

## The Application of Choice of Law and Choice of Forum Clauses to Islamic Banking and Financial Cross Border Transactions

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**Abstract:** Litigations in cross border transactions are inevitable. There would be legal uncertainty and ambiguity without identifying the governing law and the appropriate forum for settling disputes arise from the cross border transactions. Accordingly, the application of both choice of law and choice of forum clauses are vital in Islamic banking and financial cross border transactions. This paper, therefore, intends predominantly to analyze critically the application of these two clauses to Islamic banking and financial cross border transactions. Repeatedly, parties involved in such transactions used to refer a foreign law as a governing law and *Shari'ah* as a general referral to the contract. There were cases where courts refused to apply *Shari'ah* principles to the disputes and decided even contrary to it based on the ground that it is not a law of a country rather being general principles. In order to address this issue it is suggested that there should be a comprehensive and efficient international standardize set of rules which govern Islamic banking and financial products; and ample of forums to adjudicate disputes resulting from Islamic banking and financial cross border transactions in line with the *Shari'ah*. If these were facilitated, it is advisable to the parties to choose that international *Shari'ah* standard as the governing law of the contract and select one of the Islamic banking arbitration centers as the venue to resolve disputes in the spirit of *Shari'ah*.

**Key words:** Islamic Banking and Financial Cross Border Transaction, Private International Law, Conflict of Laws, Choice of Law and Choice of Forum.

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### INTRODUCTION

Islamic banking and financial system was renaissance a few decades ago in order to create banking and financial transactions among Muslim business partners in accordance with *Shari'ah* principles (Sevket Pamuk, 2005; Tarek S. Zaher and M. Kabir Hassan, 2001). Currently, it has been flourishing with its high acceleration not only in Muslim countries but also in non-Muslim countries. Islamic banking and financial transactions are conducted transcending the boundaries of countries. Consequently, cross border transactions and litigations are inevitable in Islamic banking and finance arena. It is observable that without ascertaining the governing law and the appropriate forum for dispute resolution, there would be legal uncertainty and ambiguity for settling disputes arise from Islamic banking and financial cross border transactions. Both choice of law and choice of forum clauses are crucial to be included in every cross border transaction since it can lessen subsequent dispute relating to the jurisdiction and the applicable law (Richard T. Franch *et al*, 2002). Commonly, parties involved in such transactions refer to English law as a governing law perhaps due to legal certainty that the law provides, with a clause in the contract that the parties also refer to *Shari'ah* as the general applicable law. Nevertheless, it is observed that there were some decided cases where courts refused to apply *Shari'ah* principles to the disputes and decided even contrary to *Shari'ah* based on the ground that it is not a law of a country rather being general principles. In this situation, the underlying transaction, which strictly must comply with *Shari'ah* principles lost its essence. Since *Shari'ah* compliance of all business activities is pivotal requirement in Islamic banking and financial system, it is senseless for the parties to enter into a transaction not only subjected to a foreign jurisdiction and governed by a foreign law but also decided even against the *Shari'ah*. What would be the viable solution for the parties in Islamic banking and financial cross border transactions to resolve disputes arise from their agreements in accordance with *Shari'ah*?

In order to overcome this state of affairs, it is suggested in this paper that there should be a comprehensive and efficient international standards to govern Islamic banking and financial activities and products to be referred as the governing law in Islamic banking and financial cross border transactions. In addition to this there should also be a number of sufficient and efficient forums to adjudicate disputes resulting from Islamic banking and financial cross border transactions in line with the spirit of *Shari'ah* in both the regional or global level. If these were facilitated, it is advisable to the parties to choose international *Shari'ah* standards as the governing

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law of the contract and to select one of the Islamic banking arbitration centers as the venue to settle disputes from Islamic banking and financial cross border transactions to ensure the compliance to *Shari'ah*.

***Conflict of laws:***

Naturally, a cross border transaction involves parties from different countries who are subjected to the respective jurisdiction. Thus, it is obvious that any dispute arises between them totally falls in the field of “conflict of laws,” also known as the “private international law” (David McClean and Kisch Beevers, 2009). In fact, private international law is part of the internal law of a state which deals with cases involving a foreign element. It comes into operation whenever the court faces with a dispute with the presence a “foreign element.” This branch of law determines the jurisdiction of the court which has to adjudicate the dispute and the applicable law to the dispute. These two questions need to be addressed independently in relation to a dispute arises from a cross border transaction. Therefore, when a court deals with a case involving a foreign element, it is vital to examine first whether the court has jurisdiction over the dispute. In cases where the court establishes jurisdiction, then it has to decide further which law should be the applicable law to the dispute. It is, thus, still possible for a court to have jurisdiction to resolve the dispute even though the applicable law would be a foreign system of law (P. M. North and J.J. Fawcett, 1999; Lawrence Collins, 1987; J. H. C. Morris, 1980).

***Choice of forum:***

When a commercial dispute with the presence of a foreign element is brought before a court, it will essentially determine first whether the court has jurisdiction to entertain the case. Generally, the court will reject to try the case if it finds that there is no capacity to claim jurisdiction over the case. The court will not exercise its jurisdiction over a dispute derived from a contract in which the parties select another forum to initiate legal proceeding. The court will accept to resolve a case only when it is satisfied that it has grounds to establish jurisdiction over the case (P. M. North and J.J. Fawcett, 1999). Grounds on which a court can establish jurisdiction are briefly discussed below.

