# The adjudication of Shari'ah issues in Islamic finance contracts: Guidance from Malaysia

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*Islamic finance contracts are not immune to the Shari'an compliance risk. Parties are free to raise Shari'ah issues and courts are expected to recognise and adjudicate the same. English law was and still is the most preferred choice of law in cross-border Islamic finance contracts. However, there is little that an English court can do to adjudicate Shari'ah issues. This is not surprising as it is, after all, a secular court which is not equipped to ascertain Shari'ah ruling. Hence, this article proposes Malaysian law as the law of reference. The Shari'ah issues raised before the Malaysian courts will be referred to the Shari'ah Advisory Council of the Central Bank of Malaysia for ruling which will then bind the courts. The efficacy and workability of this model has already been tested in Malaysia. This article argues that the model could be exported to and adopted by other countries wishing to introduce and develop their own Islamic finance industry.*

## INTRODUCTION

The Islamic banking and finance industry today is a complex and very vibrant addition to the existing financial system which offers hitherto unseen alternatives. It is an industry premised on the belief that wealth is entrusted to humanity by God[1] who prohibits products, services, and practices which are oppressive and unfair,[2] and who imposes upon humanity the duty to command the good, the honest, the transparent, the just and the fair, and forbids the evil.[3] The foregoing are pillars of the Islamic financial system and all the activities by any participant in the Islamic financial system must be consistent with these pillars. The products and services offered by the Islamic financial institutions (IFIs) must be free from all the prohibited elements which will harm society. These include: interest (riba); uncertainty (gharar); gambling (maysir); and impure goods. In addition, the activities contracted between the parties must be of value to the parties.

IFIs, unlike their conventional counterparts, ought to effect financial intermediation in a manner complaint with the Shari'ah (Islamic law). This is made possible through the collective efforts of many stakeholders involved, including: central banks and financial institutions; Shari'ah scholars; governments; legal practitioners; courts; academics; and last, but not least, the consumers of the Islamic financial products and services who create a substantial demand for IFIs. Shari'ah scholars in particular have contributed tremendously to the growth of the IFIs through their ingenuity and exercise of independent legal reasoning (ijtihad). They expanded and re-introduced various types of Islamic financial contracts to reinforce the intermediation process.

The most common types of Islamic finance contracts currently used by IFIs are as follows:

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[1] The *Qur'an* says "and give them from the wealth of Allah which He has given you": *Qur'an* 24:33. The *Qur'an* further says: "Indeed, we offered the Trust to the heavens and the earth and the mountains, and they declined to bear it and feared it; but man [undertook to] bear it. Indeed, he was unjust and ignorant" (*Qur'an* 33:72).

[2] For instance, the *Qur'an* prohibits interest/usury as it is perceived to be oppressive. The *Qur'an* says: "Those who consume interest cannot stand [on the Day of Resurrection] except as one stands who is being beaten by Satan into insanity. That is because they say, 'Trade is [just] like interest.' But Allah has permitted trade and has forbidden interest. So whoever has received an admonition from his Lord and desists may have what is past, and his affair rests with Allah. But whoever returns to [dealing in interest or usury] – those are the companions of the Fire; they will abide eternally therein" (*Qur'an* 2:275).

[3] The *Qur'an* says: "You enjoin what is right and forbid what is wrong and believe in Allah" (*Qur'an* 3:110). See also *Qur'an* 3:104; 9:67; 9:71.

1. Sale-based (murabahah, bay' bithaman ajil, istisna', salam, bay' al-inah, and bay' al-dayn);[4]
2. Lease-based (ijarah, ijarah muntahia bi tamlik, ijarah thumma al-bai, and ijarah mawsufah fi zimmah);[5]
3. Participatory-based (mudharabah, musharakah, and musharakah mutanaqisah);[6] and
4. Fee-based (wakalah, ujrah, and kafalah).[7]

All the documentation used in Islamic finance, including the Islamic finance contracts, must satisfy three pre-requisites. First, as seen above, they must comply with the imperatives of the Islamic law (that is, be Shari'ah compliant).[8] Secondly, the Islamic finance contracts must comply with the existing civil laws of the country having jurisdiction over the parties and their contracts.[9] Finally, besides the need of contracts being so drafted as to be enforceable in the local civil courts,[10] the courts must be willing to recognise and enforce the underlying Shari'ah tenets of the contracts.

Experience has shown that Islamic finance contracts that comply with only the first two pre-requisites (that is, are Shari'ah-compliant and conform to the existing civil laws of a country) are really ineffective until and unless the local courts are willing to adjudicate and enforce them as instruments having their basis in Islamic principles. Where the Shari'ah tenets underlying the Islamic finance contracts are not recognised and enforced by the civil courts, they cease to be entitled to be regarded as Islamic instruments. When the Islamic imperatives defining an instrument as Islamic are taken away or disregarded by the civil courts then what remains is only a conventional "finance contract". Therefore, the appropriate and effective adjudication of Islamic finance contracts is the final and absolutely necessary component for the introduction and development of the Islamic finance industry in any country.

This article examines the adjudication of Shari'ah issues which have arisen in Islamic finance contracts before the civil courts in the United Kingdom (UK) and in Malaysia. English law, which used to be, and still is, the preferred law of choice of the parties involved in cross-border Islamic finance transactions.[11] Hence, English courts will naturally be the proper forum for settlement of disputes in those transactions. On the other hand, the authors opine that Malaysia has often been unjustly overlooked as an equally, if not more, appropriate forum to decide disputes over Islamic financial contracts. The authors are fortified in this view by the fact that Malaysia has one of the most developed and effective legal frameworks for the adjudication of Islamic finance disputes. The article

[4] The meaning of the Arabic terms are as follows: murabaha (cost-plus profit sale); bay' bithaman ajil (deferred payment sale); istisna' (manufacturing sale); bay' al-inah (sale and buy-back); and bay' al-dayn (debt trading).

[5] The meaning of the Arabic terms are as follows: ijarah (leasing); ijarah muntahia bi tamlik (a lease ending in the transfer of ownership to the lessee – leases and sales are kept as separate and independent transactions); ijarah thumma al-bai (leasing to purchase); and ijarah mawsufah fi zimmah (a forward lease contract ending in ownership by way of gift/sale).

[6] The meaning of the Arabic terms are as follows: mudharabah (trade partnership, trust financing); musharakah (joint venture); and musharakah mutanaqisah (diminishing partnership).

[7] The meaning of the Arabic terms are as follows: wakalah (agency); ujrah (fee); and kafalah (guarantee).

[8] *Islamic Financial Services Act 2013* (Act 759) (Malaysia), s 28(1) states: "An institution shall at all times ensure that its aims and operations, business, affairs and activities are in compliance with Shariah." There is a general notion amongst the Islamic finance practitioners and Shari'ah scholars that Islamic finance should constantly strive to upgrade from "Shari'ah compliant" which is a minimum standards that needs to be achieved to more aspirational standards of "Shari'ah-based" products and services.

[9] In Malaysia, the authors believe, it is more accurate to use the term "common law" instead of "civil law". However, as the term "civil law" has been used very widely in contrast with the Shari'ah, the authors shall use the same term. In the Malaysian context, for instance, some of the civil laws that will apply to Islamic finance contracts are the *Contracts Act 1950* (Act 136) (Malaysia) and *Bills of Exchange Act 1949* (Act 204) (Malaysia). Furthermore, all other related civil laws shall be applicable. This has been highlighted by the Court of Appeal in *Bank Kerjasama Rakyat Malaysia Bhd v Emcee Corporation Bhd* [2003] 2 MLJ 408 at 411 and is discussed further below: see text around n 64.

[10] Certain prescribed requirements and paperwork in regards to the manner of execution, form, and registration of the documents need to be observed by the drafters of those documents. These requirements may vary from one jurisdiction to another.

[11] Balz K, "Shari'ah Risk: How Islamic Finance has Transformed Islamic Contract Law", *Islamic Legal Studies Program Harvard Law School* (September 2008) p 13. See also Colon JC, "Choice of Law and Islamic Finance" (2011) 46 *Texas International Law Journal* 412.

explores and explains the strengths and constraints of the existing Islamic finance adjudication process in both countries with a view to offering the contracting parties, especially in cross-border Islamic finance transactions, an opportunity to make informed decisions in respect of the choice of the law applicable to their transaction and choice of the forum for settlement of any disputes that might arise.

The article chronologically examines the stream of the judicial decisions, some of which have had tremendous effects on the industry. The common theme that runs through all of them, irrespective of whether they are decided by the English or Malaysian courts, is that Islamic finance litigation before the civil courts needs to be structured and guided. An appropriate legal framework must be put in place when the Shari'ah issues are raised before the civil court judges who may have little or no knowledge of Shari'ah, so that these issues are properly being addressed by the competent adjudicators. The article offers guidance from the Malaysian model which, in the opinion of the authors, is exportable to other countries aspiring to introduce and develop their Islamic finance industry.

This article limits itself to the adjudication of Shari'ah issues only. A lot has been written and said about the alternate dispute resolution (ADR) mechanisms but unfortunately, for a number of reasons, the contracting parties seem to prefer the litigation more. This has been the case, for example, with many IFIs in Malaysia which have a "credit policy" to avoid having ADR clauses in their contracts and to prefer litigation instead. Most of those institutions do that in order to avoid or mitigate credit risks due to legal uncertainty. This seems to be the trend not only in Malaysia but in many other Middle Eastern countries as well.[12] However, perhaps the true potential of the ADR as a viable dispute resolution mechanism for Islamic finance transactions has been underestimated. More research and ground work needs to be done to find out the real reasons and impediments for its rejection by the industry.

## WHAT ARE SHARI'AH ISSUES AND WHEN DO THEY ARISE?

Raising conventional issues to challenge non-compliance of a contract with the existing civil laws of a country is not a new phenomenon, and the courts are well equipped in most jurisdictions to deal with them efficiently. On the other hand, Shari'ah issues are less frequently raised by the contracting parties before the courts due to their and their counsels' lack of understanding on what they are. In cases where parties decide to raise them the judges are hesitant to adjudicate them due to their limited knowledge of Shari'ah, in addition to any other legal limitation that they may face.

