputes. Arbitration is viewed under the Rules of two specialist international arbitral institutions: the International Islamic Centre for Reconciliation and Arbitration (IICRA), Dubai and the Asian International Arbitration Centre (AIAC), Kuala Lumpur. The Rules of various international arbitral institutions are also considered. Worth noting is the fact that the English Arbitration Act 1996 would seem to permit an arbitral tribunal to deal with an Islamic Finance dispute: section 46(1)(b) provides that the 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."

The relevance of the New York Convention is considered in relation to the recognition and enforcement of international arbitration awards.

This article will first consider litigation as a method of resolving Islamic Finance disputes by looking at decisions of courts in London and New York.

Second, the article will consider arbitration as a dispute resolution alternative.

Third, a look at recognition and enforcement of arbitral awards under the provisions of the New York Convention.

2. Litigation - London and New York Courts

Courts in London and New York have particular expertise in banking disputes: especially in relation to complex financial transactions. The views of two international law firms illustrate the point. Norton Rose Fulbright:

> Parties across the world regularly choose the English courts to resolve international disputes. English courts have a reputation for consistency, honesty, transparency and technical knowledge. English judges are seen as impartial and independent. There are no juries in civil cases, no awards of punitive or exemplary damages and there is a "loser pays" system. Although costs and fees have risen in recent years, against this background they still compare favourably with other jurisdictions and with arbitration.
>
> England is a global financial centre and it is natural that litigation relating to complex financial transactions should find its home in England. The High Court in London has been one of the principal locations for large-scale financial litigation for many years

[3] "Heaven's Bankers: Inside the Hidden World of Islamic Finance": Harris Irfan, pages 58-59. Constable London. ISBN 978-1-47212-169-1

> and data made available for the year to March 2015 shows a further increase in litigation in the Commercial Court where 63% of litigants were foreign nationals.
>
> However, this position is increasingly under threat. New York law is regularly selected in contracts and claimants often see the New York courts as offering them advantages.[4]

And Ashurst:

> The finance sector has not embraced arbitration in the same way as other sectors, such as energy, insurance and shipping. Until recently, the general approach in many major financial centres had been to use either the English or New York courts – jurisdictions with which financial institutions are familiar and can rely on to produce sound judgments…[5]

Two cases will be considered. One a decision of the English Court of Appeal and one a decision of Judge Melvin L. Schweitzer sitting in the Supreme Court, New York County.

3. Litigation - English Court of Appeal

3.1 The Beximco Case

(1) BEXIMCO PHARMACEUTICALS LTD
(2) BANGLADESH EXPORT IMPORT CO LTD
(3) MR AHMAD SOHAIL FASIUHUR RAHMAN
(4) MR AHMED SALMAN FAZLUR RAHMAN
(5) BEXIMCO (HOLDINGS) LTD — *Appellants*

- and -

SHAMIL BANK OF BAHRAIN E.C. — *Respondent*

Lord Justice Potter (with whom Lord Justice Laws and Lady Justice Arden agreed) delivered the judgment of the Court of Appeal on an appeal from the High Court of Justice, Queen's Bench Division, Mr Justice Morison.[6]

The case involved claims under financing agreements. The single issue on appeal was concerned with the governing law of the agreements: English law or Sharia law? Can there be two governing laws? The case is of particular interest because the Court of Appeal considered Islamic principles – *Riba, Morabaha* agreements and *Ijarah* leases.

RIBA

The background to the appeal was set out in paragraphs 1-3 of Lord Justice Potter's judgment:

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[4] Norton Rose Fulbright: https://www.nortonrosefulbright.com/en/knowledge/publications/0ee0087d/the-financial-list-resolving-financial-markets-disputes-in-london

[5] https://www.ashurst.com/en/news-and-insights/legal-updates/quickguide---use-of-arbitration-in-finance-disputes/

[6] [2004] 1 WLR 1784; [2004] EWCA Civ 19

1. This is an appeal from the judgment of Mr Justice Morison dated 1 August 2003 whereby he gave summary judgment in favour of the claimant Shamil Bank of Bahrain E.C. ("the Bank") against the first and second defendants as principal debtors in respect of monies advanced to them by the Bank under various financing agreements and against the third, fourth and fifth defendants as guarantors of certain of those agreements. The total judgment sum awarded was some US $49.7million. The appellants were refused permission to appeal by Morison J, but permission was granted by Clarke LJ on 17 September 2003 in relation to a single issue relating to the construction and effect of the form of the governing law clause contained in the financing agreements. That clause reads as follows:

   > "Subject to the principles of the Glorious Sharia'a, this Agreement shall be governed by and construed in accordance with the laws of England."

2. It is not in dispute that "the principles of the Glorious Sharia'a" referred to are the principles described by the defendants' expert, Mr Justice (retd) Khalil-Ur-Rehmam Khan as:

   > "the law laid down by the Qur'an, which is the holy book of Islam, and the Sunnah (the sayings, teachings and actions of Prophet Mohammad (pbuh)). These are the principal sources of the Sharia. The Sunnah is the most important source of the Islamic faith after the Qur'an and refers essentially to the Prophet's example as indicated by the practice of the faith. The only way to know the Sunnah is through the collection of Ahadith, which consists of reports about the sayings, deeds and reactions of the Prophet … "

3. One principle expressly stated in the Qur'an and Sunnah is that the charging of interest upon a loan, in whatever form, is "Riba" and is contrary to the Sharia. At Sura II, 275-79 of the Qur'an it is stated that:

   > " … Allah has made buying and selling lawful and has made the taking of interest unlawful. Remember, therefore, that he who desists because of the admonition that has come to him from his Lord, may retain what he has received in the past; and his affair is committed to Allah. But those who revert to the practice, they are the inmates of the fire; therein shall they abide. … O Ye who believe, be mindful of your duty to Allah and relinquish your claim to what remains of interest, if you are truly believers. But if you do not, then beware of war from the side of Allah and his Messenger. If, however, you desist, you will still have your capital sums; thus you will commit no wrong, nor suffer any wrong yourself."

   Sura III 130 states that:

   > "O Ye who believe, devour not interest, for it goes on multiplying itself; and be mindful of your obligation to Allah that you may prosper.": *The Quran, translated by Muhammad Zafrulla Khan, Curzon Press, 1971*.