***Jurisdiction of a Court under Common Law:***

Primarily, actions can be categorized into two such as action in *personam* and action in *rem* (P. M. North and J.J. Fawcett, 1999). In an action in *personam*, there are two sets of rules, which are based on the “domicile” of the defendant. Where the defendant is not domiciled in European Community (EC) or European Free Trade Association (EFTA) a contracting state, it is governed by the traditional law which includes common law and statutory rules. Where the defendant is domiciled in EC member countries, the governing law is either the Brussels Convention or Lugano Convention respectively.

Generally, an English court can have jurisdiction based on three grounds such as presence, submission and stay of proceedings. In the case of *Maharanees of Baroda v. Wildenstein* [1972] 2 QB, the English court established jurisdiction even if the defendant is only within its jurisdiction on a fleeting visit. This is known as “exorbitant” jurisdiction. However, the defendant may apply for a stay on the ground of “*forum non conveniens*.” It is not regarded as a voluntary submission if the defendant appears before the court solely to contest its jurisdiction. If the defendant does more than merely contest the jurisdiction, i.e. if he takes any steps to defend on the merits, he is treated as having submitted to the jurisdiction of the court (Pamela Sellman, 1999).

It is possible in cases with an international element that proceedings have been commenced in more than one jurisdiction between the same parties on the same cause of action. In order to avoid the duplication of proceedings, the English court has discretion to stay an English action or restrain an action in a foreign court with the intention that a case may be heard in the most appropriate forum to prevent injustice (P. M. North and J.J. Fawcett, 1999). This application also dishearten “forum shopping” (a situation in which the claimant seeking the jurisdiction where it may be easier to prove his claim or where his award of damages may be greater). This situation can be seen in the case of *The Spiliada* [1987] AC 460, where Per Lord Goff observed that: “The basic principle is that a stay will only be granted on the ground of ‘*forum non conveniens*’ where the court is satisfied that there is some other available forum, having competent jurisdiction, which is the appropriate forum for the trial of the action, i.e., in which the case may be tried more suitably for the interests of all the parties and the ends of justice.”

Again, the English court will also stay an action in cases where the parties have contractually agreed that a foreign court is to have jurisdiction (P. M. North and J.J. Fawcett, 1999). In *The Eleftheria* [1970], the action involved the carriage of goods by sea from Romania to Hull. A clause of the contract referred disputes to the courts of the State where the carrier carries on business. The carrier was Greek and carried on business in Greece. The vessel was arrested in Hull. The defendant applied for a stay of the English proceedings. The court laid down important factors to be considered: (1) in what country the evidence may be most conveniently collected; and (2) whether the foreign law differs from English law in any significant respect. Applying these tests, it was held that the English action should be stayed.

***Jurisdiction of a Court under the Brussels and Lugano Conventions:***

Since provisions in both the Brussels and Lugano Conventions are largely identical, the Brussels Convention will only be referred for further discussion (P. M. North and J.J. Fawcett, 1999). According to Article 2 of the Brussels Convention, persons domiciled in a contracting State, whatever their nationality, shall be sued in the courts of that State. Article 16 of the Brussels Convention prescribes the case in which the national courts of the contracting States have exclusive jurisdiction, regardless of domicile, are as follow:

- (1) Proceedings concerning rights in *rem* in immovable property: the court of the State where the property is situated (*lex situs*);
- (2) Constitution, nullity or dissolution of companies: where the company has its seat.
- (3) Enforcement of judgment: the courts of the State where the judgment is to be or has been enforced.

In the Brussels Convention, two types of submission could be found such as contractual submission and submission by appearance. Article 17 of the Brussels Convention defines contractual submission as an agreement to submit a dispute to the jurisdiction of a court will oust the jurisdiction of all other courts except in cases of exclusive jurisdiction. Under Article 18 of the Brussels Convention, submission by appearance refers to a situation in which a defendant appears before a court of a member State unless another State's courts have exclusive jurisdiction.

***Jurisdiction of Arbitration:***

It is still possible for the parties to insert into the contract an alternative dispute resolution clause which embraces arbitration, mediation or conciliation instead of a court proceeding (Alan Redfern and Martin Hunter, 1991; Henry P. de Vries, 1982; W. Michael Reisman *et al*, 1997; Carolyn B. Lamm, 1989). The objective of alternative dispute resolution is to achieve the amicable settlement of a dispute by using the service of a third party such as a mediator, a conciliator or a private judge appointed by the parties. Arbitration is closer to court proceedings (J. Sorton Jones, 1985) and also the most commonly chosen alternative to court action as a means of dispute resolution due to its freedom and flexibility pertaining to choose arbitrators, venue of the arbitration, procedural rules of the arbitration and the substantive law which govern the contract (Mark A. Buchanan, 1988).

