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INTERLINK/INTERFACE BETWEEN CIVIL LAW SYSTEM AND SHARI'AH RULES AND PRINCIPLES AND EFFECTIVE DISPUTE RESOLUTION MECHANISM

By
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My focus is on the interlink/interface between the civil law system and *shari'ah*, rules and principles relating to Islamic banking, Islamic finance and *takaful*. (In Malaysia, I think, it is more accurate to use the term "common law" instead of "civil law". However, as we have been using the term "civil law" very widely in contrast with the *shari'ah*, I shall use the same term.") I will also discuss whether, at present, there is, in fact, an effective dispute resolution mechanism. I should also note that the discussion is in Malaysian context, within the present constitutional and legal framework.

I must also confess at the outset that I am neither an Islamic scholar, nor an expert on Islamic banking, Islamic finance or *takaful*. Neither am I a legal practitioner with experience in drafting related documents. As a Judge, during the eight years I was sitting in the Court of Appeal and Federal Court, I remember coming across only one Islamic banking case. That was the case of Bank Kerjasama Rakyat Malaysia Berhad v. Emcee Corporation Sdn. Bhd. (2003) 1 C.L.J. 625 (delivered on 29.1.03.) That was an application for an order for sale under the National Land Code arising from a transaction under the Al-Bai Bithaman Ajil. The issue was whether there was "cause to the contrary" as provided by section 256 of the National Land Code. This is what I said, delivering the judgment of the Court:

> "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 remedy available and sought is a remedy provided by the National Land Code. The procedure is provided by 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 made, if made, and the same principles be applied in deciding the application."

I could have come across more Islamic banking cases during my ten years as a High Court Judge. If I did, they went unnoticed. That may surprise you. But, that is the reality.

And that is because, the cases that come to court out of banking transactions, whether conventional or Islamic, are, in the High Court, usually for orders for sale under the National Land Code and the procedure for which are provided by the Code and the Rules of the High Court. There is no difference between them. The same law and procedure apply.

It is the same with appeals in claims for damages arising out of road accidents in a *takaful* contract. I use the word "appeal" because such claims are totally within the jurisdiction of the Sessions Courts and Magistrate Courts. They went unnoticed because the applicable law is the same, substantively, procedurally and evidentially. The issues to be decided, whether in a claim against a conventional insurance company or a *takaful* company, are the same, whether regarding liability or quantum of damages. In deciding the question of liability, the issue is whether the defendant is negligent. Negligence is determined according to common law principles. In road accident cases, which form a great majority of such cases, the issue is determined in reference to the Road Traffic Law and rules. Again, in determining the type of damages and the quantum thereof, it is also the common law principles that are applied. Civil courts have developed principles that have now become common law applicable in the determination of such issues. For example, damages is divided into special damages and general damages. Under general damages there is the award for pain and suffering. Then there is an award for loss of income, loss of earning capacity and also an award of interest upon judgment until the full settlement of the judgment. Each award is governed by principles established by the courts. Indeed, even in deciding how much should be awarded for a broken toe, a magistrate or a judge need only look up the table of similar awards previously given in similar cases by the courts which have been compiled in journals and books on the subject, make the necessary adjustments and determine the amount.

So, at least until I retired, those were the types of cases arising from Islamic banking and *takaful* transactions that went to court. Lawyers did not raise *shari'ah* issues in such cases and judges did not have to decide such issues.

In fact, thinking about it as I was writing this paper, I think it is most unlikely that *shari'ah* issues would ever arise in *takaful* cases in the civil courts. Why? Common sense. The plaintiff or the participant is relying on the *takaful* contract. Certainly, he will assert that the contract is valid. The *takaful* company offers what it claims to be a *shari'ah*-compliant *takaful*. When the contingency happens and the participant makes a claim, do you think that there would be a *takaful* company that would turn around and say, "Look. Actually, our product is not *shari'ah*– compliant. Therefore, the contract is null and void and we are not obliged to pay you"? I am also quite sure that there would not be

lawyers to give such legal advice to the *takaful* companies. I will be very disappointed if there are.