The underlying Shari'ah nature of the Islamic finance contract implies the unavoidable presence of Shari'ah risk. Shari'ah non-compliance of a contract may render it void. The so-called "Shari'ah defence" was used in the past, and may be used in the future by the contracting parties to challenge the validity of Islamic finance contracts on Shari'ah non-compliance grounds.[13] In other words, the contracting parties are free to raise "Shari'ah issues" in litigation and question the Shari'ah compliance of the contracts that they have entered into.

How are Shari'ah issues to be distinguished from conventional or banking issues? It could be argued that Shari'ah issues are banking and conventional issues at the same time.[14] In fact, there are few cases in Malaysia where the courts refused to admit the issues raised for adjudication as Sharia'ah issues although they could be easily classified as such.[15] Instead, they said that they are issues or matters of contractual interpretation. As the matter of fact, any issues raised in relation to the Islamic finance contracts could be termed as contractual issues. So, where and how is a line drawn? This is the question which requires a precise answer so that any uncertainty can be avoided. The councils involved in litigation and the civil court judges adjudicating the case must be able to distinguish Shari'ah issues from other conventional issues.

[12] See Lawrence J, Morton P and Khan H, "Resolving Islamic Finance Disputes", *Legal Insight* (K&L Gates, 2013) p 1.

[13] See *The Investment Dar Company KSCC v Blom Developments Bank SAL* [2009] EWHC 3545 (Ch).

[14] Trakic A, "Civil Court Jurisdiction over Islamic Banking Cases – Muamalat Division of the High Court" in Ishan Jan MN (ed), *Law and Commerce: The Malaysian Perspective* (International Islamic University Malaysia Press, 2011) pp 520-536.

[15] See *Affin Bank Bhd v Zulkifli bin Abdullah* [2006] 3 MLJ 67; *Malayan Banking Bhd v Marilyn Ho Siok Lin* [2006] 7 MLJ 249; *Bank Islam Malaysia Berhad v Azhar bin Osman* [2010] 3 AMR 363.

In Malaysia, at least, this should not be a problem. The Shari'ah Advisory Council (SAC) of the Central Bank of Malaysia (Bank Negara Malaysia or BNM),[16] which is the highest authority in the country for ascertainment of the Shari'ah issues in Islamic finance contracts, issued its *Manual Rujukan Mahkamah dan Penimbang Tara Kepada Majlis Penasihah Syariah Bank Negara Malaysia* (translated as *Manual by which the Court and Arbitrators May Refer Shari'ah Matters to the Shari'ah Advisory Council of Bank Negara Malaysia*) (the Manual).[17] The authors are sure that this is the first such procedure anywhere in the world. The Manual is a practical guide and point of reference for both civil court judges and arbitrators when referring Shari'ah issues regarding Islamic finance contracts to the SAC. The Manual goes to great lengths to make it clear that only Shari'ah issues or matters may be referred to the SAC.[18]

The Manual defines a question concerning a Shari'ah matter as follows:

> In relation to Islamic finance, a Shari'ah question involves a matter(s) that have yet to be determined by the SAC. Such questions include, but are not limited to, such aspects of the Islamic finance business as the structure, the products or services, the operation, the terms and conditions of or the documentation used in the business.[19]

The Manual is not a catalogue of abstractions for it uses lucid examples to concretise and demarcate matters within the jurisdiction of the SAC and those within the jurisdiction of the court or the arbitrator. Matters over which the SAC has jurisdiction to rule are termed Shari'ah issues or matters. The authors reproduce below parts of the Manual which they consider important:

> *Illustration I: A non-Shari'ah matter*
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> In a court proceeding, a question arises regarding the licensing status of an Islamic financial institution in Malaysia. That is not a Shari'ah matter.
>
> *Illustration II: Questions on the structure of the business, products or services*
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> The SAC has decided that the tawarruq contract may be used in structuring financing facilities. An Islamic finance institution offers a financing product based on tawarruq. A customer challenges the Shari'ah compliance of the product because it uses silver bullion as the underlying asset for the tawarruq transaction. The court may refer to the SAC the issue whether the use of silver as the underlying asset in the tawarruq transaction is permissible in the Shari'ah.
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> *Illustration III: Questions relating to implementation and operations*
>
> The SAC has decided that the bay' al-'inah contract may be used in structuring financial facilities. Financial Institution A offered such a financial product. A customer challenges it in court on the basis that it is not Shari'ah compliant because the transaction did not follow the proper transaction sequence in an 'inah contract. The court may seek clarification from the SAC on the meaning of "proper transaction sequence in an 'inah contract" or similar questions. However, the actual sequence in that above case involves a question of fact to be decided upon by the court or the arbitrator. Similarly, the question of whether or not the sequence executed in the case complies with the Shari'ah is a decision within the purview of the court or the arbitrator, not the SAC.
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> *Illustration IV: Question regarding terms, conditions and documentation*
>
> The SAC has decided that ta'wid may be used in financing products. A dispute arises in court between a customer and an Islamic financial institution regarding a ta'wid clause in the agreement between them. The customer claims that the clause is not Shari'ah compliant because it involves a prior agreement

[16] The SAC is the statutory authority established under the *Central Bank of Malaysia Act 2009* (Act 701) (Malaysia). The Act made it compulsory, by virtue of s 56, for the courts and arbitrators to refer the Shari'ah issues to the SAC for ascertainment. The ruling made by the SAC becomes binding on the courts or arbitrators in accordance with s 57. This will be further discussed in a detailed manner in the later part of the article.

[17] Bank Negara Malaysia (BNM), *Manual Rujukan Mahkamah dan Penimbang Tara Kepada Majlis Penasihah Syariah Bank Negara Malaysia* (2012). To date, it is only available in Malay. For the purpose of this article, the authors are using their own translation.

[18] BNM, n 17 at [1], [5].

[19] BNM, n 17 at [6].

> between the parties on a ta'wid rate. In this regard, the court may refer to the SAC the question of whether pre-agreement by contracting parties on a particular ta'wid rate is permissible …[20]

Furthermore, the Manual clarifies that the SAC is not a judicial body and that it is empowered only to rule on the Shari'ah compliance of the issues referred to it. The jurisdiction to make a finding of fact or to apply a particular ruling to the facts of a case and to decide thereon is vested wholly and solely in the court and the arbitrator.[21] Therefore, it is crystal clear that the SAC will only state the Shari'ah ruling on the matter referred to it. Thereafter, it is up to the court to make a finding of the facts of the case, apply the Shar'ah ruling to these facts, and arrive at a decision. Clearly, the Manual does this to prevent the SAC being accused of usurping the function of the court.

The Manual will only succeed in its goal of solving questions of Shari'ah compliance in Islamic financial matters if the civil courts are willing to refer the Shari'ah issues to the SAC, the designated experts. Only then can disputes over the Shari'ah compliance of the products and services be properly adjudicated. The record shows that civil courts have been generally reluctant to make the reference and often opted to completely ignore Shari'ah issues and treated the issues as matters of contractual interpretation, or even worse, they ascertained the issues by themselves.[22] However, in recent years, Malaysian courts are starting to come around and to refer Shari'ah matters to the SAC. Such references are an implicit acknowledgment of the role and function of the SAC in the proper adjudication of Shari'ah issues. Unfortunately, the same cannot be said for English courts. This is particularly worrying as English law is still the preferred law of choice in cross-border Islamic finance contracts. Therefore, a comparison of how each of these two jurisdictions has tackled Shari'ah issues raised in some landmark judicial decisions will be salutary.

## ADJUDICATION OF SHARI'AH ISSUES IN ENGLISH COURTS

The first Islamic finance case ever decided by an English court and, indeed, by any western court, was *Islamic Investment Company of the Gulf (Bahamas) Ltd v Symphony Gems NV*.[23] The main argument raised by Symphony Gems NV (Symphony) was that its murabahah agreement with the Islamic Investment Company of the Gulf (Bahamas) Ltd (IICG) was not Shari'ah compliant. The alleged non-compliance was demonstrated by the contractual clauses by which the IICG expressly protected itself from the murabahah associated risks. The impugned cl 4.4 provided that the purchaser was obliged to pay for the goods "whether or not" the goods were transferred to the purchaser. In other words, the buyer was obliged to fulfil its promise regardless of whether the seller fulfils theirs. Further, cl 5.7 completely excluded the bank's liability in case of any damage to the goods even before the goods were placed in the possession of the buyer.

In principle, the murabahah consists of two promises, that is, a promise by the customer to purchase the goods and a promise by the bank to sell the goods. The transaction is concluded when the goods are placed in the possession of the customer. Further, before the goods are placed in the possession of the customer, risks associated with the goods are with the bank.[24] Two expert witnesses called by the court testified that the murabahah agreement, in this case, was not Shari'ah compliant. However, the trial judge, Tomlinson J, observed that there was nothing in the agreement to indicate that the defendant was not obliged to pay the instalment if the goods were not delivered. The holding

[20] BNM, n 17 at [6].

[21] BNM, n 17 at [7].

[22] See, eg, *Arab-Malaysia Merchant Bank Bhd v Silver Concepts Sdn Bhd* [2005] 5 MLJ 210; *Affin Bank Bhd v Zulkifli bin Abdullah* [2006] 3 MLJ 67; *Malayan Banking Bhd v Marilyn Ho Siok Lin* [2006] 7 MLJ 259; *Arab-Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd* [2009] 1 CLJ 419. These cases will be dealt with in detail in a later part of the article.

[23] *Islamic Investment Company of the Gulf (Bahamas) Ltd v Symphony Gems NV* [2002] WL 346969. See Moghul UF and Ahmed AA, "Contractual forms in Islamic Finance Law and Islamic Inv Co of the Gulf (Bahamas) Ltd v Symphony Gems NV & Ors: A First Impression of Islamic Finance" (2003) 27 *Fordham International Law Journal* 155. Globally speaking, this would not be the first case as in Asia-Pacific region, more precisely, in Malaysia, the Islamic finance cases have been heard continuously in civil courts since 1987. More will be said about this in the forthcoming discussion.