Arbitration can generally be divided into two types such as *ad hoc* arbitration and institutionalized arbitration. These can be either domestic or international. However, the arbitration settlement can only be available when there is a clause refers arbitration as a means to settle disputes in the underlying agreement. An example of arbitration clause is as follow: "Any dispute arising out of or in connection with this contract shall be referred to and finally resolved by arbitration under the Rules of the London Court of International Arbitration which Rules are deemed to be incorporated by reference into this clause." In the arbitration agreement, the parties may opt for an *ad hoc* arbitration or institutional arbitration. If they select an *ad hoc* arbitration, they may agree on the identity of the arbitrator or leave this appointment to a third person. In an *ad hoc* arbitration it is advisable for the parties to provide for the application of one of the standard sets of arbitration rules in order to minimize procedural disputes. Parties may often agree on arbitration under the rules of one of the institutions which provides facilities for the arbitral settlement. Institutional arbitration has some advantages over *ad hoc* arbitration. The institution normally offers administrative assistance regarding the conduct of the arbitration and its rules contain a code of procedure to be followed (Carole Murray *et al*, 2007). International commercial arbitration is predominantly designed to settle disputes between private parties or states and private parties from different jurisdictions (Gary B. Born, 2001). Numerous international commercial arbitration centers were created and well known institutionalized commercial arbitration centres are the ICC Court of Arbitration; the International Centre for the Settlement of Investment Disputes (ICSID), the London Court of International Arbitration (LCIA) and the American Arbitration Association (AAA). All these arbitral institutions have sets of procedural rules that applicable to the arbitration process. These institutions merely facilitate guidance to the arbitrators selected by the parties (Faisal Kutty, 2006).

***Enforcement of Foreign Judgments and Arbitral Awards:***

Enforcement of foreign judgments and arbitral awards is somewhat difficult or even impossible unless there are arrangements for enforcement of judgments or awards between the country where the judgments or awards were made and the country where the judgments or awards are to be enforced (Carole Murray *et al*, 2007).

***Enforcement of Foreign Judgments under the Common Law:***

The established view of the English courts is that the foreign judgment will not be reopened and reviewed as to its merits (Peter R. Barnett, 2001). There are two major regimes relating to the enforcement of judgment under statutes such as the Administration of Justice Act 1920 Part II and the Foreign Judgments (Reciprocal Enforcement) Act 1933 (as amended under Section 35 (1) of the Civil Jurisdiction and Judgments Act 1982). According to the 1920 Act, judgments given in a part of the Commonwealth can be enforced in the United Kingdom upon registration, provided the territory in question has extended reciprocity to England and Wales. On the other hand, according to the 1933 Act, the direct enforcement of judgments is allowed in the United

Kingdom by means of a number of bilateral treaties which are based on the principles of reciprocal treatment. However, under both Acts, it is necessary to register within 12 months or longer with the discretion of the High Court from the date of the judgment (Carole Murray *et al*, 2007).

Nonetheless, the judgment may only be enforced if the adjudicating court had jurisdiction over the judgment debtor. In this regard, the English courts will only have jurisdiction after satisfying the following requirements such as the defendant must have been presented within the jurisdiction of the foreign court (*Adams v. Cape Industries Plc* [1990] Ch. 433) or the defendant has submitted to the jurisdiction of the court (*Williams & Glynn's Bank v. Astro Dinamico* [1984] 1 W.L.R. 438). Moreover, enforcement will only be allowed for a liquidated sum. The judgment will also need to be final and conclusive. A judgment is treated as final by the English court if it is satisfied that a foreign court of competent jurisdiction has finally decided the matter between the parties (*Black-Clawson International Ltd v. Papierwerke Waldhof-Aschaffenburg AG*, [1975] A.C. 591; *Lewis v. Elides* [2004] 1 All E.R. 1196). Yet a judgment of a foreign court will not normally be enforced if it was made in breach of the parties' agreement to refer a dispute to arbitration or to the courts of a different country. The judgment obtained by fraud will not also be enforced in England and Wales (*Jet Holdings Inc v. Patel* [1990] 1 Q.B. 335). However, the English court still may reopen the case afresh even though such a course of action may be regrettable (*Owens Bank v. Etoile Commerciale* [1995] 1 W.L.R. 44; *Owens Bank v. Bracco* [1992] 1 A.C. 443; [1992] C.L.J. 441). A judgment will also be refused to enforce if it is contrary to public policy, norms of morality and natural justice (Carole Murray *et al*, 2007).

#### ***Enforcement of Arbitral Awards under the New York Convention:***

The world of arbitration has been changing rapidly. By the late 1990s, it had become common for countries to base their arbitral reforms on UNCITRAL Model Law. The Member States were free to adopt or modify the Model Law to suit local conditions and considerations. The UNCITRAL Model Law approach embodied in Articles 35 and 36 explain the recognition and enforcement of arbitral awards. The Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (New York Convention) was created to cater a platform for the enforcement of the arbitral awards among contracting states. Under this Convention, a party seeking enforcement of a New York Convention award must produce with his application a duly authenticated copy of the original arbitration agreement and the award (*Yukos Oil Co v. Dardana Ltd* [2002] 1 Lloyd's Rep. 326). An order is granted *ex parte* stating that the award is enforceable (Carole Murray *et al*, 2007).