Regarding Islamic banking cases, in 2002, I made a study and discovered that, until then, there was no case in which the civil court was asked to decide a *shari'ah* issue arising thereof. But, things have changed recently. You know too well those famous or infamous judgments that were delivered by the High Court last year[1] . They have generated a lot of worries and discussions. That judgment had been reversed by the Court of Appeal.

All these show that there is interlink between civil law and *shari'ah* even in Islamic banking cases. In other words, *shari'ah* issues may arise in the civil court.

That is only looking at the cases that go to court which happens towards the end of a transaction. But, if we look from the other end, the beginning, from the process of creating the products, we will find that there is interlink between the two laws throughout the process.

Why is it so?

We must bear in mind that Islamic banking, Islamic finance and *takaful* as we know them today are a modern invention. They were born in the last few decades of the twentieth century in a world where the banking, financial and insurance systems which have now come to be known as the "conventional" systems, have been firmly established. Conventional banking, finance and insurance have developed over a few hundred years. New and newer products were invented and innovated to meet the ever-increasing and changing needs of the customers.

Law too had developed to cope with the requirement of the industry. Company law, land law, contract law, bankruptcy law, laws governing financial institutions and insurance companies, rules regarding procedure had also developed at the same time. As a result, the whole structure of laws, substantive and procedural, had come into existence as we know them today.

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1. Arab-Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors (Koperasi Seri Kota Bukit Cheraka Bhd, third party) (2008) 5 MLJ 163. Bank Islam Malaysia Berhad v. Ghazali Bin Shamsuddin & Others (unreported decision) and Bank Kerjasama Malaysia Berhad v. Fadason Holdings Sdn Bhd & Others (unreported)

There was no parallel development in the Islamic sector. When I was a boy, a bank was seen as a “sinful” place. You would not find any Malay-Muslim employee in a bank, those days. What changed it was when the government started giving scholarships in large number to Malay-Muslim students to study accountancy, economics, law, business etc. Many of them ended working in conventional banks and insurance companies. Surprisingly, by then, they were not seen as working in a “sinful” place. That was a welcomed change. I say so because without their experience in conventional banking and insurance*,* quite likely, until today we would still not have an Islamic bank or a *takaful* company. Those verses of the *Qur’an* on *riba* would probably continue to be recited melodiously by *qaris* and *qariahs* or cited by the scholars along with *hadiths* on *gharar, maisir, riba* and others in religious classes and lectures. Nothing more.

But, it is the experience and the expertise of those officers of conventional banks and insurance companies combined with the scholarship of the *shari’ah* scholars and others that had given birth to Islamic banking, Islamic finance and *takaful* products that we have today.

This coupled with the positive recommendations by the National Steering Committee on Islamic banking in 1981 had led to the establishment of Bank Islam Malaysia Berhad, the first Islamic bank in Malaysia, after the Islamic Banking Act 1983 was enacted by Parliament in 1983. One year later, the first *takaful* operator, Syarikat Takaful Malaysia Berhad, was set up under the *Takaful* Act 1984.

The Islamic products are actually adapted and modified conventional products. They are created in civil law surroundings. To create them requires expertise in both civil law and *shari’ah*, something that is quite impossible to be found in one person. Quite often, those who know civil law do not know the *shari’ah*. Those who know the *shari’ah* do not know civil law. There is a third category: those who think they know both have never practised law.

When a lawyer drafts an agreement based on *murabahah,* for example, he has to make sure that both laws, where applicable, are satisfied which means that he has to know them in the first place. When the matter goes to court, the civil court, the lawyer has to argue the case and the judge has to decide it. While they may be familiar with the civil law that is involved, the same could not be said regarding their knowledge of the underlying *shari’ah* concepts it adopts.