[24] Yaacob H, *A Critical Appraisal of International Islamic Finance Cases, and the Way Forward*, Research Paper 19 (International Shari'ah Research Academy for Islamic Finance, 2011) p 5.

that payment of the instalments is not conditional upon the delivery of the goods in itself goes against the Shari'ah law, which requires a seller to fulfil his or her promise, that is, to deliver the goods to the buyer. The judge observed that the agreement was governed by the English law and was valid under English law.[25]

The choice of law clause in the case makes it clear that English law was applicable. Be that as it may, the transaction in question was still an Islamic financial transaction which must be Shari'ah compliant. Further, it is ironic that the court called expert witnesses to elucidate the murabahah agreement from the Shari'ah point of view and yet completely disregarded their expert evidence. Why then did the court call the expert witnesses if their evidence had no bearing whatsoever on the case?[26]

The Shari'ah non-compliance of the murabahah agreements was also raised in *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd*.[27] Unlike the *Symphony Gems* case, where the governing law clause explicitly stated that only English law shall govern the contract, in this case, the governing law clause provided that: "Subject to the principles of the Glorious Sharia'a', this agreement shall be governed by and construed in accordance with the laws of England."[28] What the clause effectively means is that English law shall be the governing law in so far as it is not inconsistent with Shari'ah and in case of any inconsistency, the Shari'ah shall prevail. After series of defaults, the Shamil Bank of Bahrain applied for summary judgment. On the other hand, Beximco Pharmaceuticals Ltd argued, inter alia, that the murabahah financing agreements: "were enforceable only in so far as they were valid and enforceable both (i) in accordance with the principles of Sharia'a, and (ii) in accordance with English law; and that in fact the agreements were invalid and unenforceable under the principles of Sharia'a."[29] In addition, they argued that the murabahah financing agreements were not Shari'ah compliant, and thus void, because they were, in principle, loan transactions disguised as sale transactions in order to get around the explicit prohibition of interest.

Both parties presented expert opinions about the validity of the transactions in Shari'ah. The bank's expert witness, Dr Lau, explained that the Shari'ah Advisory Board of the bank had approved the transactions as Shari'ah compliant and, as such, they were valid. However, an expert witness for the borrowers, former Justice Khalil-Ur-Rehman Khan, disagreed stating that the financing agreements were void because, he said, they did not comply with the Shari'ah requirements of murabahah. In addition, he stated that the pronouncement of the bank's Shari'ah Advisory Board that the transactions were Shari'ah compliant should not be conclusive proof of their validity; rather, the court should decide on their validity in Shari'ah.

The case was decided by Morrison JA, who, despite the evidence of the expert witnesses, refused to recognise the Shari'ah nature of the agreements and said:

> In my view, if the court were to be concerned with the application of Sharia'a law and its impact on the lawfulness of the agreements, I would conclude at this stage that it was arguable which of the two parties' experts is right and that it would offend the principles underlying [*Civil Procedure Rules 1998* (UK), Pt 24] to seek to resolve them before a trial.[30]

Furthermore, his Lordship observed that the contracting parties could not have intended the English court to elaborate on Shari'ah issues. He said: "Looking at the background, it seems clear to

[25] Section 28 of the *Sales of Goods Act 1979* (UK) states: "*Unless otherwise agreed*, delivery of the goods and payment of the price are concurrent conditions …" (emphasis added). The Malaysian equivalent is s 32 of the *Sales of Goods Act 1957* (Act 382) (Malaysia).

[26] Yasin NM, "Islamic Commercial Contracts Cases Heard in Civil Courts under Common Law: A Case Study of Malaysia and England" (2007) 3 *Journal of Islamic Law Review* 104.

[27] *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd (No 1)* [2004] 4 All ER 1072; [2004] EWCA Civ 19.

[28] *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd (No 1)* [2004] 4 All ER 1072; [2004] EWCA Civ 19 at [1].

[29] *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd (No 1)* [2004] 4 All ER 1072; [2004] EWCA Civ 19 at [27].

[30] *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd (No 1)* [2003] 2 All ER (Comm) 849; [2003] EWHC 2118 (Comm) at [32].

me 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 writings on matters of great controversy."[31]

On appeal, the main issue was the proper construction of the choice of law clause. The defendant's counsel agreed with the contention that English law should be the law of choice, but that certain Shari'ah rules governing the agreements should be recognised by the English court by virtue of "the doctrine of incorporation", which allows foreign laws to be incorporated into a contract and to be enforced as contractual terms. The authority advanced for this proposition was passage from *Dicey, Morris & Collins on the Conflict of Laws*.[32] In rejecting the defendant's submission, Potter LJ, who delivered the judgment of the Court of Appeal, said:

> It does not seem to me that the passage cited, or the authorities referred to in the notes thereto, assist the defendants. The doctrine of incorporation can only sensibly operate where the parties have by the terms of their contract sufficiently identified specific "black letter" provisions of a foreign law or an international code or set of rules apt to be incorporated *as terms of the relevant contract* such as a particular article or articles of the French Civil Code or the Hague Rules. By that method, English law is applied as the governing law to a contract into which the foreign rules have been incorporated.[33]

His Lordship further observed:

> The general reference to principles of Sharia'a in this case affords no reference to, or identification of, those aspects of Sharia'a law which are intended to be incorporated into the contract, let alone the terms in which they are framed. It is plainly insufficient for the defendants to contend that the basic rules of the Sharia'a applicable *in this case* are not controversial. Such "basic rules" are neither referred to nor identified. Thus the reference to the "principles of … Sharia'a" stand unqualified as a reference to the body of Sharia'a law generally. As such, they are inevitably repugnant to the choice of English law as the law of the contract and render the clause self-contradictory and therefore meaningless.[34]

The Court of Appeal firmly rejected the argument of the defence counsel, but it indicated that there is a possibility of Islamic laws being recognised under the "doctrine of incorporation" if they are incorporated into a contract as "specific black letter provisions".[35] Therefore, it will not be necessary to mention, besides the governing law (English law), that an agreement is subject to Shari'ah. On the contrary, the specific provisions, rules and regulations of Shari'ah which the parties intend to uphold must be incorporated into a contract as contractual terms and, as such, could be recognised and enforced by courts. In other words, rules of foreign law could be enforced as contractual terms only if they are incorporated as such, and if they are identified clearly. Hence, it is recommended for the parties choosing English law as the law of reference in their Islamic finance contracts to refer to the specific provisions which could be found either in Shari'ah standards developed by various international standards setting bodies such as: the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI); Islamic Financial Services Board (IFSB); and the International Islamic Financial Market (IIFM); or in specific resolutions passed by the authorised Shari'ah advisory bodies, such as the SAC of BNM.

As may be expected, the decisions in the *Symphony Gems* and *Shamil Bank* cases sparked controversy. Colon argues that the Court of Appeal in *Shamil Bank*, in interpreting the contractual obligation of the parties, should have looked at their prior negotiations, motives, and the common practice adopted in the Islamic finance industry.[36] The foregoing is in stark contrast to the approach adopted by the English court in both cases. That approached has been dubbed "non-interventionist

[31] *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd (No 1)* [2003] 2 All ER (Comm) 849; [2003] EWHC 2118 (Comm) at [36].

[32] *Dicey, Morris & Collins on the Conflict of Laws* (13th ed, Sweet & Maxwell, 1999) at [32-086].

[33] *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd (No 1)* [2004] 4 All ER 1072; [2004] EWCA Civ 19 at [51].

[34] *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd (No 1)* [2004] 4 All ER 1072; [2004] EWCA Civ 19 at [52].

[35] Trakic A, "Europe's Approach to Islamic Banking and Finance: A Way Forward" (2012) 1 *Journal of International Finance and Banking Regulation* 27.

[36] Colon, n 11 at 426-427. See also Moghul and Ahmed, n 23 at 155; Hassan Z and Asutay M, "An Analysis of the Courts' Decisions on Islamic Finance Disputes" (2011) 3 *International Shari'ah Research Academy for Islamic Finance International Journal of Islamic Finance* 41.

approach" in that the court refused to enter into an examination of Shari'ah issues but uphold the terms upon which the parties have mutually agreed.[37]

Malaysian Shari'ah scholar, Rabiah, submits that the refusal by the courts in both the *Symphony Gems* and *Shamil Bank* cases is not surprising as the English courts apply the common law.[38] In her analysis, the fundamental problem emanates from the fact that although the parties were not British and the transaction did not take place in England, yet they elected to submit any dispute arising from their transaction to the jurisdiction of the English courts and English law. She further clarifies that even if the jurisdictions which do not apply Islamic law in commercial and financial transactions wish to do so, the absence of substantive code on Islamic banking law would render any such incorporation of Islamic principles into the transactions difficult. The possible codification of Islamic commercial laws itself being highly problematic renders any incorporation of Shari'ah principles in the jurisdictions in question highly unlikely.

In contrast to the *Symphony Gems* and *Shamil Bank* cases, the Shari'ah issue raised in *The Investment Dar Company KSCC v Blom Developments Bank SAL*,[39] was in relation to a wakalah agreement.[40] Blom Developments Bank (Blom), a Lebanese company, deposited the sums of US$10 million and US$1.5 million in two separate transactions, with The Investment Dar Company (TID), a Kuwaiti company, under a master wakalah agreement. As per the wakalah agreement, TID was appointed as Bloom's agent to manage the money and investment. The wakalah agreement identified English law as the law of choice. It also provided that any investment by TID must be done in a Shari'ah compliant manner. Under the contract, TID was obliged to invest the money and upon the expiry of the agreed investment period for each transection, to pay to Blom the capital sum plus anticipated profit as fixed at the time of the deposit. As time went by, it became obvious that TID had some cash flow difficulties. After having agreed to renew wakalah transactions a few times, Blom instituted an action before the English court claiming the capital sum plus the anticipated profits by way of summary judgment.

In response to that, TID raised the so-called "Shari'ah defence" by stating that the master wakalah agreement was not Shari'ah compliant. TID argued that Art 5 of its memorandum of association provided that it could engage only in Shari'ah complaint activities. Therefore, TID submitted that it lacked the capacity to enter into the instant contract (which according to TID, was not Shari'ah compliant). TID contended that the master wakalah agreement was ultra vires, that is, void. The irony here is that the same wakalah agreement was approved as Shari'ah compliant by the TID's own internal Shari'ah Committee.