Shamil Bank is incorporated under the laws of Bahrain and licensed to act as a bank by the Ministry of Commerce and Bahrain Monetary Agency:

> "The Kingdom of Bahrain is a constitutional monarchy and 95% of its population are muslims. Nonetheless, while embracing and encouraging Islamic banking practice as a national policy, the principles of Islamic law, in particular the prohibition of Riba, have not been incorporated into the commercial law of Bahrain and there is an absence of any legal prescription as to what does and does not constitute 'Islamic' banking or finance." [paragraph 4 of the judgment]

The Bank holds itself out as applying Islamic principles. Clause 36 of its Memorandum of Association provided that:

> The Board of Directors shall take the necessary actions to ensure that all the investments and other business transactions have been referred to the Religious Supervisory Board for approval before carrying out any other business transactions by the Company or by any subsidiary or affiliate company under its control. [paragraph 7]

The Bank's expert witness made it clear that:

> …provisions of this kind are not unusual. In the absence of legal prescription as to what does and what does not constitute "Islamic" banking or finance, most Islamic banks create Religious or Sharia Supervisory Boards which review annually the operations of the bank and determine whether or not these have been carried out in accordance with Islamic law. They examine on a test basis each type of transaction entered into by the Bank and evidence to show that the transaction and dealings entered into by the Bank are in compliance with Sharia rules and principles, submitting an annual report to the shareholders in that respect. In this case the Bank's own Religious Supervisory Board certified in respect of the years 1995 and 1996 that:
>
> > "The Board believes that all the bank's business throughout the said year, including investment activities and banking services, were in full compliance with Glorious Islamic Sharia'a." [paragraph 8]

MORABAHA

The Beximco group wished to raise additional working capital. The monies were advanced by way of two Morabaha Financing Agreements which in their form related to sale of goods:

> It is not in dispute that a Morabaha agreement is a sale contract recognised as valid by Islamic law whereby the seller (the financier institution) agrees to purchase goods desired by the buyer and to sell them to the buyer (the client) for a deferred price, the difference between the original purchase price to be paid by the financier and the deferred price payable by the client being a stated profit known to and agreed upon by both seller and buyer. In order to avoid the appearance or characteristics of a loan at interest and to provide for and preserve the features of a contract of sale, the financier purchases the goods in its own name, and the goods must come into its possession (actual or constructive), remaining at its risk until the commodity is sold to the client. However, for that purpose the financier may appoint the client as agent for the purchase on behalf of the financier and, once the client effects such purchase as the agent of the financier, the client may retain possession of the commodity on its own behalf. The detailed form and content of Morabaha agreements varies. There are no standard forms and, in practice, the detailed terms and conditions will be agreed by the bank and its

> customer around the essential characteristics I have mentioned. It is the function of an Islamic bank's Religious Supervisory Board to ensure that the Morabaha agreement complies with Islamic law as interpreted by the Religious Supervisory Board. [paragraph 13]

In December 1995 the Bank and the first and second defendants entered into a Morabaha Financing Agreement under which the Bank agreed to purchase, through the second defendant acting as its agent, certain goods from specified sellers for immediate onward sale to the first defendant. In return the first defendant agreed to pay to the Bank the Morabaha price *"…defined in the agreement as the aggregate of the purchase price of goods purchased plus the Profit Element, calculated by reference to clause 2 of a Market Rate Agreement also entered into between the parties… if any payment due remained unpaid for any period after its due date, compensation would be payable to the Bank."* [paragraph 14]

IJARAH

Further funds were advanced by the Bank under a 1996 Morabaha Agreement. By September 1999 the amounts due under the 1995 and 1996 Morabaha Agreements had not been paid. The Bank and the first and second defendants entered into two Exchange in Satisfaction and User Agreements, one relating to the 1995 Morabaha Agreement and the other relating to the 1996 Morabaha Agreement. The form of the ESUAs, whereby the Bank, having acquired the ownership of the first and second defendants' assets, permitted their retention and use in return for regular payment of the scheduled user fees:

> … was in principle a method of financing recognised as legitimate by the Sharia as "Ijarah", the giving of something in rent. However, when that method of financing is adopted by a bank in place of a simple interest-bearing loan, the question of whether the transaction is legitimate according to the principles of Sharia depends upon an analysis of the particular terms and conditions of the agreement and may prove controversial. [paragraph 20]

Defaults occurred and the Bank claimed against the Defendants.

The issues to be decided by the Court of Appeal were set out in paragraphs 27- 30 of the judgment:

> 27. A number of defences were advanced by the defendants before the judge below, certain of which were regarded by the judge as having the hallmarks of trumped-up defences designed to avoid or delay payment. However, the principal defence advanced was that, (a) on a true construction of the governing law clause quoted in paragraph 1 of this judgment, the Morabaha Agreements and the ESUAs were only enforceable insofar as they were valid and enforceable both (i) in accordance with the principles of the Sharia (i.e. the rules or laws of Islam) and (ii) in accordance with English law; (b) in fact, the agreements were unlawful, invalid and unenforceable under the principles of the Sharia in that, despite their form as Morabaha Agreements, in the case of the 1995 and 1996 Morabaha Agreements, and as Ijarah leases, in the case of the first and second ESUAs, (which would be enforceable if they were a true reflection of the underlying transaction) the transactions were in truth disguised loans at interest. As such they amounted to unlawful agreements to pay Riba and were thus void and/or unenforceable.

28. In this connection it was stated in the witness statement of Mr Choudhury for the defendants that he made it clear that the monies sought from the Bank by the first and second defendants were required as working capital for the Beximco group and that it was the Bank which required that the transaction be structured in the forms adopted in order to comply with Sharia law. The fourth defendant, as a director of the first, second and fifth defendants' and a personal guarantor of the ESUAs, stated that:

> " … it is not uncommon for banks, in their enthusiasm to make profitable loans, to use a Morabaha Agreement to disguise what is, as a matter of commercial reality, an interest-bearing loan. That is precisely what happened in the present case and both the Claimant and the Defendants were quite content that this should happen. Neither was under any illusion as to the commercial realities of the transactions, and the claimant was happy to dress the loan transactions up as Morabaha sales (or Ijarah leases), whilst taking no interest in whether the proper formalities of such a sale or lease were actually complied with."