#### ***Choice of law:***

Where a court establishes the jurisdiction over the case, then it will decide further which law would be the applicable law for the dispute. Choice of law refers to a law which chosen by the parties as a governing law of their contract. The court will generally apply the law that has already identified by the parties in the contract unless it is contrary to the public policy of the jurisdiction in which it is being enforced. If there is no choice of law clause in the contract, then the court will apply the law which is most closely connected to the contract. This part is a little bit more complicated to decide compare to first question of jurisdiction (Henry D. Gabriel, 2007).

#### ***Proper Law of a Contract under Common Law:***

Lord Wright enunciated the method of ascertaining the proper law of a contract in the leading case of *Mount Albert Borough Council* [1938] AC 224, as "the proper law of the contract means that law which the court is to apply in determining the obligations under the contract.... It may be that the parties have in terms in their agreement expressed what law they intend to govern, and in that case prima facie their intention will be effectuated by the court. But... the parties may not have thought of the matter at all. Then the court has to impute an intention or to determine for the parties what is the proper law which... they ... would have intended." There are, thus, two possible situations to be considered by the court. If there is governing law chosen by the parties in the contract, then the court will give effect to the law provided when it is not against the public policy. The court, only when there is no choice of law made by the parties, will determine the proper law of the contract (Indira Carr, 2005).

#### ***Where There Is Choice of Law:***

Choice of law can still be divided into two categories such as express choice of law by inserting a choice of law clause in the contract and implied choice of law (Indira Carr, 2005). Generally, parties are free to stipulate in their contract the system of law, which is to be applied to it. The only exception to this rule is that the law chose by the parties must not be in conflict with the public policy. The courts will normally enforce a choice of law clause, as Lord Wright stated in the leading case of *Vita Food Products Inc. v. Unus Shipping Co Ltd*, [1939] AC 277, that "the intention expressed is bona fide and legal, and provided there is no reason for avoiding the choice on grounds of public policy." It should also be noted that since the parties have expressed a valid choice of law in their contract, there will be a very heavy burden on a party claiming that it should not apply. The intention to choose a particular law may be implied by the contract as well. If the parties agree in the

contract that an arbitration body or a court in a particular country shall decide any dispute arising from the contract, there may be an implication that they also intend the law of that country to be the proper law of their contract. But such an implication will not be decisive (*Compagnie d'Armement Maritime SA v. Cie Tunisienne de Navigation SA* [1971] AC 572).

***Where There Is No Choice of Law:***

Where the parties have not expressed or clearly implied their intention as to which law should be applicable to the contract, the court will determine the governing law of the contract by inferring from the contract itself and from all the circumstances connected with it. The general principle is that the proper law of the contract in this situation is the system of law with which the transaction has its closest and most genuine link (Indira Carr, 2005). The court will determine the most genuine link after considering following factors such as the place where the contract was concluded, the place of performance, the place of business or residence of the parties, and the nature and subject matter of the contract.

In the case of *Off Shore international SA v Banco Central SA*, [1976] 3 All ER 749, a letter of credit did not contain any express term as to the law which was to apply to it. A dispute arose on whether the law of New York or that of Spain was the proper law of the contract. In this case, the court observed that since the payment in American dollars was to be made through a New York bank against documents to be presented in New York, the law of New York thus had the closest and most genuine connection with the contract. The principle is comprehensible from *The Assunzione* [1954] 1 All ER 278, case where a cargo of wheat was to be carried from Belgium to Italy on an Italian ship chartered by French charterers. The charterparty was entered into in France, on a standard form English contract. In this case, the connection factors with Italian law and French law are almost equal. However, the Court of Appeal held that the closest and most real connection was with Italian law, largely because the performance of the contract was to take place in Italy.

***Governing Law of a Contract under the Rome Convention:***

The main objective of the Rome Convention on the Law Applicable to Contractual Obligations 1980 (Rome Convention) is to harmonize the choice of law rules in contracts between the parties in different contracting States. Even though it is an international convention, the parties are mainly EU countries. It is entered into force on 1<sup>st</sup> April 1991. The convention was brought into legal force in the UK by the Contracts (Applicable Law) Act 1990. The rules of the Rome Convention are not entirely different from those of the common law because the Convention has taken into account rules of private international law relating to contracts from all member States and has benefited from the wealth of the common law. However, the intention of the Convention is to replace the rules of common law. According to Article 1(1), the rules of the Rome Convention shall apply to contractual obligations in any situation involving a choice between the laws of different countries.

As a matter of contrast, the terminology in the Rome Convention is different from the common law. The term "proper law" applied in the common law has been replaced with the term "applicable law." Nevertheless, the fundamental rules for determining what the applicable law is not dissimilar to those of the common law. The overriding principle is the "freedom of choice" of the parties. A contract shall be governed by the law chosen by the parties. The choice must be express or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case. Under Article 3(1) of the Rome Convention, the parties can also select the law applicable to the whole or a part only of the contract.