Unlike in the *Symphony Gems* and *Shamil Bank* cases, the High Court judge, Purle QC, acknowledged the Shari'ah issue and observed that there was a triable issue in both claims. The Shari'ah issue was scheduled to be deliberated further during the trial but TID decided to withdraw the

[37] Bin Zakaria TA, "Recent Reforms in the Legal Framework of Islamic Finance in Malaysia: Court's Perspective", Speech delivered at the Ahamad Ibrahim Kulliyyah of Laws, International Islamic University Malaysia (4 December 2013) pp 14-18. He argues that the non-interventionist approach was also adopted to a certain extent by the Malaysian Court of Appeal in the frequently cited case of *Bank Kerjasama Rakyat Malaysia Bhd v Emcee Corporation Bhd* (2003) 2 MLJ 408. With due respect, the authors would disagree with this comparison because the Shari'ah issue was never raised before the court in the *Emcee Corporation* case as opposed to *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd (No 1)* [2004] 4 All ER 1072; [2004] EWCA Civ 19. The scope and the significance of the Court of Appeal decision in *Emcee Corporation* would be dealt with in the later part of the article. Another opposite and equally damaging approach would be, what Tun Arifin CJ calls the "interventionist approach" which was at one point of time present in Malaysian courts. By applying this approach, the courts not only recognise the Shari'ah issues but take upon themselves to make Shari'ah rulings. Shari'ah contracts, which took Shari'ah scholars and bankers years to develop and market, run risk of being declared by the judges, who may not even be Muslims, as Shari'ah non-compliant. This approach will certainly have a negative effect on the Islamic finance industry and financial markets.

[38] Adawiah ER, "Constraints and Opportunities in Harmonization of Civil Law and Shari'ah in the Islamic Financial Services Industry" (2008) 4 *Malayan Law Journal* i.

[39] *The Investment Dar Company KSCC v Blom Developments Bank SAL* [2009] EWHC 3545 (Ch).

[40] Wakalah is an agency agreement commonly used in Islamic finance.

case for some other reasons. Nonetheless, this is one of those rare cases in which an English court recognised a Shari'ah issue which it was prepared to plumb despite the fact that English law was the governing law of the contract.

Very often, to avoid having to repay a loan or settle some other facility (Islamic or conventional), defaulting customers put up all kinds of defences. One of them, as in this case, was that the product was not Shari'ah compliant. That is ironic as they did not raise the question when they were applying for and enjoying the facility; more so in the case of non-Muslim customers. Why do they become "pious Muslims" when they have to repay their debts when they do not otherwise even accept the religion? In any event, to all who raise such a defence: "Is it Shari'ah compliant to not repay one's debt?"

This case has been subject of many scholarly criticisms, mostly regarding the manner in which the IFI invoked the Shari'ah defence, despite its own Shari'ah Committee recognising the contract to be Shari'ah compliant. Hakimah argues that this type of arguments raised by the IFI is very damaging to its credibility.[41] In fact, according to her, the investors would be rather sceptical to enter into Shari'ah compliant transactions if they know that another contracting party may try to avoid contractual obligations by invoking the Shari'ah defence. More importantly, the IFIs behavior could generate serious problems for the whole Islamic finance industry as the public at large would lose confidence in it.[42] However, some argue that the lack of capacity (ultra vires) risk is not a new legal risk and it is equally applicable to both Islamic and conventional finance transactions.[43] This is true, but it needs to be noted that when legal capacity risk is coupled with the Shari'ah compliance risk, as in this case, then it can become a very serious matter which could have a tremendous implications on the Islamic finance market.

## Lessons learnt from the Islamic finance cases heard before the English courts

Notwithstanding the scope for further debate on the adjudication of the Islamic finance contracts in English courts, it would behoove parties considering English law as the law of their cross-border Islamic finance contracts to pay heed to the following matters:

1. The freedom of the parties in Islamic financial contracts to raise Shari'ah issues before the English courts should not blind them to the likelihood of those Shari'ah issues being properly recognised and adjudicated being very small. Likewise, while the courts may admit expert opinions on the issues, the courts may, as indicated in the above cases, discount such testimony on a variety of technical grounds.
2. The indifference to the underlying Shari'ah nature of the contracts is not surprising because the English courts (and other civil and common law courts in general) lack the necessary legal framework to adjudicate Shari'ah issues. Hence, the Shari'ah principles underpinning the contract will not be enforced. Instead, the contract will be treated as a conventional contract and subjected to conventional common law contract interpretation at the expense of the Shari'ah.

[41] Yaacob, n 24, pp 1-27. See also Yaacob H, *Analysis of Legal Disputes in Islamic Finance and the Way Forward: With Special Reference to a Study Conducted at Muamalat Court, Kuala Lumpur, Malaysia*, Research Paper 25 (International Shariah Research Academy, 2011) pp 1-72.

[42] Trakic, n 35 at 28-29.

[43] Godden M, *The Implications for the Islamic Finance Market of The Investment Dar Company KSCC v Blom Developments Bank Sal [2009] EWHC 3545 (Ch)* (Norton Rose Fulbright, March 2010), http://www.nortonrosefulbright.com/knowledge/publications/27334/the-implications-for-the-islamic-finance-market-of-the-investment-dar-company-kscc-v-blom-developments-bank-sal-ewhc-3545-ch.

3. Specifying Shari'ah as the governing law together with the English law in the choice of law clause provides no relief because the courts do not recognise the so-called combined law approach. The courts have expressly declared, in conformity with various statutory instruments, that the contract can be governed only by "the law of a country" and not a non-state legal system such as the Shari'ah.[44]
4. Although Shari'ah cannot govern a contract together with English law, the contracting parties are allowed to incorporate clearly identified "black letter" Shari'ah provisions by reference into their contact and enforced them as contractual terms. This has been suggested by the Court of Appeal in the *Shamil Bank* case, and it is expressly allowed by the Recital 13 of the Rome I Regulation[45] which states: "This Regulation does not preclude parties from incorporating by reference into their contract a non-State body of law or an international convention." That said, the enforceability of such Shari'ah remains uncertain. It remains to be seen whether English court will walk the talk in the cases which come before it in the future.
5. The party which raises a Shari'ah issue must be sincere and not just use it as a way of avoiding its obligations. A customer genuinely concerned about the Shari'ah compliance of a facility would have investigated the product or the agreement and satisfied him or herself on that point before he or she even signed it. A pious Muslim does not order and consume food and when the bill comes, argue that the food is not halal, to avoid payment. "Haram" food, when consumed, does not become "halal" if one can avoid paying for it.[46]

## ISLAMIC FINANCE ADJUDICATION IN MALAYSIA

Malaysia has a unique dual financial system, comprised of the conventional finance industry and the IFIs operating harmoniously in parallel with one another.[47] One of Malaysia's innovations is the creation of the SAC as the highest national authority for the approval of Shari'ah products and on certain Shari'ah positions on issues arising in proceedings in the courts and before arbitrators. The authors argue that there is a direct link between the entire success story of the Islamic finance in Malaysia and the developments undertaken in regards to the SAC.

Islamic finance in Malaysia would certainly not be what it is today but for the enormous contribution given by the SAC. Furthermore, the SAC's crucial role in the Islamic finance industry, particularly in the adjudication process, has been facilitated by pro-active legislative interventions in the *Central Bank of Malaysia Act 2009* (Act 701) (Malaysia) (CBMA 2009). In 2003, the *Central Bank of Malaysia Act 1958* (Act 509) (Malaysia) (CBMA 1958) was amended to recognise the SAC and its role in Islamic finance industry. In 2009, the CBMA 1958 was completely repealed with the new CBMA 2009 where more detailed provisions on the SAC and its role in adjudication of Islamic finance cases have been highlighted. Therefore, the adjudication of Shari'ah issues in Malaysia needs to be looked through the prism of three different periods, namely:

1. The pre-*Central Bank of Malaysia (Amendment) Act 2003* (Act 519) (Malaysia) (CBM(A)A 2003) period;
2. The period between CBM(A)A 2003 and CBMA 2009; and
3. The post-CBMA 2009 period.

[44] See *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd (No 1)* [2003] 2 All ER (Comm) 849; [2003] EWHC 2118; *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd (No 1)* [2004] 4 All ER 1072; [2004] EWCA Civ 19. The statutory instruments include the *Regulation (EC) No 593/2008 of the European Parliament of the Council of 17 June 2008 on the Law Applicable to Contractual Obligations*, OJL 177 (2008) (Rome I Regulation). The Rome I Regulation governs the choice of law matters in the UK.

[45] *Regulation (EC) No 593/2008 of the European Parliament of the Council of 17 June 2008 on the Law Applicable to Contractual Obligations*, OJL 177 (2008).

[46] Mohamad TAH, *Interlink/Interface Between Civil Law System and Shari'ah Rules and Principles and Effective Dispute Resolution Mechanism*, Speech delivered at the Islamic Financial Services Industry Legal Forum 2009 (Kuala Lumpur, 28-29 September 2009), http://www.tunabdulhamid.my.

[47] *Central Bank of Malaysia Act 2009* (Act 701) (Malaysia), s 27.

One commonality that runs through all these three periods is that the forum for adjudication of Shari'ah issues has remained unchanged. Therefore, before proceeding to discuss the three periods, the article will discuss the jurisdiction of civil courts to hear Islamic finance cases in Malaysia.

## Civil courts' jurisdiction over Islamic finance cases in Malaysia

List I (Federal List) of the Ninth Schedule of the *Federal Constitution of Malaysia*, lists the matters on which the Federal Parliament may legislate. The matters enlisted in List I are the matters which fall under the exclusive jurisdiction of civil courts. On the other hand, List II (State List) of the Ninth Schedule of the Constitution lists the matters on which the State Legislative Assemblies may legislate. Shari'ah courts of the respective States shall have jurisdiction over those matters.

Islamic law is one of the matters on which the States have exclusive right to legislate and the Shari'ah courts to adjudicate with the exception of Islamic banking and finance which falls under lex marcatoria (merchant laws) under the Federal List.[48] In fact, banking and insurance falls under Item 4(k) of List I (Federal List) of the Ninth Schedule of the *Constitution*. Therefore, Islamic banking and finance cases are heard and decided in civil courts and the law applicable to them is the same as the law applicable to conventional facilities. Having said this, there are scholars who argue that the Federal Parliament and civil courts should not have the jurisdiction over Islamic banking matters.