29. The rival expert evidence as to the validity of the agreements under Islamic law was as follows. The Bank's expert, Dr Lau, the former director of the Centre of Islamic and Middle Eastern Law, stated 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. Even within particular jurisdictions such as Pakistan, which are committed and constitutionally obliged to introduce Islamic financial systems, the issue is subject to on-going debate and a high degree of uncertainty. In the absence of any agreement on the boundaries of 'Islamic banking' or, indeed, on what ought to be the precise ingredients of a Morabaha agreement, it is in practice up to individual banks to determine the issue. In the absence of any legal prescription as to what does and what does not constitute Islamic banking or finance, most Islamic banks, including those in Bahrain, seek the advice of Islamic scholars who examine and approve particular agreements and forms of agreement, the role of the Religious Supervisory Committee being to formulate the bank's interpretation of the Sharia.

30. Strictly interpreted " the Glorious Sharia'a" refers to the divine law as contained in the Qur'an and Sunnah. However, most of the classical Islamic law on financial transactions is not contained as 'rules' or 'law' in the Qur'an and Sunnah but is based on the often divergent views held by established schools of law formed in a period roughly between 700 and 850 CE. The particular form and content of Morabaha agreements varies. If a bank's Religious Supervisory Board is satisfied that the bank's activities are in accordance with Sharia law, that concludes the matter, there being no provision in Bahrain law, or Islamic law generally, for an appeal by a customer of the bank against the Board's rulings and certifications. Finally, even if the relevant agreements amounted to agreements to pay Riba, the principal sums advanced could be validly claimed.

Dr Lau's conclusion was that the concern of the defendants that the sums advanced were not used to purchase the goods and/or equipment (which were the subject of the 1995 and 1996 Morabaha Agreements), but were in fact part of the general working capital of the first and

second defendants was of no relevance to the question whether or not the Morabaha agreements complied with Islamic law. Dr Lau said:

> In my opinion for the Morabaha Agreements to be in accordance with Islamic law all that is required is that they are certified as such by Shamil Bank's Religious Supervisory Board and the principal amounts are dispensed in accordance with the terms of the 1995 and 1996 Morabaha Agreements.
>
> [paragraph 31]

At paragraphs 32-34, the position of the defendants' expert, Mr Justice Khan, former chairman of the Sharia Appellate Bench of the Supreme Court of Pakistan, is set out:

> 32. He acknowledged that "wherever a question of interpretation of the principles contained in the Qur'an and Sunnah is involved, the application of the rules of Sharia'a has and will continue to give rise to disputes between different jurists". He also did not contradict the assertion of Dr Lau that most of the classical Islamic law on financial transactions was not to be found in the Qur'an and Sunnah. However, he made clear (as Dr Lau did not dispute) that the injunction against the payment of Riba is contained in both those holy books and that it is uncontroversial that under Islamic law interest charged on loans by banks is Riba and prohibited. Equally, any agreement in which, in substance, interest is being charged upon a loan is unlawful, void and unenforceable.
>
> 33. Mr Justice Khan acknowledged that the Sharia recognises two modes of financing as permissible, namely Morabaha and Ijarah agreements, but asserted that, for such transactions to be valid, the requirements prescribed and provided for in the agreement must be fulfilled, failing which the transaction as a whole will be void according to the principles and rules of Sharia. On the basis of the (uncontradicted) assertion of the defendants that the advances were never applied or intended to be applied in the purchase or lease of any property, the relevant agreements were void. The ESUAs were similarly void and unenforceable on the basis of a number of arguments advanced, the principal one of which was that, irrespective of their form as purported Ijarah leases of assets, the ESUAs simply constituted a rescheduling or roll-over of the 1995 and 1996 Morabaha Agreements, the bank charging interest or an additional amount over and above the sums due in consideration of the giving of time. This too was Riba and accordingly prohibited and void.
>
> 34. Finally, so far as the position of the Bank's Religious Supervisory Board was concerned, Mr Justice Khan stated that certification by the Board that the operations of the Bank were according to the Sharia would not be a decision binding on any court dealing with the dispute under the law of Sharia. The dispute would fall to be resolved by the court in the light of its own view of the position under Sharia law. In any event there was no evidence that the Board had had knowledge of, nor was it required to approve, the particular transaction in this case, its function being one of overall supervision and approval of the methods and procedures adopted by the bank in the course of its business.

On the issue of governing law (and therefore on the liability of the Defendants /Appellants to the Plaintiff /Respondent Bank), Lord Justice Potter stated at paragraph 55 of his judgment that:

> …so far as the "principles of … Sharia" are concerned, it was the evidence of both experts that there are indeed areas of considerable controversy and difficulty arising not only from the need to translate into propositions of modern law texts which centuries ago were set out as religious and moral codes, but because of the existence of a variety of schools of thought with which the court may have to concern itself in any given case before reaching a conclusion upon the principle or rule in dispute. The fact that there may be general consensus upon the proscription of Riba and the essentials of a valid Morabaha agreement does no more than indicate that, if the Sharia law proviso *were* sufficient to incorporate the principles of Sharia law into the parties' agreements, the defendants would have been likely to succeed. However, since I would hold that the proviso is plainly inadequate for that purpose, the validity of the contract and the defendants' obligations thereunder fall to be decided according to English law. It is conceded in this appeal that, if that is so, the first and second defendants are liable to the Bank.

The appeal was dismissed.

3.2 Significance of the Beximco case

In the course of considering the governing law issue, the Court of Appeal dealt with issues relating to *Riba, Morabaha* agreements and *Ijarah* leases. It is that aspect of the *Beximco* case which has created considerable interest in jurisdictions outside England.

Another aspect of the *Beximco* case is of interest in relation to the *Fortis Bank* case referred to later: the "dressing up" of the transaction in the *Beximco* case is similar to the "synthetic" Letter of Credit in the *Fortis Bank* case: the relevant passages in the *Beximco* case are referred to in the next section.

4. Litigation - Supreme Court, New York County

Fortis Bank (Nederland) N.V. v Abu Dhabi Islamic Bank [7]

4.1 Disguising the underlying transaction

The *Fortis Bank* case involved a "synthetic" Letter of Credit which had no nexus to the transaction in question.