The Convention is very clear that the parties' intentions are to be given paramount consideration in the matter of choice of law. Where the parties have expressly agreed on a particular legal system to govern their contract, the courts have to give effect to that choice. This is known as the rule of "party autonomy." Where there is no express choice of the governing law, the court may look into the terms of the contract or the circumstances of the case to ascertain whether there is an implied choice by the parties. Article 4(1) provides that where there is no express or implied choice of law, "the contract shall be governed by the law of the country with which it is most closely connected." In fact, this is similar to the common law position. In *Amin Rasheed Shipping Corp v. Kuwait Insurance Co*, [1984] AC 50, it was held that the contract is to be governed by the system of law which has the closest and most genuine connection with the contract.

A departure from the common law is found in rebuttable presumptions. These presumptions are intended to assist the courts in ascertaining the close connection. In common law system, the courts have full discretion to determine the proper law in the absence of a choice of law. Article 4 (2) of the Rome Convention provides that the contract is most closely connected with the country where the party who is to affect the performance which is characteristic of the contract has his habitual residence, or, in the case of a body corporate, its central administration.

The Rome Convention contains several limitations on the application of the applicable law which chosen by the parties or the law of the country most closely connected with the contract. Article 3 (3) provides where the parties have chosen a foreign governing law and all other relevant factors of the contract are connected with one country only, their choice will not prejudice the application of the rules of the law of that country which cannot

be derogated from by contract (“mandatory rules”). Moreover, Article 7 (2) declares that there is no restriction of the application of the mandatory rules of the law of the forum, whatever the applicable law of the contract. Under Article 16, the rule of law of another country will be refused where the application of that law is contrary to public policy of the forum.

***Application Of Choice Of Law And Choice Of Forum Clauses To Islamic Banking And Financial Cross Border Transactions:***

There are several obstacles concerning the application of choice of law and choice of forum clauses to Islamic banking and financial cross border transactions. First and foremost burning issue is relating to the court of adjudication. Repeatedly, the parties prefer to choose English courts as the forum to settle the disputes arising from the cross border transactions for various reasons. In most cases, the parties generally express English law as the governing law of the contract and include a phrase, which states that the applicability of English law is subject to the principles of the *Shari'ah*. These sorts of general referral to the *Shari'ah* before English courts had somehow led to disregard the applicability of the *Shari'ah* as the governing law of the underlying transaction (Nima Mersadi Tabari, 2010).

The second hindrance is that there is no comprehensive regulatory framework which governs Islamic banking and financial products. Originally, legal principles, which govern the Islamic banking and finance transactions are derived from the primary sources of *Shari'ah* such as the Qur'an and *Sunnah* (sayings, teachings and actions of the Prophet Mohammad - peace be upon him). Having said so, more often than not, legal ruling on a particular contract or product in Islamic finance is not directly to be found in the primary sources. Instead, this ruling is produced by the Islamic scholars by applying legal reasoning (*ijtihad*) to deduce rulings based on the primary and secondary sources of *Shari'ah* (Mohammad Hashim Kamali, 1999). Since most *Shari'ah* rulings in modern Islamic finance involve human reasoning, the divergences of opinions among the *Shari'ah* scholars are inevitable. It can be varied from scholar to scholar, country to country and region to region.

In most of the countries, principles of *Shari'ah* relating to Islamic banking and finance have not been substantiated by prescribed statutes. Exceptionally, Iran had already passed laws to ensure that all domestic retail and commercial banking is undertaken on an interest free basis (Rodney Wilson, 2007). On the other hand, “riba” (means “excess,” “increase” or “any unjustifiable increase of capital, whether in loans or trade”) (Zamir Iqbal, 1997; Nabil Saleh, 1986) is tolerated in Saudi Arabia and even sanctioned by banking laws in Bahrain, Qatar and Oman (W. M. Ballantyne, 1986). In some countries, Islamic and conventional banks exist parallel, and there has been a tendency to bring Islamic banks within the established regulatory framework. Currently, majorities are lacking legal regimes as to what Islamic banking products do and do not comply with *Shari'ah*. Generally speaking, Islamic banking is controversial in nature due to the fact that the actual practice of Islamic banking differs widely in the Islamic world.

In the absence of comprehensive legal frameworks, Islamic banks and financial institutions usually seek the advice from *Shari'ah* scholars to determine compliance of *Shari'ah*. Most of the Islamic countries, thus, establish a *Shari'ah* Board, *Shari'ah* Advisory Board, Religious Supervisory Board or *Shari'ah* Supervisory Board whose duty is to ensure that the operation and products of the banks are in compliance with *Shari'ah* principles. This has given rise to another issue because opinions of a *Shari'ah* Board are considered merely as guiding principles upon a court but not binding. In almost all jurisdictions, there is no law that binds the courts to follow the opinions of the *Shari'ah* Boards. Only in Malaysia, by virtue of the amendment made to Central Bank Act (2009), Court is bound to follow the decision of the Shariah Advisory Council of Bank Negara Malaysia (SAC) to matters relating to *Shari'ah*. Justice Khan has correctly remarked in this regards that “so far as the position of the Bank’s Religious Supervisory Board was concerned, certification by the Board that the operations of the Bank were according to the *Shari'ah* would not be a decision binding on any court dealing with the dispute under the law of *Shari'ah*.” The court, thus, may ignore the opinion from *Shari'ah* Board and decide the case with its own interpretation on the compliance with the *Shari'ah*. Since the *Shari'ah* is open for various interpretations which may lead to uncertainty and unpredictability, it will be difficult to use it as a choice of law in Islamic banking cross border transactions. In addition, it is not a national law of a country rather being general principles of law, i.e. the *lex mercatoria*. Again, when the parties choose a law as the governing law of the contract it should be only one law and must not be confused with other (Dicey and Morris, 2000).