Satkunasingam and Shanmugam put forward two arguments why the Islamic banking should fall under the State jurisdiction.[49] First, they argue that the matters pertaining to "Islamic religious revenue" such as zakat, fitrah, baytul mal, and "similar Islamic religious revenue" (charitable institutions) fall under the exclusive jurisdiction of the States. Likewise, Islamic banks, unlike their conventional counterparts, project a "social welfare" dimension with features of the charitable institutions and, thus, according to them, Islamic banking matters should fall under the jurisdiction of States. Alternatively, they argue that since the Shari'ah courts have exclusive jurisdiction over matters of "Islamic law and doctrine" and Islamic banking is a matter of "Islamic law and doctrine", then the Shari'ah courts should have jurisdiction to adjudicate it and the States to legislate on it. As a result, all the laws enacted by the Federal Parliament on Islamic banking would be declared unconstitutional and, thus, null and void.

The authors respectfully disagree with these arguments due to many flaws in the reasoning. On the first argument, applying the ejustem generous rule to interpret the meaning of the "similar Islamic religious revenue", the only conclusion that can be reached is that it refers to similar institutions of a charitable nature. In principle, an Islamic bank is not a charitable institution as it is incorporated under the *Companies Act 1965* (Act 79) (Malaysia) as a "company" which seeks to profit, and it has shareholders that have reasonable expectations on receiving dividends. On the other hand, the charitable institutions are established purely for charitable reasons and no profits are distributed back to the shareholders as dividends, but are merely channeled back to the charity. The best example of a charitable institution is the Waqf.

In response to the second argument, it is true that Islamic banking is intrinsically connected with the "Islamic law and doctrine", but at the same time, it is deeply related to the civil law system. In other words, all the conventional laws governing the conventional banking facility will apply to the Islamic banking facility as well. The learned Court of Appeal judge, Tun Abdul Hamid Mohamad in *Bank Kerjasama Rakyat Malaysia Berhad v Emcee Corporation Sdn Bhd*[50] held that the law applicable to the Islamic banking facility is the same as the law applicable to the conventional banking facility.

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[48] List I (Federal List) of the Ninth Schedule of the *Federal Constitution of Malaysia*. See also Tajuddin HHA, "Dispute Settlement Mechanisms – The Malaysian Approach" in Trakic A and Tajuddin HHA (eds), *Islamic Banking & Finance: Principles, Instruments & Operations* (Current Law Journal, 2012) pp 315-347; Yaacob H, *The New Central Bank of Malaysia Act 2009 (Act 701): Enhancing the Integrity and Role of the Shari'ah Advisory Council (SAC) in Islamic Finance*, Research Paper 6 (International Shari'ah Research Academy for Islamic Finance, 2010) pp 1-29.

[49] Satkunasingam E and Shanmugam B, "Governance of Islamic Banks in Malaysia: Challenges and Prospects" in Trakic and Tajuddin, n 48, pp 417-434.

[50] *Bank Kerjasama Rakyat Malaysia Berhad v Emcee Corporation Sdn Bhd* [2003] 1 CLJ 625.

Furthermore, the Shari'ah courts have jurisdiction "only over persons professing the religion of Islam".[51] An Islamic bank, despite having the prefix "Islamic", cannot be labelled as a "person professing the religion of Islam". The provision was drafted in relation to the "natural person", that is being able to profess shahadah, perform the daily prayers, observe the fasting in the month of Ramadan, pay zakah, and perform the Hajj.[52] Certainly, it cannot be claimed that a limited liability company can perform all these pillars of Islam. In addition, it is not in the interest of justice for the Shari'ah courts to have jurisdictions over persons not professing the religion of Islam, as they are not able to appear and defend themselves. Subsequently, the order made in default may be just ignored by them, and yet, there is nothing the Shari'ah court can do to enforce it, as the Shari'ah court has no jurisdiction to make the orders against them.

Therefore, to summarise, adjudicating the Islamic banking cases by the Shari'ah court is, in the authors view, not the answer, for the following reasons:

1. There is the jurisdictional issue. Banking and insurance are federal matters (Item 4(k) of List I (Federal List) of the Ninth Schedule of the *Constitution*) and not a State matter within the jurisdiction of the Shari'ah courts.
2. One party may not be a person "professing the religion of Islam". Shari'ah courts have no jurisdiction over them. When they are sued, they are unable to appear to defend themselves. When an order is made in default, they may just ignore the orders since the Shari'ah court has no jurisdiction to make the orders against them. Do we want such things to happen? For that matter, is a bank or a financial institution, even if it bears the name "Islamic" or a takaful (insurance) company a "person professing the religion of Islam"?
3. A host of other related laws, for example, bankruptcy law, companies' winding-up laws, and land law are outside the jurisdiction of the Shari'ah courts. What this means is that the judgment creditor, even if he or she manages to get a judgment, may not be able to resort to remedies under those laws.
4. Shari'ah judges may be conversant in Shari'ah, but, fiqh mu'amalat is a specialised area and they may not necessarily be conversant in the area. In any event, they are not conversant in the civil laws mentioned earlier.[53]
5. The Shari'ah courts are State courts. There are 14 such courts, each independent of the other. At the apex, there are 14 Shari'ah Courts of Appeals compared to one Federal Court in the civil court system. Consistency in the judgments, even on the same issue, may be quite difficult to achieve.
6. The geographical jurisdiction of the Shari'ah court, being a State court, is limited to the State. That will give rise to issues of choice of the forum, service of the court's process, and execution of judgments.
7. Most corporate lawyers, not being Shari'ah lawyers would not be able to appear in the Shari'ah courts.
8. The documents are in English, drafted by common law lawyers following common law precedents which Shari'ah court judges are not familiar with.
9. There will be problems of reciprocal enforcement of judgments of Shari'ah courts, being State courts, in foreign countries.

## Pre-CBM(A)A 2003 period

When Islamic banking was first introduced in Malaysia in the 1980s, the focus was to ensure that the product was Shari'ah compliant. For that purpose, a Shari'ah Committee was established at Bank Islam Malaysia Berhad, the only Islamic Bank in the country at the time.[54] It was that committee that first approved a product to be marketed.

[51] List II (State List) in the Ninth Schedule of the *Federal Constitution of Malaysia*.

[52] These are known as the Five Pillars of Islam. The shahadah is the principal profession of faith for Muslims. The zakah is a form of religious tax (charity). The Hajj is the pilgrimage that every Muslim who is physically and financially capable must perform to Mecca at least once in their life.

[53] Fiqh mu'amalat can be translated as Islamic commercial jurisprudence.

[54] See Bank Islam Malaysia Berhad's website, http://www.bankislam.com.my.

When more Islamic banks and takaful companies were established, it was decided that it would be better to have an SAC at the national level for approving new products in order to ensure uniformity and avoid inconsistency in rulings on the same issue, in addition to making available the best expertise for the job. For example, it would cause confusion if a Shari'ah Committee of one company were to say that bay' bithaman ajil is Shari'ah compliant while another says no. Therefore, while every IFI was required to have its own Shari'ah Committee, the SAC was established administratively on 1 May 1997 for that purpose.[55] From then onwards, all new Islamic banking and takaful products were required to get the approval of the SAC before being introduced to the public.

BNM, as usual, was thinking ahead. BNM was worried about Shari'ah issues that might arise in cases before the courts. At first, it thought that perhaps the solution would be to establish a Muamalat Court.[56] Before going any further, the authors should clarify what the Muamalat Division of the High Court is.

### *Muamalat Court*

The Muamalat Court is not a separate court system established to hear Islamic banking and takaful cases. It is purely an administrative arrangement in Kuala Lumpur alone. Prior to the introduction of Islamic banking, the High Courts in Kuala Lumpur were divided into a number of divisions, namely Criminal, Family and Property, Commercial, and Appellate and Special Powers. That was only done for administrative reasons. All it means is that cases of a similar type are registered in the same "division". Later the Commercial Division was broken into Commercial and Muamalat. This arrangement was only made in Kuala Lumpur. At other places, especially where there is only one judge, all types of cases are registered in the same court and heard by the same judge. Do not think, then, that the "Muamalat Court" is more than a name given to a "division".

Based on a study made by the International Shari'ah Research Academy for Islamic Finance, most of the cases brought before the Muamalat Division of the High Court are in relation to bay' bithaman ajil, widely known as BBA facility. In fact, 90% of the total number of cases brought before the court is comprised of BBA cases. The remaining 10% of cases involve all the other contracts, such as ijarah, al-ijarah thumma al-bai, qard, 'inah, etc.[57] The contentious issues in relation to BBA facility are often raised by customers when there is a default in payment. Most of the time, the main issue is the quantum of claim. The banks strictly interpret the BBA agreements. Thus, when a customer defaults, the bank will claim full settlement price despite the fact that the customer would not be utilising the full tenure of the contract. The customer, on the other hand, would argue that the bank should not be entitled to unearned profit and that ibra' (rebate) should be given to the customer.[58] The BBA facility has been the subject of many scholarly discussions in the past few years.[59] There are instances where different courts have decided differently on the same Islamic banking matter. The asymmetric approaches by the Malaysian judges deciding Shari'ah issues could widen the uncertainty and affect the future development of the Islamic banking and finance industry.

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[55] See Bank Negara Malaysia website, http://www.bnm.gov.my.

[56] Muamalat is the set of rules related to commercial or civil acts under Islamic law.

[57] Yaacob, n 41, p 11.

[58] See *Affin Bank Bhd v Zulkifli bin Abdullah* [2006] 1 CLJ 438; *Malayan Banking Bhd v Ya'kup bin Oje* [2007] 5 CLJ 311; *Bank Islam Malaysia Bhd v Lim Kok Hoe* [2009] 6 CLJ 22; *Bank Islam Malaysia Berhad v Azhar Bin Osman* [2010] MLJU 358; *Dalam Mahkamah Rayuan Malaysia Rayuan* (unreported, Sivil No: W-02-609-2010). However, on 31 January 2013, BNM issued BNM, *Guidelines on Ibra' (Rebate) for Sale-Based Financing* (January 2013) according to which the granting of ibra' by the Islamic financial institutions in cases of "early settlement" including default cases is obligatory. So, it is believed that the issues in relations to ibra' have been solved with issuance of these Guidelines. For further discussion on ibra' see Mohamad TAH and Trakic A, "Granting of Ibra' by Islamic Banks in Malaysia: A Matter of Discretion or Obligation" (2013) 9 *Journal of International Banking Law and Regulation* 356.

