NEO-JUDICIAL PROCEDURE FOR ADJUDICATION AND ARBITRATION ON ISLAMIC FINANCIAL CASES: REFERENCE TO SHARIAH COUNCIL ON SHARIAH MATTERS

by

ABDUL AZEEZ MARUF OLAYEMI¹

and

SITI MASHITO Mahamood²

and

AHMAD HIDAYAT BUANG³

Abstract

The Islamic financial institutions hitherto, had suffered adverse civil court decisions. The situation is blamed on the obnoxious legal reasoning of the courts of jurisdiction. Thus, the Malaysian policy-makers took the cognisance of the matter and their efforts in the regard culminates in the enactment of ss 56 and 57 of the Central Bank of Malaysia Act 2009. The section mandates courts to refer to the Shariah Advisory Council to answer questions in cases that involve the industry. The contention as to whether the section does not encroach on the constitutional power of the judiciary was also cleared in Tan Sri Abdul Khalid Ibrahim v Bank Islam (M) Bhd [2013] 3 MLJ 269. The case indicates the section as a new procedural requirement for adjudication and arbitration in the cases that involve the Islamic financial institutions. The current paper advocates for the universality of the nascent procedure.

Keywords: New Judicial procedure, Islamic Banking and Financial Cases

¹ Post-Doctoral Research Fellow, PhD, MCL, LLB, MCIArb, IBA, Department of Shariah and Law, API/IPPP, University of Malaya, Malaysia, E-mail: ma1129uk@yahoo.co.uk, ma1129uk@um.edu.my.

² Associate Professor, PhD, Department of Shariah and Law Department, Academy of Islamic Studies, University of Malaya, Kuala Lumpur, Malaysia.

³ Professor, Dato, Department of Shariah and Law Department, Academy of Islamic Studies, University of Malaya, Kuala Lumpur, Malaysia.

⁴ Tan Sri Abdul Khalid Ibrahim v Bank Islam (M) Bhd [2013] 3 MLJ 269
INTRODUCTION

‘Reason is the life of the law, nay the common law is nothing else but reason’\(^5\)

The enactment of the ss 56 and 57 of the Central Bank of Malaysia Act 2009 (‘the CBMA’), which requires courts and arbitrators, to refer to the Shariah Advisory Council for answers on Shariah questions in the cases of Islamic financial institutions is a commendable reasoning. The Islamic financial institutions had hitherto viewed the decisions of the civil law court as uninformed due to fact that the court lacks expertise in Shariah law. Thus, upon the challenging of the provision of the sections as unconstitutional and ultra vires in *Tan Sri Abdul Khalid Ibrahim v Bank Islam Berhad* [2012] 1 LNS 634,\(^6\) on the argument that it usurped the judicial function of the court, in response, the Appeal Court interpreted the judicial role of the Shariah Council as provided in the sections as merely procedural. The interpretation does not only brought the matter to rest, it created a new procedural requirement for judicial and arbitral proceedings in the cases of Islamic banking and finance in Malaysia. The current writing advocates for the universality of the new procedural requirement. The adoption of the procedure by jurisdictions that practice Islamic banking and finance across the world will lend more credibility to judicial and arbitral decision on the cases involve the institutions. This is due to the fact that the majority of the countries that practice Islamic finance, are either those that have only Islamic family law as a component of their legal system or those that totality lack Shariah law component in in their legal system. The banking and financial industry is generally under the jurisdiction of the civil law court that lacks experts of Shariah law.

SHARIAH COUNCIL AND THE NATURE OF ITS JUDICIAL FUNCTION

To start with, historically, the necessity for the creation of Shariah Council, ab initio, stems from the juristic axiom that ‘it is impermissible for an entity, regardless of whether it is an institution or an individual, to embark on a trade without acquiring the required knowledge of the Shariah rules that govern such trade’.\(^7\) Thus, since the combination of trading activities and the legal profession in a personality is naturally cumbersome, the merchants, in the medieval period, diverged to the practice of employing the services of Shariah

---

6 *Supra* note 1.
7 Omar Bin al-Khattab (RA) said: (nobody should trade our market, except a person that learns the rules (of religion) on trade). Narrated by al-Tirmidhi.
scholars and jurists for answers on the legal question on their domestic and foreign trades and transactions. This is the practice that evolved to the creation of the Shariah Advisory Council or Board as it is being practiced in the modern Islamic finance. The primary function of the Shariah Council is to advise the institutions on the Shariah rules that guide their activities, and audit such activities to ensure compliance with Shariah principles.