This finding can be seen in the remarkable case of *Shamil Bank of Bahrain v. Beximco Pharmaceuticals Ltd.* [2004] 2 Lloyd’s Rep 1. In this case, the parties inserted a choice of law clause in their *Murabaha* (a sale contract in which the bank buy cash a commodity identified by the customer and sell it to the customer with a deferred payment at a price which is higher than the original price) (Ibrahim Warde, 2000) financing agreements as follows: “Subject to the principles of the Glorious *Shari'ah*, this agreement shall be governed by and construed in accordance with the laws of England.” Potter L J observed that the applicable law in this case should be the English law rather than *Shari'ah* for following reasons. First, in common sense, a contract cannot be governed by two different systems of law. The United Kingdom is a member to the Rome Convention and, thus, it is enforced in the United Kingdom under the Contracts (Applicable Law) Act 1990 (Jason C. T. Chuah,

2006). According to the Rome Convention, a contract shall be governed by the law chosen by the parties if the governing law that has been chosen by the parties is a reference to the law of a country (Article 1 (1) and 3 (1) of the Rome Convention). It also encourages the courts in finding the governing law of a contract, to consider the law of the jurisdiction that the performance takes place (Article 10 (2) of the Rome Convention). In the case of *Islamic Investment Company of the Gulf (Bahamas) Ltd v. Symphony Gems NV & Other* [2002] EWHC 1, the Islamic Investment Company of the Gulf and Symphony Gems entered into a *Murabaha* agreement which subjected to English law and jurisdiction of English Court. Additionally, it is stated that “the purchaser wishes to deal with the seller for the purposes of purchasing supplies under this agreement in accordance with Islamic *Shari’ah*.” In this case, the judge observed that it is a contract governed by English law as the parties had chosen English law as the governing law without any restriction or limitation and the agreement was not to be applied in a jurisdiction where *Shari’ah* law was the law of the land. Thus, the court would have applied *Shari’ah* as the governing law of the contract in accordance with Article 10 (2) of the Rome Convention if the contract is to be performed in a country where the *Shari’ah* is the law of the land (Balz, K, 2004). By any means, it is clear that under Article 5 of the Rome Convention impliedly excludes choosing a law which is not the law of a State and there is no room for the parties to choose a non-national system of law like *Shari’ah* as the governing law of the contract (Andreas Junius, 2007).

Nonetheless, it does not mean that the doctrine of incorporation was overlooked in this case. This doctrine can only sensibly operate when the parties sufficiently identified specific “black letter” provisions of a foreign law, an international convention, or any set of rules to be incorporated as terms of the relevant contract. In this way, English law would be the governing law of a contract into which the foreign rules have been incorporated. In cases where the foreign incorporated rules are uncertain in relation to their effects, then the court will seek evidence of the foreign provisions which have already been identified and interpreted by experts in foreign law and was applied in cases in their home jurisdiction. In this case, what makes the matter worse is that principles of *Shari’ah* are neither identified nor interpreted clearly in the terms of the contract. Accordingly, the court observed that principles of *Shari’ah* are unqualified as a reference to the body of law and inevitably apply the English law as the governing law of the contract and render the clause self-contradictory.

Moreover, in the case of *Sanghi Polyesters Ltd (India) v. The International Investor (KCFC)* [2000] 1 Lloyd’s Rep 480, the *Istisna’a* (a sale contract in which the seller agrees to manufacture or construct and deliver the product on a future date at the given price) contract further provided that “this dispute shall be governed by the laws of England except to the extent it may conflict with the Islamic *Shari’ah* which shall prevail.” In the arbitral award, accordingly, principal and the profit claims were awarded except additional damages which would in conflict with Islamic *Shari’ah*. Nonetheless, on appeal, the court held that “whatever *Shari’ah* law might be, it was not the law of England and Wales.” Again, in the case of *Petroleum Development (Trucial Coasts) Ltd. v. Sheikh of Abu Dhabi* [1951] 18 ILR 144, the arbitrator applied principles of English law although the applicable law should be the Abu Dhabi laws which is originated from *Shari’ah* on the ground that there was no general law of contract in the *Shari’ah*. In the same vein, in *Ruler of Qatar v. International Marine Oil Co. Ltd.*, [1953] 20 ILR 534, though the arbitrator acknowledged that Qatar law which is also based on *Shari’ah* was the proper law, still refused to apply it by articulating that there is no sufficient principles to interpret this particular contract in *Shari’ah*.”