So, we have to address this problem. Removing the cases to the *shariah* court is, in my 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* company a "person professing the religion of Islam?" That provision was drafted in the context of natural persons who are capable of professing the *shahadah*, perform the daily prayers, observe the fasting in the month of *Ramadan*, pay *zakah* and perform the *Hajj*. Can a limited company, as a legal person, commit sin, go to paradise or hell, as the case may be? How does a limited company, as a legal person, believe in the "Rukun Iman"? I shall leave the question for you to answer. But, we must understand the concept of a limited company as a legal person to answer them.
3. A host of other related laws, e.g. bankruptcy law, companies' winding-up laws, land law are outside the jurisdiction of the *shari'ah* courts. What it means is that the judgment creditor, even if he 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 specialized area and they may not necessarily be conversant in the area. In any event, they are not conversant in the civil laws mentioned earlier.
5. The *shari'ah* courts are State courts. There are fourteen such courts, each independent of the other. At the apex, there are fourteen *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 them.
9. There will be problems of reciprocal enforcement of judgments of *shari'ah* courts, being State courts, in foreign countries. Existing law, the Reciprocal Enforcement of Judgments Act 1958 is only applicable to judgments of the civil courts.

Setting up a *"mu'amalat* court" at the federal capital, in my view, is not going to solve the problems either. I say so for the following reasons:

1. Naming a court in the Commercial Division at Kuala Lumpur a "*mu'amalat* court" will not make the judge a *shari'ah* scholar or an expert in Islamic banking and *takaful*.
2. Even if we manage to find one judge who is knowledgeable in civil law as well as in Islamic banking, *takaful* and the *shari'ah*, the problem is still not solved in other courts, i.e. the Magistrates' Courts , Sessions' courts, High Courts in other states, the Court of Appeal and even the Federal Court. To require all cases of Islamic banking and *takaful* to be filed and heard in Kuala Lumpur would cause unnecessary difficulties to the parties and witnesses, besides being costly. Cases in the Magistrates' courts and the Sessions Court would still remain in the respective courts. The problem in the Court of Appeal and the Federal Court remains unsolved. Even if only cases that involve *shari'ah* issue should be filed or transferred to the *mu'amalat* court in Kuala Lumpur, it is still costly for the parties in those cases. But, that too will not cover cases in the Magistrates' courts and the Sessions Courts.

However, it was hoped that by assigning a judge with experience in Islamic banking and *takaful* in one of the courts in the Commercial Division in Kuala Lumpur to hear Islamic banking an *takaful* cases, would help. That has been done.

Under the circumstances and under the present constitutional setup, the best and the most practical solution that I could think of was to make provision in the law that any *shari'ah* issue in Islamic banking and *takaful* arising in any court or tribunal should be referred to the Shari'ah Advisory Council of Bank Negara, the same body that approves the product before the launch. At that time, I suggested that it be made compulsory for the courts to refer such issues to the Shari'ah Advisory Council and that the ruling of the council be made binding on the courts. However, the last-mentioned suggestion was not agreed to.

However, recently, after the judgments that I have mentioned, the proposal has been accepted and made law. This has been translated into section 56 of the new Central Bank of Malaysia Act (CBA) 2009 which provides for compulsory reference to the Shari'ah Advisory Council for ruling from a court or an arbitrator. By virtue of section 57 of the CBA, any ruling made by the Shari'ah Advisory Council shall be binding on the Islamic financial institutions, the court or the arbitrator, as the case may be. The CBA has received Royal Assent and is expected to come into force very soon.

It looks as if I have to retire before my view was appreciated. Anyway, it is still not too late and I am still alive to see it happens despite what many people thought had happened to me on 1st September 2009.[2]

Admittedly, that is not a perfect solution, but, I think that is the best we can have under the present circumstances. Perhaps, some people are not happy with it. Let us see their proposals, in concrete form including the proposed laws to be made.