[59] Yasin NM, "Islamic Banking: Case Commentaries Involving Al-Bai Bithaman Ajil" (1997) 3 *Malayan Law Journal* cxcii. See also Mohamad AAA, "Al-Bai Bithaman Ajil – Its Consistency with Religion of Islam: With the Special reference to Arab-Malaysia Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors and Other Cases" (2008) 6 *Malayan Law Journal* xiv; Dahlan NHM and Aljunid SZSAK, "Shariah and Legal Issues in the Bay' Bithaman-Al-Ajil (BBA): A Viewpoint" (2010) 6 *Malayan Law Journal* lxxv.

During this period, civil courts were already adjudicating Islamic finance cases, but, interestingly enough, Shari'ah issues were not raised by the parties. Hence, the courts did not adjudicate them. The Islamic finance cases decided by the courts during this period have been briefly discussed below.

### *Islamic finance cases decided by the courts prior to CBM(A)A 2003*

Perhaps the first Islamic banking case to have reached the then Supreme Court was *Tinta Press Sdn Bhd v Bank Islam Malaysia Bhd*.[60] It arose from a leasing agreement. Had it not been for a line in the head note, "Facility granted on Islamic banking business, which included profit margin", no one would have realised that it was a case arising from an Islamic banking transaction. The only issues were whether the High Court was right to grant a mandatory injunction and whether the transaction was a loan or a lease transaction. The Supreme Court held that the learned judge had rightly concluded from the documents and the affidavit evidence that the agreement in this case was a lease agreement and not a loan agreement, if the authors may add, from the civil law perspective. It is to be noted that the word "Shari'ah" was not even mentioned throughout the judgment of either the High Court or the Supreme Court.

In *Bank Islam Malaysia Bhd v Adnan bin Omar*,[61] the plaintiff bank had granted to the defendant a facility under the concept of BBA. The defendant defaulted. The plaintiff filed the originating summons under Order 83 of the *Rules of the High Court 1980* (Malaysia) seeking an order for sale of the charged land. All the challenges were on the ground of non-compliance with the provision of Order 83, Rule 83(3) of the *Rules of the High Court 1980*, and not for con-compliance with Shari'ah.

The next case is that of *Dato' Hj Nik Mahmud bin Daud v Bank Islam Malaysia Bhd*[62] where, again, no Shari'ah issue was raised. A challenge was mounted for contravention of land law, particularly the *Kelantan Malay Reservations Enactment 1930* (Malaysia) and the *National Land Code 1965* (Act 56) (Malaysia).

Even as late as January 2003, in *Bank Kerjasama Rakyat Malaysia Bhd v Emcee Corporation Bhd*,[63] a case involving a BBA transaction, the only issue in question was the validity of the charge. There was no Shari'ah issue. Justice Tun Abdul Hamid Mohamad, delivering the judgment of the Court of Appeal, made the following observation:

> As was mentioned at the beginning of this judgment, the facility is an Islamic banking facility. But that does not mean that the law applicable in this application is different from the law that is applicable if the facility were given under conventional banking. The charge is a charge under the *National Land Code* ("the Code"). The remedy available and sought is a remedy provided by the Code. The procedure is provided by the *National Land Code* and the *Rules of the High Court 1980*. The court adjudicating it is the High Court. So, it is the same law that is applicable, the same order that would be, if made, and the same principles that should be applied in deciding the application.[64]

Judges are very fond of quoting this passage but, unfortunately, often out of context. The point to remember is that, in that case, there was no Shari'ah issue at all. It was an ordinary application for an order for sale in which only the civil law (for example, the *National Land Code*, the *Rules of the High Court 1980*) apply.

The authors could not find any cases decided prior to 1 January 2004 (the date that CBM(A)A 2003 came into force) in which a Shari'ah issue was raised that required a decision by the civil court.

## Period between CBM(A)A 2003 and CBMA 2009

BNM and the IFIs knew that it was just the matter of time before Shari'ah issues were raised before the courts. The uncertainty and constant worry that the Shari'ah nature of the Islamic finance contract

[60] *Tinta Press Sdn Bhd v Bank Islam Malaysia Bhd* [1986] 1 MLJ 25 (High Court); *Tinta Press Sdn Bhd v Bank Islam Malaysia Bhd* [1987] 2 MLJ 192 (Supreme Court).

[61] *Bank Islam Malaysia Bhd v Adnan bin Omar* [1994] 3 AMR 2291 (Ranita Hussain JC).

[62] *Dato' Hj Nik Mahmud bin Daud v Bank Islam Malaysia Bhd* [1996] 4 MLJ 295 (Idris Yusoff J).

[63] *Bank Kerjasama Rakyat Malaysia Bhd v Emcee Corporation Bhd* [2003] 2 MLJ 408.

[64] *Bank Kerjasama Rakyat Malaysia Bhd v Emcee Corporation Bhd* [2003] 2 MLJ 408 at 411 (Tun Abdul Hamid Mohamad JCA).

may not be duly recognised and adjudicated prompted BNM to take some proactive steps to curb the possible problem. Initially, BNM thought that establishing the Muamalat Court would be a step in the right direction, in terms of the proper adjudication of Shari'ah issues. However, in 2002, a study made by Tun Abdul Hamid Mohamad JCA, in which he concluded that establishing the Muamalat Court would not solve the problem. He proposed that Shari'ah issues arising in the courts be referred to the SAC of BNM to ascertain the Shari'ah position. That proposal was accepted. The CBMA 1958 was amended by the CBM(A)A 2003, which came into force on 1 January 2004.

A new s 16B was added to CBMA 1958. For the first time, a federal law in Malaysia established the SAC to "be the authority for the ascertainment of Islamic law for the purposes of Islamic banking business, takaful business, Islamic financial business, Islamic development financial business, or any other business which is based on Syariah principles and is supervised and regulated by the Bank".[65]

It should be observed that according to s 16B it was not mandatory for the court or the arbitrator to refer a Shari'ah issue to the SAC. Even if it did, the ruling given by the SAC pursuant to such reference was not binding on the court. However, if the arbitrator chose to refer the issue to the SAC, the ruling of the SAC was binding on the arbitrator.[66] It appears that the discrepancy was due to the fear that making the ruling binding on the court would raise the issue that the SAC had usurped the function of the court in determining the "law".

### *Islamic finance cases decided by the courts after CBM(A)A 2003 but before CBMA 2009*

Perhaps the first reported judgment delivered during this period was the case of *Tahan Steel Corporation Sdn Bhd v Bank Islam Malaysia Berhad (No 1)*.[67] It was an application for an "interim injunction to restrain the defendant from dealing in security documents executed in connection with an Islamic banking facility … granted to the plaintiff". Out of the five issues raised, none was a Shari'ah issue. However, even though the amendment was barely two months old, the learned judge did refer to it and even quoted s 16B(8) and then concluded: "That would be food for thought. But in the context of adjudicating encl 2, the ruling of the Syariah Advisory Council was not sought after. Perhaps the parties knew that the whole banking transaction in the present case was Islamic in nature."[68]

On 7 April 2004, that is, four months after CBM(A)A 2003 came into force, Dato' Zainal Adzam J delivered his judgment in *Bank Islam Malaysia Berhad v Pasaraya Peladang Sdn Bhd*.[69] It was an application for an order for sale arising from a charge in a BBA transaction. No Shari'ah issue arose in this case.

In the following year, *Arab-Malaysian Merchant Bank Bhd v Silver Concept Sdn Bhd*,[70] was decided. To the authors' knowledge, it is the first Islamic finance case in Malaysia where the Shari'ah issues were raised before the court for adjudication. It is a case arising from a BBA transaction where the bank applied for an order for sale, and the issue was whether there was cause to the contrary. However, there were two issues that touched on the Shari'ah, that is, whether a BBA transaction was prohibited by the Shari'ah and the issue of deprivation of the defendant's right to a rebate (muqasah).[71] These two issues could have been the first questions to be referred to the SAC. On the competency of civil court judges to decide Shari'ah issues, the learned judge observed: "In the event any litigation is commenced, it must be appreciated that not every presiding judge is a Muslim, and

[65] *Central Bank of Malaysia Act 1958* (Act 509) (Malaysia), s 16B(1). The authors' retain the spelling of "Syariah" for "Shari'ah" as it appears in the passage quoted.

[66] *Central Bank of Malaysia Act 1958* (Act 509) (Malaysia), s 16B(7)-(9).

[67] *Tahan Steel Corporation Sdn Bhd v Bank Islam Malaysia Berhad (No 1)* [2004] 6 CLJ 25.

[68] *Tahan Steel Corporation Sdn Bhd v Bank Islam Malaysia Berhad (No 1)* [2004] 6 CLJ 25 at 31 (Abdul Malik Ishak J).

[69] *Bank Islam Malaysia Berhad v Pasaraya Peladang Sdn Bhd* [2004] 1 LNS 280.

[70] *Arab-Malaysian Merchant Bank Bhd v Silver Concept Sdn Bhd* [2005] 5 MLJ 210 (Suriyadi J).

[71] Initially "rebate" granted by the banks to their good customers was called "muqasah", although the original meaning of the term is "set-off" and not "rebate". Soon after, the mistake was spotted by the Islamic banks and "muqasah" was replaced with the correct term "ibra'".

even if so, may not be sufficiently equipped to deal with matters which ulamaks take years to comprehend."[72] The learned judge, however, did not find it necessary to refer the Shari'ah issues to the SAC nor, from the record, was there any request for him to do so. Instead, the learned judge took it upon himself to expound the Shari'ah principles involved, perhaps the first civil court judge to do so in an Islamic finance case in Malaysia. The authors will not comment here on his exposition of the Shari'ah.

In December 2005, Abdul Wahab Patail J decided the case of *Affin Bank Bhd v Zulkifli bin Abdullah*,[73] which concerned a BBA transaction. The issue before the court was the actual amount that a customer has to pay to the provider of a BBA facility in the event of a default. On the question of whether the court should refer Shari'ah issues to the SAC or not (obviously the learned judge must have meant the SAC even though he did not say so specifically), the learned judge said:

> Since the question before the court is the interpretation and application of the terms of the contractual documents between the parties and of the decisions of the courts, reference of this case to another forum for a decision would be an indefensible abdication by this court of its function and duty to apply established principles to the question before it. It is not a question of Syariah law. It is the conclusion of this court, therefore, that there is no necessity to refer the question to another forum.[74]

Note that, despite the provision of the law, in practice a judge may avoid referring a Shari'ah issue to the SAC by saying that it is a question of "interpretation and application of the terms of the contractual documents between the parties". That is even more likely when there is no application by a party for the court to make a reference. If there is an application, then the party dissatisfied with the decision may pursue the issue on appeal.