A similar situation existed in the *Beximco* case: the Court of Appeal judgment made clear the fact that the Morabaha Agreement was used to disguise the underlying transaction, which transaction was an interest-bearing loan.

[7] 2010 NY Slip Op 52415(U) [32 Misc 3d 1232(A)] Decided on August 25, 2010. Published by New York State Law Reporting Bureau.

At paragraph 15 of the *Beximco* judgment of Lord Justice Potter, reference is made to the ostensible purpose of the Morahaba Financing Agreement:

> In accordance with clause 4.1 of the 1995 Morabaha Agreement, the Bank advanced to the second defendant US $15 million ostensibly for the purposes of purchasing the specified goods. Between 28 March 1996 and 28 September 1997, the first defendant made seven payments in accordance with the 1995 Payment Schedule Letter.

And again at paragraph 17:

> In accordance with clause 4.1 of the 1996 Morabaha Agreement, on 15 July 1996, the Bank paid to the first defendant US $ 15 million ostensibly for the purpose of purchasing the specified goods….

At paragraph 28-referred to earlier- is the explanation for the "disguise":

> " … it is not uncommon for banks, in their enthusiasm to make profitable loans, to use a Morabaha Agreement to disguise what is, as a matter of commercial reality, an interest-bearing loan. That is precisely what happened in the present case and both the Claimant and the Defendants were quite content that this should happen. Neither was under any illusion as to the commercial realities of the transactions, and the claimant was happy to dress the loan transactions up as Morabaha sales (or Ijarah leases), whilst taking no interest in whether the proper formalities of such a sale or lease were actually complied with."

And at paragraph 47 reference is made to "dressing up" the Morabaha sales (or Ijarah leases):

> It is common ground in the context of the summary judgment application that, when the parties 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, and both were content "to dress the loan transactions up as Morabaha sales (or Ijarah leases), whilst taking no interest in whether the proper formalities of such a sale or lease were actually complied with."

4.2 Abu Dhabi Islamic Bank

Before looking at the decision in the *Fortis Bank* case, it is useful to note that Abu Dhabi Islamic Bank on its website sets out a view of Islamic Banking:

> Understanding Islamic Banking[8]
>
> The basic principles of Islamic Banking revolves around several well-established concepts - based on Islamic canons, these cover the following: - First and foremost, Islamic banking must operate within the framework of the religion, based on Qura'n and Sunna. Hence only Halal activities are allowed. This holds ethics paramount and,

[8] https://www.adib.ae/understanding-islamic-banking-0

consequently those activities forbidden to Muslims, i.e. gambling, liquor, hoarding and usury based lending are strictly avoided.

The Bank does not, for example finance liquor manufacturing, transportation, storage or distribution companies. Scholars trained in Islamic law (Islamic Jurisprudence) screen the suitability of investments on an ongoing basis and provide guidance on products to the Bank's management. Interest, known as Reba in Islam is forbidden. Hence, all banking activities must avoid interest. Instead of interest, the Bank earns profit (mark-up) and fees on financing facilities it extends to customers. Also, depositors earn a share of the Bank's profit as opposed to interest.

Partnership and the Sharing of Risks.

Another principle of Islamic finance is based on profit sharing partnership between the parties involved in a transaction. The return on savings and investment accounts are variable, and dependent on the Bank's performance and the profits from Halal business transactions only. While these profits are not necessarily guaranteed and are subject to a degree of risk, these are managed professionally to ensure better returns than many other conventional alternatives. Current accounts do not earn income as they are taken as Qard, from depositors to the bank and because they can be drawn on demand by customers without notice. They do not bear any risk of loss either since they are kept as a safekeeping or Amanat.

4.3 Fortis Bank (Nederland) N.V. v Abu Dhabi Islamic Bank

This is a decision of Justice Melvin L Schweitzer.[9]

The Claims

The Plaintiff, Fortis Bank, incorporated in The Netherlands, sought summary judgment against the Defendant, Abu Dhabi Islamic Bank [ADIB], a bank established in the UAE. The claim related to a Letter of Credit of approximately $40 million.

[9] The Honorable Melvin L. Schweitzer's remarkable and distinguished legal career includes a decade of service on the New York State bench, six of those years as Acting New York State Supreme Court Justice, First Judicial Department, Commercial Division. He served with distinction on this specialized court, handling all manner of complex commercial cases. Prior to his judicial service, Hon. Schweitzer practiced law for more than 30 years, primarily as a Senior Partner, for a prominent New York law firm, and focused on corporate and securities law, public finance and insurer insolvency….
In private practice, Justice Schweitzer represented virtually all of the money center banks as underwriter's counsel in bond offerings for such issuers as the City of New York (including the period of 1975-1982 during the City's fiscal crisis), the State of New York, New York colleges and universities, and other city and state issuers around the country. He acted as principal outside securities counsel for one of the largest advertising companies in the world, and also acted as counsel to the New York Superintendent of Insurance in the liquidation of a major property and casualty insurance company. Additionally, as an advocate in private practice, he participated in formal and informal mediation proceedings involving construction and insurer insolvency disputes.
https://www.namadr.com/neutrals-bio/hon-melvin-l-schweitzer-ret/

Plaintiff moved for summary judgment pursuant to CPLR 3212. Defendant moved to compel the production of documents from plaintiff pursuant to CPLR 3124.

Note on Letters of Credit

In a footnote to his judgment, Justice Schweitzer gave an overview of Letter of Credit transactions:

> The transactions revolving around this particular letter of credit are singular enough to warrant an overview of the roles of the parties in a standard letter of credit transaction. To begin, an applicant requests a letter of credit from an issuing bank for the beneficiary in order to support a commercial or financial transaction. The issuing bank then issues the letter of credit, which may provide for an arrangement involving a confirming or negotiating bank. Fortis acted as the negotiating bank in this transaction. The role of the negotiating bank is to pay the beneficiary, sometimes early and at a discount, so that the beneficiary does not have to wait for payment by the issuing bank pursuant to the terms of the letter of credit. An additional or second confirming bank may be a party to the transaction. In this case, ADIB at various times, has been referred to as an advising bank and a confirming bank. ADIB's role in this transaction was that of a confirming bank, which assumes the risk of the issuing bank and agrees to honor a conforming presentation of documents.