There is another area, caused by the interlink, that I think should be looked into. I am referring to the Rules of Court relating to the granting of interest by the court upon judgment. The Rules of Court allows the court to make an order of interest of up to 8% from the date of judgment until the date of full payment. This provision was made long before the existence of Islamic banking in Malaysia. It was meant for all judgments. No amendment has been made until today, for application to Islamic banking cases.

At one seminar four or five years ago, a bank officer complained that the civil court was giving interest in Islamic banking cases. My reply was: If you don't want it, don't ask for it. Don't blame the court for giving it when you ask for it. The rules allow the court to give it, you ask for it, on what ground is the court going to refuse it?

But, that is not the problem, really. The real problem is this: so long as the provision is there, when the court makes an order, it is in the form of interest, which is prohibited. If it is not asked for or is refused by the court, it may encourage the judgment debtor to delay payment of Islamic banking or a *takaful* judgment sum, because whether he pays it now or ten years later, he still pays the same amount.

One non-Muslim lawyer told me: "One good thing about Islamic Bank is that it is very slow in going to court for enforcement." If that is true, that is bad, in my view. It means that judgment debtors will keep avoiding settling judgment debts to Islamic banks. They would settle judgment debts to conventional financial institutions first, or use the money for some other purpose first.

On 26.5.2005 and 24.8.2006, the Shariah Advisory Council of Bank Negara had made a ruling that it is permissible for the Islamic Banking Institutions to get an order of compensation of up to 8% of the judgment sum. However, it may only take for itself an amount equivalent to the actual loss which is calculated based on the annual average

[2] Tun Abdul Hamid Omar, the former Lord president (also known as "Ketua Hakim Negara") passed away. Many people thought it was me. One Online newspaper even carried my photograph. It is nice to know that people care.)

for overnight weighted rate of the Islamic money market of the preceding year. The rest should be given to charity.

This should be made a rule of court. After all, the Central Bank of Malaysia Act 2009 has now formally recognised the dual financial system that Malaysia has been having over 40 years. It's about time that other laws and procedures follow suit.

Effective dispute resolution mechanism.

That is part of the title given to me. Frankly, I am not sure whether there is an effective dispute resolution mechanism, which is an alternative to the court system.

As usual, when one talks about alternative dispute resolution, one looks for an alternative to court proceedings. The standard argument is that court proceedings are not satisfactory for various reasons. (I shall not repeat them.) The alternative is arbitration and mediation, giving the standard good points attached to them. (I shall not repeat them either.)

In 2004, the Kuala Lumpur Regional Centre for Arbitration, in conjunction with Bank Negara and support of the Securities Commission had come out with Rules for Arbitration of Kuala Lumpur Regional Centre for Arbitration (Islamic Banking and Financial Services) (the "KLRCA (IBFS) Rules") with high hopes that Islamic banking and financial cases would go for arbitration at the centre, at least, to complement the court system. The Governor of Bank Negara was quoted as saying in StarBiz dated 26th. August 2004 as follows:

> "To complement the court system, disputes may also be referred to the arbitration centre for resolution. In this regard, the Kuala Lumpur Regional Centre for Arbitration will be enhanced to serve as a platform to deal with cases involving Islamic banking and finance, and to extend these services beyond our borders"

Similarly, Dato' Syed Ahmad Idid, Director of the Kuala Lumpur Regional Centre for Arbitration was quoted as saying in StarBiz dated 2nd May 2005 as follows:

> "We know there is a lot of money flowing between Asia and the Middle East. Middle East money has been invested in Asia and therefore we are offering our service in case there are business

> disputes. For a start, we have invited Muslim arbitrators, especially those with Islamic banking background, to handle Islamic banking disputes".

With all the good things that had been said in favour of arbitration, one would expect the arbitration centre to be swarmed by cases and that there would be a drastic reduction of cases filed in the courts. Does that happen? I am advised that to date not a single Islamic banking or *takaful* case has gone to the centre for arbitration.