In June 2006, David Wong J delivered his judgment in *Malayan Banking Bhd v Marilyn Ho Siok Lin*.[75] This is perhaps the first reported case decided by a non-Muslim judge and, perhaps, the first reported case from the States of Sabah and Sarawak. As usual, the bank applied for an order for sale of the property charged by the defendant, a non-Muslim, who had obtained a BBA facility from it. The contention of the defendant, which the learned judge considered to be the crux of the case, was whether or not the plaintiff was entitled to claim for the full sale price less what had been paid, that is, RM 928,589.12 as at 21 February 2005. In the authors view, that clearly was a Shari'ah issue. The learned judge concluded the following:

> Sale price is defined in both documents to be the sum of RM 995,205.64. Faced with such plain language in the aforesaid clauses, does this court have the option to ignore it? In my view, the answer is in the affirmative, and my ground for saying so lies in the words used in s 148(2)(c) [*Sarawak Land Code 1958* (Sarawak), Ch 81], and they are "… and the court after hearing the evidence may make such order as in the circumstances seems just". These words empower the court with the flexibility (as opposed to the imperative power in s 256 of the *National Land Code 1965*) to make any order *even if it means ignoring the terms contained in the BBA documents* provided it is just in the circumstance. Needless to say, the court must have good reasons *to ignore or, put in another way, rewrite the terms therein*. This involves the process of taking into consideration "all the circumstances of the case". That would include the public interests, the peculiarities of the contract, and the compliances by the parties of the agreed terms contained therein. Of course at the end of the day, the primary aim must be to make an order *as in the circumstance seems just*.[76]

The authors find the conclusion of the learned judge very disturbing. Imagine a non-Muslim judge deciding an Islamic banking case involving a non-Muslim customer of an Islamic bank saying that he or she is entitled to ignore and to rewrite the term of the BBA contract which Shari'ah scholars and bankers took years to develop and to market, if it seems unjust to him or her.

[72] *Arab-Malaysian Merchant Bank Bhd v Silver Concept Sdn Bhd* [2005] 5 MLJ 210 at [17].

[73] *Affin Bank Bhd v Zulkifli bin Abdullah* [2006] 3 MLJ 67.

[74] *Affin Bank Bhd v Zulkifli bin Abdullah* [2006] 3 MLJ 67 at 75.

[75] *Malayan Banking Bhd v Marilyn Ho Siok Lin* [2006] 7 MLJ 249.

[76] *Malayan Banking Bhd v Marilyn Ho Siok Lin* [2006] 7 MLJ 249 at 263 (emphasis added).

In August 2007, Hamid Sultan JC delivered the judgment in *Malayan Banking Berhad v Ya'kup bin Oje*.[77] Again the case arose from a BBA facility and the issue was whether the court should allow the order for sale for the repayment of the sum in the original form, or limit the sum to be repaid under the order for sale, or make other orders or directions as case required. The learned judge, instead of referring the Shari'ah matters to the SAC, wrote a lengthy treatise on Islamic jurisprudence, Islamic economics, Islamic banking, the concept of justice and Shari'ah, the doctrine of 'ilah and other topics, quoting extensively from the English translation of the *Qur'an* and other sources.

In July 2008, Abdul Wahab Patail J delivered his judgment in what will turn out to be one of the most controversial Islamic finance cases in Malaysia to date. The case in question is *Arab-Malaysian Finance Bhd v Taman Ihsan Jaya dn Bhd*.[78] Again, this case arose from a BBA transaction. There was default in the payment of instalments, and the bank went to court to apply for an order for sale under the *National Land Code*:

> The defendants argued that the transaction herein, comprising as it were of the letter of offer, the PPA, the PSA and the charge or assignment in question, became transparently financing in nature and smacked of transactions for profits, and in the circumstances, beseeched the court to examine the same and determine whether it involved elements not approved by the religion of Islam – or had otherwise contravened the provisions of the [*Islamic Banking Act 1983* (Act 276) (Malaysia)] or the [*Banking and Financial Institutions Act 1989* (Act 372) (Malaysia).[79]

The learned judge, on his own, made Shari'ah rulings such as no Shari'ah Committee anywhere in the world had ever done. For example he stated that:

> The Islamic financing facilities are presented as Islamic to Muslims of all mazhabs. The facilities do not say they are offered only to Muslims of a certain mazhab, for example Syafi'e. If a facility is to be offered as Islamic to Muslims generally, regardless of their mazhab, then the test to be applied by a civil court must logically be that there is no element not approved by the Religion of Islam under the interpretation of any of the recognised mazhabs. That it is acceptable to one mazhab is not sufficient to say it is acceptable in the Religion of Islam when it is not accepted by the other mazhabs.[80]

The learned judge also wrote a lengthy judgment covering topics such as: religion and law; civil court and Islamic finance cases; Islamic banking and financing; riba and usury; common law and equity; as well as other elements, such as form and substance, concept and implementation, equitable interpretation, ibra' or muqasah, BBA and others, by citing numerous versus from the Malay and English translations of the *Qur'an*, as well as from the Old and the New Testaments of the *Bible*. The learned judge finally granted the order for sale to the plaintiff banks and ordering the defendants to return the original facility amount to the plaintiff banks.

That judgment shocked the industry and the Shari'ah scholars. The authors believe that it was this judgment that was responsible for the change in the law regarding the requirement to refer Shari'ah issues to the SAC and to make the ruling of the SAC binding on the courts.

In 2009, just before CBMA 2009 came into force, two more judgments were delivered. The first is *Tan Sri Abdul Khalid bin Ibrahim v Bank Islam Malaysia Berhad*.[81] The case was only at the stage of an application for a summary judgment, that is, the issue to be determined by the court was whether there were issues to be tried. So long as there is even one issue to be tried, summary judgment should be refused and the case must go to full trial. Tan Sri Khalid challenged the validity of the BBA facility agreements for want of compliance with the principles of Shari'ah on three main grounds. First, the BBA facility agreement, either read together with the security documents or even independently, denotes a financing arrangement, not the sale transaction that it is purported to be. Secondly, the BBA facility agreement is bay' al-'inah, as the recital of the agreement shows a connection between the

[77] *Malayan Banking Berhad v Ya'kup bin Oje* [2007] 6 AMR 135.

[78] *Arab-Malaysian Finance Bhd v Taman Ihsan Jaya dn Bhd* [2009] 1 CLJ 419.

[79] *Arab-Malaysian Finance Bhd v Taman Ihsan Jaya dn Bhd* [2009] 1 CLJ 419 (head note).

[80] *Arab-Malaysian Finance Bhd v Taman Ihsan Jaya dn Bhd* [2009] 1 CLJ 419 at 424.

[81] *Tan Sri Abdul Khalid bin Ibrahim v Bank Islam Malaysia Berhad* [2010] 4 CLJ 388 (Rohana Yusuf J). This judgment was delivered on 21 August 2009.

asset purchase agreement (APA) and asset sale agreement (ASA). Thirdly, the disposal of the pledged Guthrie shares by the bank without notifying Tan Sri Khalid is contrary to the Islamic principle known as al-rahn, which requires the consent of the pledgee before any disposal of it. Consequently, the learned counsel for Tan Sri Khalid submitted that the BBA agreement was contrary to law or public policy and could not be enforced under s 24 of the *Contracts Act 1950*. He also produced three Shari'ah opinions raising issues about the validity of the BBA agreement from a Shari'ah perspective.

On the issue that the agreement was null and void, the learned judge said:

> Having examined the SAC, its role and functions in the area of Islamic banking, I do not see the need for me to refer this issue elsewhere though I am mindful that under s 16B(7) I am not bound by its decision. From its constituents in s 16B(2) the members are made of people of varied disciplines besides Syariah scholars. This, I believe will enable the body to arrive at a well informed decision instead of deciding the Syariah issue in isolation. *Bearing in mind the response from the SAC to this case, namely, that BBA is a recognised form of transaction and is within Syariah, I have no hesitation to accept that view and will not venture any further into its finding …*[82]

The authors would like to interject here that at that point of time it was not yet mandatory for the court to refer a Shari'ah issue to the SAC, the ruling of the SAC was not binding on the court, the procedure for reference had not been established yet, and this is the first known case where a judge made an enquiry of the Secretariat regarding the validity of the BBA agreement.

Five days after Rohana Yusuf J delivered the *Tan Sri Khalid* case, the Court of Appeal came down with the judgment in *Bank Islam Malaysia Berhad v Lim Kok Hoe*.[83] On the issue of the validity of BBA agreement, the Court of Appeal strongly concluded that it is not for the civil court judges to decide whether a matter is Shari'ah complaint or not. This is what Raus Sharif JCA, delivering the judgment of the court, observed:

> Thus, we already have the legal infrastructure to ensure that the Islamic banking undertaken by the banks in this country does not involve any element which is not approved by the Religion of Islam. The court, will have to assume that the Syariah advisory body of the individual bank and now the Syariah Advisory Council under the aegis of Bank Negara Malaysia, would have discharge their statutory duty to ensure that the operation of the Islamic banks are within the ambit of the Religion of Islam. This is more so, when the customers in these appeals have not made any allegations that the Syariah advisory body of [Bank Islam Malaysia Berhad or BIMB] or the Syariah Advisory Council established by the Bank Negara had failed to exercise their statutory duties. Thus, the learned judge, with respect, should not have taken upon himself to rule that the BBA contracts were contrary to the Religion of Islam without having any regard to the resolutions of the Syariah Advisory Council of the Central Bank Malaysia and the Syariah Advisory body of BIMB on the validity of BBA contracts.[84]

## Post CBMA 2009 period

The new CBMA 2009 was passed by Parliament and subsequently received the Royal Assent on 19 August 2009, and was published in the gazette on 3 September 2009. However, it only came into force on 25 November 2009. Chapter 1 of Pt VII, ss 51 to 58, are devoted entirely to the SAC. However, from the adjudication point of view, ss 56 and 57 are the most important development that this new law brought. Section 56 makes it compulsory for the civil court judge or arbitrator, when faced with a Shari'ah issue, to do either one of the two things, that is, refer the issue to the already published resolutions of the SAC on the matter (if any), or to refer the issue to the SAC for its ascertainment. The ruling made by the SAC upon such reference is binding on the court or arbitrator by virtue of s 57. In addition to it, on 19 June 2012, the SAC issued its Manual.[85]

[82] *Tan Sri Abdul Khalid bin Ibrahim v Bank Islam Malaysia Berhad* [2010] 4 CLJ 388 at 401 (emphasis added).