By analyzing cases mentioned above, it is clear that English Courts have usually been reluctant to tackle issues of *Shari’ah* compliance of underlying transactions and simply enforced the English law without putting any endeavor to determine the *Shari’ah* principles as intended by the parties at the time of the conclusion of the contract. In fact, *Shari’ah* also has a set of mandatory rules which are intended to protect the interest of the community (Aisha Nadar, 2009). The prohibition of “*riba*” is one of the public policies applicable to Islamic banking and financial transactions (T.S. Twibell, 1997). Thus, transactions with the present of “*riba*” are considered violating the mandatory rules of *Shari’ah* and Islamic public policy. Nonetheless, mandatory rule and public policy under *Shari’ah* were ignored by English courts in deciding the aforesaid cases even though they are, in fact within the vicinity of the applicability of *Shari’ah*.

However, this situation has changed to some extent in recent cases. In the case of *Investment Dar Company KSCC v. Blom Developments Bank Sal* [2009] EWHC 3545 (Ch), the *Wakala* (agency) agreement was expressed to be governed by English law. The Investment Dar Company was excluded from taking benefit on non-compliance with the *Shari’ah* as the objective of the company was to carry out all financial transactions in a *Shari’ah* compliant manner. It was held that the *Wakala* agreement did not comply with *Shari’ah* and was therefore void. Besides, in the case of *Musawi v. R E International (UK) Ltd & Others* [2007] EWHC 2981, the court acknowledged that it is entitled to apply *Shari’ah* to the resolution of the dispute under Section 46 (1) (b) of the Arbitration Act 1996. Again, in *Halpern v. Halpern* [2007] EWCA Civ 291, the court observed that the parties are to apply some form of rules or non-national law as a governing law of the contract if there is an arbitration clause.

By analyzing these recent cases, it is obvious that the practice of incorporating the principles of *Shari’ah* will be honoured and considered more in arbitration. The parties are free to choose even non-national law alike

*Shari'ah* in the process of arbitration. In the recent development, the Working Group of the United Nations Commission on International Trade Law (UNCITRAL) has agreed to change the wording of law clause to "rules of law" instead of "law" which confined only to the national law and exclude the *lex mercatoria* (Richard Bamforth, 2008). By looking at these latest developments, the application of *Shari'ah* to Islamic banking and financial disputes will be appreciated before an arbitration centre. Accordingly, it is appropriate for the parties in Islamic banking and financial cross border transactions to refer to arbitration which can also include the application of non-national laws as contractual terms to interpret the contract (Duncan Speller and Jonathan Fly, 2007).

#### **Comparison Between Arbitration And Litigation**

The previous analysis manifested that *Shari'ah* principles were mostly disregarded in deciding disputes in Islamic cross border transactions although they are strictly required to comply with the *Shari'ah*. Consequently, there were suggestions to look for other modes of dispute resolutions and arbitration has become an alternative to the normal litigation process. In Islam, disputed parties are even encouraged to settle the dispute in the process of mediation and arbitration rather than the traditional judicial litigation (Salah Al-Hejailan, 1996). The Qur'an signifies the importance of reconciliation among believers in dispute in the following verses.

"And if two parties or groups among the believers fall to fighting, then make peace between them both... Then if it complies, then make reconciliation between them justly, and be equitable. Verily, Allah loves those who are the equitable." (The Qur'an, Al-Hujurat, 49:9)

"The believers are nothing else than brothers (in Islamic religion). So make reconciliation between your brothers, and fear Allah, that you may receive mercy." (The Qur'an, Al-Hujurat, 49:10)

In choosing arbitration, the parties opt for a private dispute resolution procedure instead of going to a court of law. In normal litigation, judges are appointed by the government and they determine the dispute on their own choice. The Judges may or may not have enough expertise in the disputed areas of law. However, in arbitration, the unique feature is that parties are free to choose the arbitrators, governing law, procedures, language, time and venue for the arbitration. Moreover, parties can select judges who are specialized in a particular area of law, for example, Islamic banking and finance. Arbitration is confidential to the parties and its hearings are private. Thus, cross border transactions which are in need of flexibility and rapid settlement of dispute opt for the arbitration than the litigation process.

In modern commercial transaction, the importance of arbitration is undeniable. However, some challenges still exist in choosing arbitral dispute resolution. Initially, the parties must clearly indicate arbitration as a mean of dispute resolution in the agreement by inserting an arbitration clause without which the settlement by way of arbitration might not be possible. Subsequently, the enforceability of the arbitral award becomes crucial matter. Although the New York Convention can be one of the multilateral treaties which essentially addresses the issue of recognition and enforcement of foreign judgments and arbitral awards, it has only 146 State parties (United Nations Commission on International Trade Law UNCITRAL, Status: 1958 - Convention on the Recognition and Enforcement of Foreign Arbitral Awards available at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/NYConvention\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html)). The rest of the countries in the world are not parties to it. Yet again, enforcement of foreign judgments and awards encounters delays resulting from procedural difficulties in some of the State parties to the New York Convention. For example, Egyptian law allows enforcement of foreign judgments and arbitral awards only when they are not against public policy or morals, or in conflict with any of Egyptian judgments or awards. In this sense, Syria has adopted a more flexible approach. A foreign judgment or an arbitral award is enforceable in Syria if it is final, conclusive and enforceable in the country where it was given (Fatima Akaddaf, 2001).