Why? Let me try to guess some of the reasons. I use the word “guess” because I don’t claim to make a “study” of the issue. These are the reasons that came to my mind as I was writing this paper. First, let us look at *takaful* cases:

1. In claims arising from *takaful* transactions, most of the cases are claims for damages for personal injuries caused by road accidents. I have mentioned the law applicable to such cases, which are common law principles. I have given my reason why I think *shari’ah* issues would, very unlikely, arise in such cases. Minus the *shari’ah* issues, the claim is just like any other claim in conventional insurance. So, why go for arbitration under the system?
2. Lawyers representing the claimants would themselves try to work out a settlement, directly with the insurance company or trough the company’s lawyers. Quite often, they are settled without even going to court. From experience, lawyers from both sides can reasonably assess the liability, the damages and the amount of compensations that should be paid.
3. Where the claims are big, the insurance companies would not want to settle easily and promptly. The weapon that the claimant lawyer has is to file a suit in court. As the process in court proceeds, the parties keep talking. Let me tell you that from my experience many cases were settled on the morning the evidence was going to be adduced!

Those I think are the reasons why such cases do not go to the KLRCA.

Let us now look at the reasons why Islamic banking cases do not go to KLRCA:

1. Most cases, if not all, arise from defaults in installment payments. The customer either cannot pay or would like to delay or avoid paying the debt. In all these cases, it is in their interest to delay proceedings. This is more so in Islamic banking transactions as they will not be penalized with interests. So, they raise all kinds of defences, including lately, that the contract is void being non-compliant with *shari’ah*. Under the circumstances, it is unlikely that they would agree to arbitration. If they sincerely want to settle the debt but are unable to do so, it is better for them to negotiate directly with the financial institutions. They do

not have to spend money on lawyers and/or arbitrators. Lawyers and arbitrators are not cheap either.

2. Financial institutions would not go to court unless all avenues have been exhausted. It costs them money to go to court or, for that matter, for arbitration. When they do go to court, the first remedy that they would seek is for an order for sale of the charged asset. That order can only be made by the High Court. If there is a short-fall, the financial institutions would file a suit for it. With the judgment, they have many ways of executing it including bankruptcy and winding-up proceedings. Arbitrators do not have all these remedies.
3. (This is applicable to *takaful* cases as well), Rule 33(1) of the KLRCA (IBFS) Rules, in brief, states that when the arbitrator has to form an opinion on a point related to *shari'ah* principle, the arbitrator is required to refer the matter to the relevant Shari'ah Advisory Council for its decision. The requirement to refer the matter or issue to the relevant Shari'ah Advisory Council is a good provision as it promotes consistency in the decisions on similar issues. However, looking at it from the point of view of the parties, the reason why they opt for the arbitration under the rules is because it is assumed that the arbitrator is knowledgeable in Islamic banking, Islamic finance, *takaful* and the *shari'ah* and will be able to decide the issues. Otherwise, why spend money on him at all? More so, why pay the lawyers to take the case to the arbitrator and then pay the arbitrator to refer the issue to the Shari'ah Advisory Council? Either part could do so directly for free or through their lawyers, in which case they need only pay their lawyers.
4. (This, too, is applicable to *takaful* cases), while civil court judges are not conversant in *shari'ah* and Islamic banking and *takaful*, I am more inclined to believe that it is equally difficult to find arbitrators who are knowledgeable in Islamic banking, takaful, *shari'ah*, civil law and procedure and practical experience in the practice of law or as a judge. After all, most of the registered arbitrators are either civil law lawyers or ex-judges of the civil court. We are back to square one.