[83] *Bank Islam Malaysia Berhad v Lim Kok Hoe* [2009] 6 CLJ 22.

[84] *Bank Islam Malaysia Berhad v Lim Kok Hoe* [2009] 6 CLJ 22 at 38-39.

[85] See BNM, n 17.

### *Islamic finance cases decided by the courts after CBMA 2009*

On 28 January 2010, about three months after CBMA 2009 came into force, Rohana J delivered her judgment in *Bank Islam Malaysia Berhad v Azhar bin Osman*.[86] After the decision of the Court of Appeal in *Bank Islam Malaysia Berhad v Lim Kok Hoe*,[87] this case was one of the many cases sent back to the High Court for determining the quantum the customer should pay to the bank. The issue is really whether the bank is entitled to the full sale price when default occurs in a BBA contract. The authors think that this is a Shari'ah issue. However, the learned judge framed the issue in a way that made it look like a question of interpretation of the contract. Approached in that way, the question of referring the issue to the SAC did not arise at all. From the judgment, it appears that even the counsel did not request the court to refer the question to the SAC. Briefly, the learned judge decided that the bank was not entitled to the full sale price. There was no mention of the SAC even though the CBMA 2009 had already come into force; however, the judgment (Azhar) was reversed by the Court of Appeal on 20 October 2010.[88] What is important to note is that during this period the court and arbitrators started referring Shari'ah issues to the SAC.

The authors have shown from the cases discussed above that, in the *Tan Sri Abdul Khalid* case, Rohana J had caused an enquiry to be made to the SAC as to whether a ruling had been made on the status of the BBA agreement. However, the first "real" reference came sometime in the middle of 2011, it was from arbitrators and, interestingly, the signatory of the letter making the reference was the former Chief Judge of Malaya.

Very soon after that, the first reference came from the Muamalat Court and the judge who made the reference was none other than Mohd Zawawi J, whose judgments are discussed below. His question was whether the rate of ta'wid could be fixed or agreed upon (predetermined) by contracting parties in an agreement without any proof of the loss suffered by the bank?[89] In March 2012, another reference was made by Mohd Zawawi J. There were more questions raised now; each was divided into several parts, and the SAC gave a seven-page answer. Part of the answer was later adopted as Illustration IV of the Manual. The third reference from the courts and the last to date again came from the same judge and the same court and was on the subject of al-rahn. So the system has clearly started to function.

The High Court's reference of Shari'ah issues to the SAC of the BNM, pursuant to ss 56 and 57 of the CBMA 2009, was contested by the plaintiff in *Mohd Alias Ibrahim v RHB Bank Bhd*.[90] The plaintiff contended that the impugned provisions are unconstitutional as they usurp the judicial power of the courts, provided under Art 121(1) of the *Constitution*, and delegate the courts' decision-making power in relation to the Islamic financial business to the SAC. In addition, the binding nature of the SAC rulings on the court, by virtue of impugned provisions, allegedly affects the parties' natural right to be heard.

The learned Mohd Zawawi J, after referring to the Federal Court judgment in *PP v Kok Wah Kuan*,[91] concluded that "judicial power" is vested in the two High Courts (that is, the High Court in Malaya, and the High Court in Sabah and Sarawak), but the extent to which it is vested in them will depend on what federal law provides. Furthermore, deliberating on the function and the nature of the rulings of the SAC, the judge said:

> The sole purpose of establishing the SAC is to create a specialized committee in the field of Islamic banking to speedily ascertain the Islamic law on financial matters so as to command the confidence of all in terms of the sanctity, quality and consistency of the interpretation and application of Syariah principles pertaining to Islamic finance transactions before the court. The SAC cannot be said to be

[86] *Bank Islam Malaysia Berhad v Azhar bin Osman* [2010] 3 AMR 363

[87] *Bank Islam Malaysia Berhad v Lim Kok Hoe* [2009] 6 CLJ 22.

[88] *Bank Islam Malaysia Berhad v Mohd Azmi Bin Mohd Salleh* (unreported, Civil Court of Appeal, No W-02-609-2010).

[89] Ta'wid is a compensation charged to a debtor for late payment.

[90] *Mohd Alias Ibrahim v RHB Bank Bhd* [2011] 4 CLJ 654.

[91] *PP v Kok Wah Kuan* [2007] 6 CLJ 341.

> performing a judicial or quasi-judicial function as the process of ascertainment has no attributes of a judicial decision. Hence, this is not an attempt by the executive to take over the judicial power traditionally exercised by the courts.
>
> The rulings as passed by the SAC constitute a form of expert opinion in the matter of Islamic finance. Further, considering that its members were highly qualified in the fields of Syariah, economics, banking, law and finance and appointed based on standards enunciated in s 53 of Act 701, every such ruling, in the context of Islamic banking and takaful, can also be regarded as a collective itjihad. Within the contexts of administration of Islamic laws in Malaysia, these rulings, however, are not fatwas.[92]

This judgment has been confirmed by the Court of Appeal.[93]

On 2 December 2011, Mohd Zawawi Salleh J delivered another judgment in *Tan Sri Khalid Ibrahim v Bank Islam Malaysia Berhad*.[94] On the role of the SAC, the learned judge reiterated: "Looking at the purpose of s 56 of Act 707, it is clear that SAC is required to ascertain the applicable Islamic law to the above Syariah Issues. Upon ascertainment of the Islamic Law, the court would then apply it to the facts of the present case."[95] This statement is consistent with paragraphs 7 and 8 of the Manual reproduced earlier. It is interesting to note that at the time the judgment was delivered, the Manual had not been issued yet. The drafters of the Manual, too, were not aware of the judgment. However, their understanding of the role of the role of the SAC is similar.

The learned judge concluded:

> Thus, as has been expounded in Alias's case, the necessity of a special body like SAC to ascertain the Islamic law most applicable in Malaysia especially in this Islamic banking industry is undeniable. Difference of opinion on Syariah issues relating to Islamic banking should be resolved within SAC.[96]

These observations by the learned judge are very heartening indeed. There lies the difference between a judge with some Shari'ah educational background and those without. He or she who knows the seriousness of the matter understands the problem. As time goes on it is hoped there will be more judges with a Shari'ah background to handle Islamic finance cases. The difficulty is finding candidates who are well versed in both civil law and the Shari'ah. Quite often, besides those who are quite well versed in either the civil law or the Shari'ah, those who are supposed to know both are neither here nor there. Of course, experience counts.

Having said that, the decision was appealed and on 14 May 2012, the Court of Appeal decided the appeal in *Tan Sri Abdul Khalid Bin Ibrahim v Bank Islam Malaysia Berhad*.[97] The court unanimously upheld the judgment of Mohd Zawawi J and held that ss 56 and 57 of the CBMA 2009 were "valid and constitutional".

The case was later brought to the Federal Court on the ground of the unconstitutionality of ss 56 and 57 of the CBMA 2009. The Federal Court granted the leave to appeal. However, the Federal Court never got the opportunity to deliberate the matter and deliver what would have been a ground breaking decision as the parties agreed to an out-of-court settlement.

## CONCLUSION

The adjudication of Shari'ah issues has not been addressed adequately in the past. The contracting parties in cross-border Islamic finance contracts, willingly or by the application of law, bring their disputes before the English courts, which are then expected to adjudicate Shari'ah issues. There is little that English courts can do when it comes to the adjudication of Shari'ah issues raised by the contracting parties. They are unwilling to venture into the discussion of those issues for fairly good

[92] *Mohd Alias Ibrahim v RHB Bank Bhd* [2011] 4 CLJ 654 at 657-658.

[93] *PP v Kok Wah Kuan* (unreported, Court of Appeal Civil Appeal No W-02-1420-2011[0]).

[94] *Tan Sri Khalid Ibrahim v Bank Islam Malaysia Berhad* [2012] 3 CLJ 249.

[95] *Tan Sri Khalid Ibrahim v Bank Islam Malaysia Berhad* [2012] 3 CLJ 249 at 258.

[96] *Tan Sri Khalid Ibrahim v Bank Islam Malaysia Berhad* [2012] 3 CLJ 249 at 270.

[97] *Tan Sri Abdul Khalid Bin Ibrahim v Bank Islam Malaysia Berhad* [2012] 1 LNS 634 (Low Hop Bing, Zaharah Binti Ibrahim and Aziah Binti Ali JJCA).

reasons, one of which is, that their ruling may not reflect the correct Shari'ah position on the matter. In most cases, they may not be adequately equipped with the knowledge of muamalat to rule on those issues. This is evident from many cross-border Islamic finance cases in which Shari'ah issues had been raised before the English courts, expressly chosen by the contracting parties. Even today, English law still remains as the most preferred choice of law by the parties involved in cross-border Islamic finance contracts. The evidence of this is the recent judicial decisions in *Dubai Islamic Bank PJSC v PSI Energy Holding Company BSC*,[98] *Standard Bank PLC v Sheikh Mohamed Bin Issa Al Jaber*,[99] and *Dar Al Arkan Real Estate Development Company v Bank Alkhair BSC*.[100] In each one of these cases the parties that are not from the UK, have chosen English law as the governing law for their contracts.

Therefore, the article proposes to the parties in cross-border Islamic finance transactions to choose Malaysian law as the law of reference. By doing so, they will not only ensure that the contract is recognised and enforced according to common law rules, but they will also ensure that the Shari'ah nature of the contract is properly recognised and adjudicated by the courts. The Shari'ah issues raised before the courts will be referred to the SAC for the ruling which will bind the court. The efficacy and workability of this model has already been tested in Malaysia. The article argues that this model could be exported and adopted by other countries wishing to introduce and develop their own Islamic finance industry.

[98] *Dubai Islamic Bank PJSC v PSI Energy Holding Company BSC* [2011] EWHC 1019 (Comm).

[99] *Standard Bank PLC v Sheikh Mohamed Bin Issa Al Jaber* [2011] EWHC 2866 (Comm).

[100] *Dar Al Arkan Real Estate Development Company v Bank Alkhair BSC* [2012] EWHC 3539 (Comm).