Background

The Judge set out the background to the case:

> This action for breach of contract is brought by Fortis Bank (Nederland) N.V. (Fortis), an international provider of banking and insurance services incorporated in the Netherlands, against Abu Dhabi Islamic Bank (ADIB), a bank established in the United Arab Emirates. The action is set against the backdrop of a series of financial transactions pertaining to an approximately $40 million letter of credit. On June 16, 2008, Bank Awal (Awal), a bank established in the Kingdom of Bahrain, issued a Letter of Credit (Letter of Credit) in favor of the beneficiary, Bunge S.A. (Bunge), a large European commodities trading company based in Switzerland, purportedly to facilitate the sale of Brazilian soybeans and maize. This transaction was alleged to have been entered into by Awal upon the application of the financial arm of its parent holding company, Al Gosaibi Trading and Services Co. (ATS).
>
> Under the terms of the Letter of Credit arrangement, Fortis, acting as the negotiating bank … was entitled to reimbursement from Awal 360 days after it negotiated documents required under the Letter of Credit and paid Bunge, the beneficiary. Awal was obligated to reimburse Fortis on that date, contingent upon its receipt from Fortis of confirmation that documents had been presented by Bunge "in conformity with the L/C terms at their [Fortis'] counter and have been forwarded to the issuing bank [Awal]...."
>
> On June 16, 2008 by SWIFT message, AWAL requested that ADIB add its confirmation to the Letter of Credit. On June 14, 2008 by SWIFT message to Fortis, ADIB, in exchange for a fee of $499,999.96 from Awal, did add its confirmation to the Letter of Credit, thus also obligating it to reimburse Fortis. This confirmation references

any ports in Taiwan or Spain as the place of final destination or delivery of the commodities to be shipped.

Development of the Letter of Credit Claims

Justice Schweitzer noted that the Letter of Credit confirmation arrangements were governed by the Uniform Customs and Practice for Documentary Credits ("UCP"), rather than the Uniform Commercial Code ("UCC"): “The UCP does not have the force of law, but is binding if the terms of a letter of credit explicitly incorporate its provisions.”

In June 2008, Fortis received the documentation required under the Letter of Credit and sent a SWIFT message to ADIB on June 23, 2008:

> … informing ADIB that it, in fact, had negotiated "credit complying" documents and that, in accordance with the terms of the Letter of Credit, it would be sending these documents directly to Awal, the issuing bank. Fortis asked ADIB for confirmation that it would reimburse Fortis 360 days later, on June 15, 2009. In its SWIFT message, Fortis stated that "in due course we shall claim reimbursement from you for this amount with value date 15.06.2009." ADIB replied on June 24, 2008, acknowledging its obligation under its confirmation of the Letter of Credit and stating it would reimburse Fortis on that date. On July 2, 2008, Awal confirmed to ADIB that it had received and accepted the documents sent to it by Fortis and confirmed the maturity date of the Letter of Credit. Awal's SWIFT message to ADIB also said that Awal had instructed its bank in New York, HSBC, to honor ADIB's reimbursement claim on the maturity date.
>
> The following year, on June 4, 2009, Fortis demanded reimbursement from ADIB under the confirmation arrangement, but ADIB did not reimburse Fortis. Consequently, Fortis has brought the present action to compel ADIB to make payment under its confirmation obligation.
>
> On June 14, 2009, one day before the June 15 maturity date for the reimbursement, ADIB went to court in the Kingdom of Bahrain and obtained an *ex parte* injunction against its paying Fortis on the confirmation. ADIB alleges that it sought this injunction because it had been informed that agents of Awal's Saudi holding company, the Saad Group, were involved in fraud concerning forged signatures on financial facilities enabling the Saad Group to raise capital. Reports had appeared in the press that the Saad Group was in financial difficulty, had defaulted on its obligations and had its accounts frozen. The reports also referenced irregularities in trade finance transactions within ATS. In the Bahraini court, ADIB alleged that the sale of goods underlying the Letter of Credit never took place and was merely an arrangement to finance ATS. ADIB demanded that Fortis supply them with copies of the "credit complying" documentation it had negotiated and sent to Awal. Fortis responded that nothing in the confirmation transaction, as structured, and which ADIB had negotiated, entitled ADIB to presentation of such documents as a condition to its obligation to reimburse Fortis.
>
> Fortis, in connection with this action, sought an order of attachment from this Court, in order to establish *quasi in rem* jurisdiction over ADIB. The Court granted Fortis' application for the order of attachment on September 25, 2009 on the basis of ADIB's contacts with New York, which consisted of New York bank accounts with Citibank, JP Morgan Chase, and Bank of America, ADIB's receipt of its $499,999.96 fee in the

JP Morgan Chase account, and ADIB's demand to be paid $39,999,996.52 on the Letter of Credit from Awal's bank in New York, HSBC. *Fortis Bank (Nederland) N.V. v Abu Dhabi Islamic Bank*, 9/25/09.

On December 14, 2009, the High Civil Court of Bahrain rejected ADIB's case against Fortis and also AWAL and ATS. The injunction that ADIB had received enjoining its payment to Fortis was lifted the same day.

"Synthetic" Letter of Credit

ADIB then alleged that the Letter of Credit was a so-called 'synthetic,' or 'structured,' letter of credit:

> …which had no nexus to the trade or commercial transaction referred to therein. To support this assertion, ADIB submitted a Declaration of Pottengal Mukundan, a Director of the International Maritime Bureau (IMB), a division of the International Chamber of Commerce. According to his Declaration, IMB investigates fraud and malpractice in shipping and trading for banks, shipping companies and charterers. Mr. Mukundan was asked by counsel for ADIB to review the documentation issued in connection with, and circumstances surrounding, the Letter of Credit for indicia of fraud. He was also asked whether the circumstances suggested "the Letter of Credit was not used to facilitate the trade transaction for which ADIB supplied its confirmation." Mr. Mukundan's Declaration sets forth a litany of what he characterizes as aberrations in the transaction, which he says raise serious concerns regarding the legitimacy of the Letter of Credit as a means of payment for the goods shipped. Of particular significance to Mr. Mukundan is that Dasca, one of the ultimate purchasers in Spain …, paid Bunge Iberia, S.A. directly for the purchase of 30,000 Metric Tons of maize, thus obviating the need to draw on the Letter of Credit to secure payment for that particular shipment. Mr. Mukundan's investigation also revealed that the payment was made two weeks before the maize had arrived in Spain and before the Letter of Credit was first confirmed.
>
> In further support of its assertion that this Letter of Credit had no nexus to the transaction referred to therein, ADIB also submitted to the court a Declaration of Vincent O'Brien, a trade finance specialist also experienced in international banking operations….