However, although, the primary function of the Shariah Advisory Council is to play an advisory role in the operation and transaction of the Islamic financial institutions, to ensure compliance with the Shariah principles, nevertheless, ss 56 and 57 of the Central Bank of Malaysia Act 2009 (‘the CBMA’) has added participation in adjudication and arbitration to the function of the Council. The adjudication and arbitration of Shariah matters between Islamic financial institution and its customer has been a hectic task for the courts of jurisdiction which is the civil law court. This is due to the fact that financial institutions in general, regardless of whether they are conventional or Islamic financial institutions, are under the jurisdiction of the civil court. However, the judges of the civil law courts lack the competency of decision on matters of Shariah law, which is the basis of the practices and activities of Islamic banking and finance. This is not to say that there is no Shariah Court in the countries that practice Islamic finance. But, that the jurisdiction of the court does not cover Islamic financial institutions. Its jurisdiction is restricted to the matters of Islamic personal law. It lacks the power to decide matters of the Islamic banking and finance.

Moreover, the customers of the Islamic financial institutions are comprised of both Muslims and the non-Muslims, and its decision is not binding on non-Muslims. Thus, only the civil court that exercises paramount decision can solely decide both the cases of the conventional and Islamic financial institutions. However, this situation led the civil courts to give lopsided decisions. This is why the CBMA 2009, in its ss 56 and 57 tried to resolve the problem by mandating courts and arbitrators to refer Shariah questions to the Shariah Council for proper answers. Nevertheless, this is viewed by some experts and the aggrieved parties as unconstitutional and ultra vires, on the claim that such provision usurped the constitutional function of the court. However, this contention was put to rest in the subsequent landmark cases.

8 al-Tartib al-Idariyah, 2/19.
As explained in the above, many observers and practitioners view the provision of ss 56 to 57 of the Central Bank of Malaysia Act 2009, as unconstitutional, ultra vires, null and void, due to the fact that, the ss mandate the courts to refer to Shariah Advisory Council (‘SAC’) for answers to Shariah questions in the cases of Islamic finance, and compel the court to the adoption of the decision of the council as its judgment. This, according to them amounts to the usurpation of the judicial function of the court. The reason for this position is that, constitutionally, only the courts are vested with judicial power. Thus, the imposition of the Shariah Council on the court, in this respect, implies that the Council is playing a judicial role, as contrary to its required advisory role. However, the appellate court in Tan Sri Abdul Khalid Ibrahim v Bank Islam (M) Bhd [2013] 3 MLJ 269 and subsequent cases, made it clear that the provision does not give judicial power to the Shariah Council. Rather, what the section provided for, is a new judicial procedure. The new procedural requirement is that, courts must refer to the Shariah Council on any Shariah question in the cases of the Islamic financial institutions.

In although, reference to the Shariah Council on Shariah question is mandatory and the decision of the council is binding on the court, yet, the court remains the authoritative arbiter as required by the constitution. For instance, in Tan Sri Abdul Khalid Ibrahim v Bank Islam Bhd the Shariah question that was raised was about the validity of BBA contract. In the case, the major issue is the recovery of ‘BBA Debt’. However, a question about the validity of the contract was raised, and the court referred the question to the Shariah Advisory Council. Yet, the defendant contested that reference to the Shariah council is ultra vires and it is, null and void. Hence, the question of whether reference to the Shariah Advisory Council is unconstitutional was brought before the appellate court.

In response, the appellate court stated that ‘reference to SAC by the court for Shariah issues is merely procedural. It explained that SAC in this respect, is

---

9 See, Mygovernment, the Malaysian Government Official Portal. (Judicial power in Malaysia is vested in the superior courts (comprising the Federal Court, the Special Court, the Court of Appeal, the High Court of Malaya and the High Court of Sabah and Sarawak); and Subordinate Courts (comprising the sessions court, the magistrates’ court, the Syariah Court, the Juvenile Court, the Penghulu Court and Native Court) as provided for by the Federal Law), http://mygov.malaysia.gov.my accessed 10 November 2014.

10 Ibid.
in the position of ‘Statute-Appointed Expert’ whose task is the providing of answers to questions of Shariah law in the cases that involves the Islamic financial institutions’. Therefore, ss 56 and 57 of the CBMA are valid federal laws of Malaysia. In short, the court concluded that the reference to the Shariah Advisory Council or the adoption of the resolutions of the SAC by the court is a new procedural requirement. Therefore, SAC does not determining the outcome of a case as that is a function of the judiciary.