There is another forum shat should be mentioned i.e. the Financial Mediation Bureau (FMB) established by Bank Negara, not under any law but administratively. The function of the bureau is to facilitate amicable settlement and, if parties cannot agree, to make an award binding on the financial service provider e.g. banks and insurance companies, but not on the customer. It has limited jurisdiction in terms of the amount of the claim. However, the jurisdiction of the Bureau covers banking and Islamic banking, insurance and *takaful*. In 2008, for example, 1,197 conventional and 81 *takaful* cases were registered with the FMB, making a total of 1,278. These figures do not include personal injury claims which are outside the jurisdiction of the Bureau. (For comparison, in the same year 2,049 personal injury claims arising from conventional insurance and takaful

were registered in the Sessions Court and Magistrate Courts in Kulala Lumpur alone (564 in the Magistrates Courts and 1485 in the Sessions Court)). In the same year, the Bureau registered 1,059 conventional and Islamic banking cases. Unfortunately, we do not have the breakdown according to conventional and Islamic banking. There are altogether 8 mediators and assistant mediators. They are all common law lawyers, many of whom had served in the Legal and Judicial Service. Lawyers are not allowed to appear at the tribunal to represent their clients.

The point to note is that, so far, no *shari'ah* issues had ever been raised. The cases, whether conventional or *shari'ah* were dealt with in the same way, following the same procedure. There is no appeal and, so far, there has not been any attempt to go for judicial review, may be because the amount involved are, comparatively, quite small, there are no lawyers involved and the cases are more straightforward, not cases in which facts are in dispute or where there is an is allegation of fraud. In fact, a party, usually a bank or an insurance company, may abort the mediation by filing a suit in the court.

It is clear that the tribunal is not and cannot be an effective alternative dispute resolution mechanism for Islamic banking and *takaful* cases if we are looking people with the knowledge of *shari'ah*, Islamic banking and *takaful.*

I think I should share with you an observation made by the mediator whom I interviewed while preparing this paper. She said that previously, when the recovery officers of the *takaful* companies were all Muslims, cases could be settled more easily because those officers were quite prepared to compromise in order to arrive at a fair settlement. But, that has changed when the *takaful* companies started employing non-Muslims as recovery officers. Their attitude is the same as their counterparts in conventional insurance companies: no compromise and they must protect the interest of the company! In one case, even though the officer admitted that the proposed settlement was fair, yet he would not agree because he said he was the custodian of the *takaful* fund. "For whom?" asked the mediator. "For the share holders" replied the officer!

I hope that *takaful* companies will look into this. Islamic law has the *"maqasid"*. Islamic product has a soul. They should not be lost.

And this is my own observation. A party (customer) who raises *shari'ah* issues, in my view, is not really interested in the *shari'ah*-compliance of the transaction. If he is really concerned about it, he should or would have checked the product or the agreement before he even signs it. He could even refer it to Shariah Advisory Council for an

opinion. A pious Muslim does not order the food and eat it 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! I am sorry if I am giving a *"fatwa"* here.

Ladies and gentlemen,

It appears that we have not found an effective alternative dispute resolution mechanism for Islamic banking, Islamic finance and *takaful* cases in Malaysia. But, I do not think that it really matters. I think that the present system is workable under the present circumstances and within the ambit of the existing constitutional provisions. In fact, in my view, the civil court system remains relevant, indeed irreplaceable. This is more so, when we consider the various remedies that only the civil court can offer to enforce the judgments, e.g, bankruptcy, winding-up, order for sale and others. Civil court judges are familiar in this area of laws. Regarding knowledge of Islamic banking, Islamic finance and *takaful*, just as most of us, including *shari'ah* scholars, have to learn from scratch, civil court judges too, like lawyers, over time, will know enough to understand the technicality of the products and decide the cases. Of course, in-service training and exposure will help. In fact, the Judiciary has already started such a program. More can be organized. Regarding *shari'ah* issues, if they ever arise, all that the Judges have to do is to refer them to the relevant Shari'ah Advisory Council. The law is already in place to cater for such contingency. After all, how often do such issues arise?

Lastly, I do not even see the necessity to call for the amendment of the Constitution, another popular response but, quite often, without really understanding the problems to be solved and what solutions to offer.

Thank you.