The Fraud Rule and the Sztejn case

Justice Schweitzer noted that, generally, the fraud rule in the law of letters of credit is a rule whereby:

> "…although documents presented are facially in strict compliance with the terms and conditions of the letter of credit, payment thereunder may be stopped if fraud is found to have been committed in the transaction before payment is made." Xiang Gao, The Fraud Rule in the Law of Letters of Credit, 29 (Kluwer International 2002).
>
> The landmark case that established the fraud standard in the law of letters of credit was *Sztejn v J. Henry Schroder Banking Corp.*, 177 Misc 719 (Sup Ct, NY Co. 1941). In *Sztejn*, the plaintiff, Sztejn, contracted to purchase bristles from an Indian company,

> Transea. The plaintiff asked Schroder to issue a letter of credit to the benefit of Transea which then procured the correct documentation of the transaction and drew a draft to the order of Chartered Bank. Chartered Bank then presented the draft and documents to Schroder for payment. But Sztejn had received rubbish instead of bristles and sought to have the letter of credit and the draft declared void. In *Sztejn* the court decided to look past the fact that the documents used in the transaction conformed to the requirements of the letter of credit and examined the legitimacy of the underlying transaction. Finding the shipment of rubbish rather than bristles to be fraudulent, the court blocked payment on the Letter of Credit.
>
> Here, ADIB alleges that the transaction at issue in this case is even more suspect than the fraudulent transaction the court voided in *Sztejn*. Without any physical goods being represented by the documents at all, ADIB argues that this "synthetic" or "structured" Letter of Credit involves a transaction where the "goods" are worth *less* than a box of rubbish. Fortis counters that *Sztejn* is inapplicable on these facts because there simply is no fraud here due to ADIB's knowledge of the exact structure and purpose of the Letter of Credit prior to ADIB's having agreed to reimburse Fortis.
>
> To be sure, the case here is more structurally complex than the facts in *Sztejn*. Here, the entity most similar to the plaintiff in *Sztejn* is ATS, which does not assert fraud. Furthermore, the confirmation arrangements between ADIB and Awal, and between ADIB and Fortis, did not exist in *Sztejn*. These facts, however, do not lead to a finding of fraud in this case.[10]

Justice Schweitzer stated that, although *Sztejn* is an influential case-

> … which has been cited in countless letter of credit fraud cases in the United States and around the world, ADIB has directed the court's attention to several federal and international cases that it believes should guide the court's thinking. The case most directly analogous to the facts of the case here is a British decision, *Banco Santander SA v Banque Paribas*, 2000 WL 191098 (Eng. Ct of App, Civ Div, Feb. 25, 2000). In *Banco Santander*, the court ruled that a bank which discounts a letter of credit by paying prior to the date of maturity is not entitled to protection against assertion of the fraud rule if there was fraud subsequently discovered in the underlying transaction. This is true even if the discounting bank was unaware of the fraud when it discounted the letter of credit. Again, ADIB believes it has shown fraud that puts Fortis in an even more exposed position than Banco Santander. It argues that Banco Santander was not made aware of the fraud until after the discount, while Fortis knew about the allegedly fraudulent transaction from the inception…
>
> The court is of the view that ADIB's reliance on *Banco Santander* is misplaced. Even if *Banco Santander* were good law, its value to the court does not rise above mere

[10] "The development of English case law in relation to the fraud exception is based on the American case*:*
Sztejn v. Henry Schroder Banking Corporation. This was a decision of Judge Schientag…That decision of an American Court given some 60 years ago has been often quoted in the English Courts. Indeed, Lord Diplock in the *United City Merchants* case referred to Sztejn as 'the landmark American case'."
"Trade Finance Fraud" ICC International Maritime Bureau.
Chapter 21 "The Fraud Exception in English Law", Anthony Connerty.
The Foreword to the book was written by Captain P. Makundan, Director of the ICC International Maritime Bureau.
April 2002. ICC Publication No 643 ISBN No. 92-842-1312-6

> suggestion. The logic of *Banco Santander* is a path that the court might have chosen to follow (assuming, of course, that there was a fraud of which Fortis was unaware at the time it discounted the Letter of Credit) in the absence of the UCP 600 revisions. Because of such revisions, however, the case has no binding authority. The logic in *Banco Santander* thus is essentially irrelevant here. Even if the court were to believe that *Banco Santander* were correctly decided, the UCP 600 revisions would prevail in this case…
>
> It appears the "synthetic" or "structured" Letter of Credit used in this case may be something of a novel and unusual device in trade finance. It differs from traditional notions of how a letter of credit is structured and what it is supposed to facilitate. Being novel and unusual, however, is not the same as being fraudulent. ADIB asserts that the "synthetic" or "structured" Letter of Credit's actual purpose was to raise funds for ATS by somehow disadvantaging ADIB. While ADIB says that the "synthetic" or "structured" Letter of Credit is fraudulent in that it appears to underpin a loan rather than a sale of goods, it has not explained what the practical difference between the two arrangements is *viz.* ADIB. The Letter of Credit was set up in a way that severely limited ADIB's role. Bunge was to present the documents to Fortis, Fortis was to send those documents to Awal, Awal was to confirm receipt of the documents to ADIB, and ADIB was to reimburse Fortis. ADIB had no role to play in the underlying transaction. In truth, the underlying transaction should be irrelevant to ADIB.