In contrast, it can be seen that the principle of this Malaysian case is in tandem with the procedure of the American courts in *National Group for Communications and Computers Ltd v Lucent Technologies International Inc*, where both parties agreed that the contract will be governed by the law of Saudi Arabia which is Shariah law. The facts of the case are that National Group entered into a multi-million dollar contract with Lucent Technologies on the project of telephone services for the kingdom of Saudi Arabia. Consequently, National Group liquidated the project as a result of the action of Lucent Technologies which terminated its subcontract. Thus, National Group instituted an action for breach of contract against Lucent Technologies and sought for both actual and expected damages, in a US district court.12

Thus, as stated in the contract, the US district court accepted the Saudi Arabian Law as the governing law of the contract, and analysed tenets of Shariah, by reciting article 48 and other rules of the ‘Basic Regulation of the Kingdom of Saudi Arabia’ which provides that:

the courts shall apply in cases brought before them the rules of the Islamic Shari’ah in agreement with the indications in the Book [The Qur’an] and the Sunna and the regulations issued by the ruler that do not contradict the Book or the Sunna.13

In addition to this, the court relied on the opinion of experts in the *hadith* that says ‘Do not buy fish in the sea, for it is gharar’.14 Likewise the *hadith* that the Prophet (SAW) forbade the sale of what is in the wombs, sales of the contents of the udders, the sale of a slave when he is runaway’,15 and other *hadith* on the

---

13 Nat’l Grp, 331 F Supp 2d at 294 (quoting the Basic Regulation of The Kingdom of Saudi Arabia article 48 (1992)).
14 Musnad Ahmad, Hadith No 3547.
15 Muslim, Hadith, No 2792, al-Bukhari, No 3580.
general prohibition of uncertainty in transactions.\textsuperscript{16} The court then reached the conclusion that Shariah law does not recognise expectation damages for the fact that it amounts to uncertainty.\textsuperscript{17}

Moreover, in the Malaysian case of \textit{CIMB Islamic Bank Bhd v LCL Cor Bhd \& Anor} [2012] 3 MLJ 869 which was an application for the recovery of the debt, the question was whether \textit{Ibra’} (rebate) is not discretionary under Islamic law? However, the court ruled that \textit{Ibra’} clause is binding if it is mutually inserted in a contract. The source of the decision of the court on this matter is the resolution of the Shariah Advisory Council of the Central Bank of Malaysia, Bank Negara Malaysia (BNM, SAC), whereby the council in its 95th Meeting, which was held on 28 January 2010 passed a resolution that ‘Ibra’ is binding if its clause forms part of a contract.’

Furthermore, in \textit{Mohd Alias Bin Ibrahim v RHB Bank Bhd \& Anor} [2011] 3 MLJ 26; [2011] 4 CLJ 654, the applicant applied to the court for the cancelation of BBA contract on the argument that it was not a valid contract. However, the court referred to the Shariah Advisory Council for clarification on the matter, and the court accepted the decision of the council that the contract is a valid contract. Nevertheless, the appellant appealed on the ground of the question of constitutionality of the decision of the Shariah Advisory Council. However, the appellate court ruled that ss 56 and 57 that provided for such procedure it is not unconstitutional. The court explained that what the sections provided for, was the given authority to SAC as an expert in Shariah law, to answer question on the application of principles of Shariah law in the practices of the institutions. Thus, the task of SAC in this respect is the ascertainment of the Shariah matters in the cases that are brought before the court.

In the same vein, the United States courts purport to be positive toward the standardisation of the new procedure in many cases that involved Islamic religion. That is, such as divorce cases and etc. For instance, in \textit{Jabri v Qaddura}, an arbitration agreement that involved Islamic term was enforced by the American appellate court.\textsuperscript{18} The lower court previously refused the application of Jabri, the wife, for the enforcement of an arbitration agreement that was earlier made before a United Kingdom Shariah Council. However, the appellate court upheld the enforcement of the arbitration award, which includes the ‘conservatorship’ of children, child-support, one-half of the value

\textsuperscript{16} Musnad Ahmad, Hdtih No 3547.
\textsuperscript{17} Sahih al-Muslim, Vol 3, Hadith, 1153 and 1533.
\textsuperscript{18} \textit{Jabri v Qaddura}, 108 SW3d 404, 413 (Tex App Fort Worth 2003, no pet).
of the couple’s home and payment of the remaining part of the deferred bride-price of the wife.\textsuperscript{19} However, although, the courts were successful in these cases, in other jurisdictions unfortunately, the court apparently erred due to lack of Shariah expertise and the absence of a procedure that requires courts to refer such cases to the Shariah Council. Hence, the necessity of the universalisation of the new mandatory procedural requirement.