#### **Conclusion:**

Truthfully, Islamic banking and financial transaction must comply strictly with the *Shari'ah* principles and anything contrary to it obviously cannot be labeled as Islamic commercial activity. However, lacking of proper law places the parties in a situation where they have no choice but to apply the foreign law as a governing law and the *Shari'ah* as a general referral to the contract even though they know that there is high probabilities that the court may ignore the principles of *Shari'ah* that have been stipulated in the contract. It is, in fact, meaningless for the parties simply to employ the term of *Shari'ah* and enter into a transaction, which will later be decided even against the *Shari'ah* principles for various reasons. Thus, there is no certainty of applicability by referring to the *Shari'ah* as the governing law of a contract. Again, it is also objectionable to apply *Shari'ah* ever since it is not a law of a country.

In order to remove these hardships, three main things can be suggested. Firstly, the drafting of the clauses in the contract shall be clear, precise and in compliance with the *Shari'ah*. When the clauses are clear, the court will just apply the provisions in the contract without having to interpret the intention of the parties. This will avoid the judges to ignore the principles of *Shari'ah* that have been referred to by the parties in the contract. Secondly, there should be an international standardized set of rules, which contains definition, interpretation and



application of Islamic banking and financial products to be referred as governing law in the contract. The legal and regulatory facilities should also be certain and constant. It is important to attain legal certainty to avoid undesirable results for the parties in dispute resolution. Any legal uncertainties on Islamic banking and financial transaction will make it less attractive and may affect the furtherance of the industry.

For the purpose of creating an international *Shari'ah* standard in Islamic banking and financial transaction, scholars are required to have continuous interaction among them. By that, certain common and standardize standards can be formulated to be used in Islamic banking and financial industry. It is somewhat unattainable to eradicate total divergences of opinion in relation to *Shari'ah* principles. However, it does not mean there is no way to overcome this challenge. Numerous paradigms could be found pertaining to the standardisation of law at the international level, in the field of both public international law and private international law. In ancient times, it was almost impossible even to think of unifying laws from different countries. In shaping international practices, efforts are being made by various Islamic institutions such as the Auditing and Accounting Organization for Islamic Financial Services (AAOIFI) and the Islamic Fiqh academy of the Muslim World League to standardize and harmonize rules and principles concerning Islamic banking and finance. The authors are of the opinion that the *Shari'ah* standards of the AAOIFI can be used as general terms to be used as general referral in the contract. In that manner, rather than just indicating *Shari'ah* principles as the general reference, the parties to the contract may add that the *Shari'ah* principles intended for are as per AAOIFI *Shari'ah* standards. By doing so, in case of dispute, the court will have a direct reference to determine what is meant by the *Shari'ah* principles. This will reduce uncertainty to what is *Shari'ah* principles and this will definitely facilitate the judges in their recourse to the *Shari'ah* should the need arises.

Thirdly, there should be ample of forums to adjudicate disputes resulting from Islamic banking and financial cross border transactions in line with the spirit of *Shari'ah*. It might think that if the parties identify the international *Shari'ah* standard as governing law of the contract in the agreement, the court of adjudication generally has to apply the law has chosen by the parties. Thus, it cannot be an issue here. However, it should not be ignored that there is still possibility of applying the rules of the law of the forum in situation where they are mandatory irrespective of the law otherwise applicable to the contract (A. J. E. Jaffey, 1996). It is expected that with the rapid growth of the industry and the increase cross border transactions, the disputes will also increase. In this regards, arbitration has been molded as alternative mechanism for the resolution of dispute arises out of cross border transactions. To accommodate that, several international arbitration institutions should be established at both, international and regional levels apart from existing arbitration institutions. Some well known arbitration institutions are the International Islamic Centre for Reconciliation and Commercial Arbitration for Islamic Finance Industry, the Dubai Courts Amicable Disputes Settlement Centre, the Dubai International Arbitration Centre (DIAC), Abu Dhabi Commercial Conciliation and Arbitration Centre (ADCCAC), GCC Commercial Arbitration Centre, the Cairo Regional Centre for International Commercial Arbitration (CRCICA), the International Islamic Centre for Reconciliation & Arbitration (IICRA), the Riyadh Convention for Judicial Co-operation and the Amman Arab Convention on Commercial Arbitration and the Kuala Lumpur Regional Centre for Arbitration. There have been calls for the establishment of a European Islamic Center for Reconciliation and Arbitration for the Islamic finance Industry (Mohammad Bakkar, 2008). Accordingly, it is advisable to the parties involved in Islamic banking and financial cross border transaction to insert a choice of forum clause that refer to an Islamic banking arbitration institution as another mechanism to dispute resolution. The parties can appoint arbitrators who are well verse in *Shari'ah*. This can assist in the proper implementation of *Shari'ah* principles as intended by the parties to the contracts (Anwar Ahmed Qadri, 1968). In a nutshell, it is indispensable to create an international *Shari'ah* standard and additional Islamic banking arbitration institutions in order for the parties involved to be able to choose that international *Shari'ah* standard as the governing law of the contract and one of the Islamic banking arbitration institutions as the forum for settling disputes in the realm of *Shari'ah*.

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