Letters of Credit and the Independence Principle

The Court's view was that one of the most important principles underpinning letters of credit is that of independence:

> Under this principle, the obligation of the issuing or confirming bank to honor the beneficiary's demand for payment is viewed as distinct from the other transactions involved, including the underlying commercial or financial transaction and the agreement between the applicant and the issuer. *See*, Xiang Gao, *The Fraud Rule in the Law of Letters of Credit*, 23, *supra*. A showing of fraud is the only method by which a confirming bank might hope to avoid payment.
>
> While maintaining the fraud standard laid out in *Sztejn*, New York courts have embraced the independence principle. The Appellate Division, First Department, has held that, "[a] Letter of Credit represents a separate contract between the issuing or confirming bank and the beneficiary, independent of the contract for the sale of goods between the buyer and the seller" *Fertico Belgium, S.A. v Phosphate Chems Export Assn, Inc.*, 100 AD2d 165, 172 (1st Dept), *appeal dismissed*, 62 NY2d 802 (1984). The only time that a separate letter of credit contract between the bank and the beneficiary can be interfered with is when "fraud in the transaction" has been shown. *Id* at 173. Barring a clear showing of fraud, the independence principle "provides that the issuing bank's obligation to honor drafts drawn on a letter of credit by the beneficiary is separate and independent from any obligation of its customer to the beneficiary under the sale of goods contract and separate as well from any obligation of the issuer to its customer under their agreement" *Ross Bicycles, Inc. v Citibank, NA*, 161 Misc 2d 351, 354 (NY Co 1994). As noted, *supra*, the Letter of Credit transaction here is somewhat more complicated than the transactions contemplated by the courts in the cases cited above. Nonetheless, an issuer of a letter of credit, including the issuer or negotiating bank here,

is not obligated to deal with questions concerning the underlying transaction. *See Boulder & Co., Inc. v Citibank, N.A.*, 28 AD3d 180, 181 (1st Dept 2006). The independence principle is also enshrined in both the UCP and the UCC.

To overcome the independence principle and not meet an obligation, a party must show fraud. In the end, virtually all of ADIB's legal contentions are premised on the belief that there is clear proof of fraud in the structure of the transaction underlying the Letter of Credit. It appears, however, that ADIB clearly was aware of the structure of the transaction even before it agreed to add its confirmation. It is disingenuous for ADIB now to claim it has no obligation to honor the Letter of Credit and reimburse Fortis essentially because of the very structure of which it was fully aware.

Fortis has shown there is no genuine issue of material fact in this case by demonstrating that ADIB knew of the structure of the transaction before undertaking its own reimbursement obligation. The burden has thus shifted from Fortis to ADIB. ADIB has not met the burden of demonstrating a genuine issue of material fact…

Accordingly, defendant's motion to compel discovery is denied, and plaintiff's motion for summary judgment is granted.

5. Arbitration of Islamic Finance Disputes

Whilst many parties involved in financial and banking disputes prefer litigation as a dispute resolution method, there is an alternative: arbitration.

This section looks at two arbitral systems aimed specifically at Islamic Finance disputes and considers the suitability of international commercial arbitral institutions such as the LCIA, ICC, AAA/ICDR and CIETAC.

5.1 Asian International Arbitration Centre

The AIAC is based in Kuala Lumpur. It was founded under the auspices of Asian-African Legal Consultative Organisation (AALCO) over four decades ago.

The AIAC's 2018 Arbitration Rules [11] contain provisions dealing with Shariah principles. Rule 11 is concerned with the procedure for reference to Shariah Advisory Council or Shariah Expert:

1. Whenever the arbitral tribunal has to:
   (a) form an opinion on a point related to Shariah principles; and
   (b) decide on a dispute arising from the Shariah aspect of the contract; the arbitral tribunal may refer the matter to the relevant Council or Shariah expert for its ruling.
2. For the purposes of Rule 11(1) above, the relevant Council or Shariah expert shall be:
   (a) the Shariah Council under whose purview the Shariah aspect to be decided falls, where there is one; or

[11] https://www.aiac.world/wp-content/arbitration/Arbitration-Rules-2018.pdf

(b) where the Shariah aspect to be decided does not fall under the purview of a specific Shariah Council, a Shariah Council or expert is to be agreed between the Parties. Where the Parties fail to agree to a Shariah Council or expert, the provisions relating to experts appointed by the arbitral tribunal under Article 29 shall apply.

3. Any reference under Rule 11(1) above shall include any relevant information as the relevant Council or Shariah expert may require to form its opinion including the question(s) or issue(s) so referred, the relevant facts, issues and the questions to be answered by the relevant Council or Shariah expert.
4. If a reference to the relevant Council or Shariah expert has been made, the arbitral tribunal shall then adjourn the arbitration proceedings until the ruling has been given by the relevant Council or Shariah expert, as the case may be, or if there are any other areas of dispute which are independent of the said ruling, shall proceed to deliberate on such areas which are independent of the said ruling.
5. The relevant Council or Shariah expert, as the case may be, shall then deliberate and make its ruling on the issue or question so submitted.
6. The relevant Council or Shariah expert shall deliver its ruling within the period of 60 days from the date the reference is made.
7. Where the relevant Council or Shariah expert fails to deliver its ruling within 60 days, the arbitral tribunal may proceed to determine the dispute and give its award based on the submissions it has before it. The validity of an award given pursuant to this Rule shall not be affected in any way by the unavailability of the relevant Council or Shariah expert's ruling.
8. For avoidance of doubt, the ruling of the relevant Council or the Shariah expert may only relate to the issue or question so submitted by the arbitral tribunal and the relevant Council or the Shariah expert shall not have any jurisdiction in making discovery of facts or in applying the ruling or formulating any decision relating to any fact of the matter which is solely for the arbitral tribunal to determine.

5.2 International Islamic Centre for Reconciliation and Arbitration

IICRA was founded in 2005. Based in Dubai, it is an independent international non-profit organization. IICRA specializes in the settlement of financial, commercial, banking, investment and real estate disputes in compliance with Sharia Law by means of conciliation and arbitration.

IICRA's Arbitration Rules [12] are in the process of being reviewed. The revised Rules are expected to be published in July.

Article 28 of the current Rules provides that in all cases-

> …the Panel shall exclude any provisions that contradict in the law that should be applied if such provisions are not in conformity with the rules of Islamic Sharia. The Arbitration Panel may invoke for the disputed issue whatever it deems appropriate from

[12] https://www.iicra.com/contact/

among the viewpoints of various schools of Islamic thought, rulings of Islamic Fiqh academies, and opinions of Sharia supervisory boards at Islamic financial institutions.

Article 28 makes it clear that the Panel –

> …may choose to be guided by local or international commercial rules or conventions that are not at variance with the provisions of Islamic Sharia. In all cases, the Panel shall abide by the requirements of justice and neutrality in its administering the proceedings and shall be careful in hearing the submissions of each party in full.

Article 37 provides that the Arbitration Panel-

> …may refer the draft ruling before it is signed to the Sharia board of the Centre. The Shari'a Board may introduce amendments in the form on the ruling. It may also draw the attention of the Arbitration Panel to substantive issues related to Islamic Sharia, without any prejudice to the liberty of the Arbitration Panel in drafting the ruling.

5.3 International Arbitral Institutions

Whilst organizations like the AIAC and IICRA provide specifically for Sharia principles, the Arbitration Rules of institutions such as the LCIA, ICC, AAA/ICDR and CIETAC [amongst others] could be used in relation to Islamic Finance disputes. Those Rules give a definition of applicable law wide enough to cover Islamic principles.

The LCIA Rules [in force 1 October 2020] provide in Article 14.2:

> The Arbitral Tribunal shall have the widest discretion to discharge these general duties, subject to the mandatory provisions of any applicable law or any rules of law the Arbitral Tribunal may decide to be applicable; and at all times the parties shall do everything necessary in good faith for the fair, efficient and expeditious conduct of the arbitration, including the Arbitral Tribunal's discharge of its general duty.

The latest version of the ICC Rules [in force 1 January 2021] provide in Article 21:

1) The parties shall be free to agree upon the rules of law to be applied by the arbitral tribunal to the merits of the dispute. In the absence of any such agreement, the arbitral tribunal shall apply the rules of law which it determines to be appropriate.
2) The arbitral tribunal shall take account of the provisions of the contract, if any, between the parties and of any relevant trade usages.
3) The arbitral tribunal shall assume the powers of an amiable compositeur or decide ex aequo et bono only if the parties have agreed to give it such powers.

The AAA/ICDR International Arbitration Rules [in force 1 March 2021] in Article 34 state in relation to Applicable Laws and Remedies:

The arbitral tribunal shall apply the substantive law(s) or rules of law agreed by the parties as applicable to the dispute. Failing such an agreement by the parties, the tribunal shall apply such law(s) or rules of law as it determines to be appropriate.

Article 49 (2) of the CIETAC Rules provides that:

Where the parties have agreed on the law applicable to the merits of their dispute, the parties' agreement shall prevail. In the absence of such an agreement or where such agreement is in conflict with a mandatory provision of the law, the arbitral tribunal shall determine the law applicable to the merits of the dispute.

5.4 The English Arbitration Act

As mentioned earlier, the English Arbitration Act 1996 seems to authorise an arbitral tribunal to deal with Islamic Finance disputes. Section 46 of the Act dealing with Rules applicable to substance of dispute states:

> (1) 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.
> (2) For this purpose the choice of the laws of a country shall be understood to refer to the substantive laws of that country and not its conflict of laws rules.
> (3) If or to the extent that there is no such choice or agreement, the tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.

"Other considerations" in section 46(1)(b) –

> …would also encompass a system of law such as Jewish law or Sharia law otherwise invalid under subs. (1)(a): *Halpern v. Halpern* [2007]2 Lloyd's Rep 56… [13]

And-

> English courts have considered the meaning of 'such other considerations' under section 46 (1) (b) of the Arbitration Act 1996 in the following cases:
>
> …in *Halpern v. Halpern*…which concerned the application of Jewish law, the Court of Appeal ruled that if the seat of arbitration were England, then section 46(1)(b) of the 1996 Act would permit the tribunal to apply the parties' choice of some other form of rules or non-national law to govern the merits of their dispute.
>
> Nevertheless, the meaning of 'such other considerations' is not yet entirely settled… [14]

6. Enforcement: The New York Convention

The enforcement in one state of a judgement made in the Courts of another state may not always be straightforward.

[13] The Arbitration Act 1996: A Commentary [Fifth Edition]: Harris, Planterose & Tecks, page 245. Wiley Blackwell. ISBN 978-0-470-67398-0

[14] Redfern and Hunter on International Arbitration [Sixth Edition], paragraph 3.190. OUP. ISBN 978-0-19-871425-5

In comparison, the enforcement of an international arbitral award made in one state may be enforceable in the Courts of another state under the provisions of the New York Convention.

As at March 2021, 168 states were parties to the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards, generally known as the New York Convention. The Convention requires courts of contracting states to give effect to private agreements to arbitrate and to recognize and enforce arbitration awards made in other contracting states.

7. Conclusions

As the use of Islamic Finance increases so the risk of disputes increases. This article has looked at litigation and arbitration as methods of resolving such disputes.

The preferred method of dispute resolution – as in the case of banking /finance disputes generally – is litigation. In particular, litigation in the Courts seen to have specialist knowledge of such disputes: the London and New York Courts.

Two cases have been considered.

In the *Beximco* case the English Court of Appeal considered various aspects of Islamic Finance. The parties to the dispute were under no illusion as to the commercial realities of the transactions and were content "to dress the loan transactions up as Morabaha sales (or Ijarah leases), whilst taking no interest in whether the proper formalities of such a sale or lease were actually complied with."

The disguising of the underlying transaction in the English case bore similarities to the case decided by Justice Melvin L Schweitzer in the Supreme Court, New York County. The *Fortis Bank* case involved a “synthetic” Letter of Credit which had no nexus to the underlying transaction which involved the Abu Dhabi Islamic Bank.

An alternative to litigation in national courts is arbitration. Two organisations dealing with Islamic Finance arbitration have been considered: the Asian International Arbitration Centre in Kuala Lumpur and the International Islamic Centre for Reconciliation and Arbitration based in Dubai.

In addition, there are various international arbitral institutions whose arbitration Rules give a definition of applicable law wide enough to cover Islamic principles: the Rules of the LCIA, ICC, AAA/ICDR and CIETAC.

The English Arbitration Act seems to authorise an arbitral tribunal to deal with Islamic Finance disputes.

The recognition and enforcement provisions of the New York Convention provide an incentive for the use of arbitration as a method of resolving Islamic Finance disputes.

No doubt both litigation and arbitration will continue to be used for the resolution of Islamic Finance disputes. Both have their advantages and disadvantages.