THE NECESSITY FOR THE UNIVERSALITY OF THE NEW PROCEDURE

The need for the universality of the new judicial procedure as introduced to the Malaysian courts stems from the fact that the legal system of most countries that practice Islamic banking and finance do not have Shariah law as a segment of their legal system. More so, the few countries that have Shariah law as a component of their legal system, restrict the application of only Shariah law to the Islamic family law. In another word, the majority of the countries that practice Islamic banking and finance are secular countries\textsuperscript{20}. Thus, the entire banking and financial institutions in such countries are subjects of the jurisdiction of the secular civil court. This is inclusive of the Islamic banking and financial institutions in such countries.

Therefore, the problem of civil law jurisdiction covers Islamic financial institution is not peculiar to Malaysia. It is a global problem. For instance, almost all the countries that practice Islamic finance in the Asian, American, African and European continents are all secular countries. Most of the countries are either English Common Law or French Civil Law countries, and the Islamic law component that is included in the legal system of some of the countries, is restricted to only the application of family law. The following table and chart give a snapshot of the countries that practice Islamic finance with the segment of Shariah in their legal system.

\textsuperscript{19} Ibid.
\textsuperscript{20} Otto, Jan Michiel (30 August 2008). \textit{Shariah and National Law in Muslim Countries}\ Amsterdam University Press at pp 8–9.
Neo-Judicial Procedure for Adjudication and Arbitration on Islamic Financial Cases: Reference to Shariah Council on Shariah Matters

Snapshot of global coverage of Islamic banking and finance

<table>
<thead>
<tr>
<th>Legal System</th>
<th>Countries that practice Islamic banking and finance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Absence of Shariah Law</td>
<td>Albania, Australia, Azerbaijan, Bosnia, Cameroon, Cayman Islands, China, Ivory-Coast, Cyprus, Denmark, Germany, Japan, Kenya, Kosovo, Russia, Senegal, South Africa, Sri Lanka, Switzerland, Tunisia, Turkey, Uganda, UK, United States.</td>
</tr>
<tr>
<td>Shariah personal law only</td>
<td>Afghanistan, Algeria, Bahrain, Bangladesh, Burkina Faso, Djibouti, Egypt, Gambia, Iraq, Jordan, Kuwait, Lebanon, Malaysia, Maldives, Mauritania, Nigeria, Oman, Pakistan, Phillipine, Qatar, Singapore, Somali, Sudan, Syrian, UAE, Yemen.</td>
</tr>
<tr>
<td>Full Shariah</td>
<td>Brunei, Iran, Saudi Arabia.</td>
</tr>
</tbody>
</table>

![Image 1](mlja2017_1_00010_1.jpg)
![Image 2](mlja2017_1_00010_2.jpg)
Almost all the cases that involve Islamic banking and finance that came before the civil law courts emanates from the lack of knowledge of the customers about the principles of Islamic banking and finance, and its understanding in the light of the practices of the conventional banking system. This is so, due to the fact that, most of the cases that was brought before the courts are issues in the interpretation of contracts and concepts of Islamic commercial law, such as Bai’ Bi-Thamanin Ajil (BBA), Bai’al-I, Bai’al-Murabahah, al-Ijarah, as well as other hybrid contracts which are understood by the customers of the Islamic banks and Islamic Financial Institutions as a loan based contracts with interest element. The customers often take the advantage of the loopholes in the gap between the difference in the conventional and the Islamic contract to seek a declaratory judgment\(^{21}\) that the contracts are actually interest based and repugnant to the practice of Islamic banking. However, although, the courts often deviate from the normal procedure of passing judgment on the question of law by the court, to favourably or unfavourably pass judgments that are administrative in nature on the Shariah questions. The fact remains that reference by the court to the Shariah Council will lend more credibility to its judgment. Some of the questions that are brought before the civil law courts are discussed below.

**Question of the validity of Bi-Thmanin Ajil contract**

A BBA contract, which is a hybrid contract often surfaces in many cases. In fact, the question of the validity of BBA contract constitutes most of the issues before the courts. That is, the question of whether BBA contract as practiced by Islamic bank is different from a conventional loan contract. For instance, the question surfaced in the case of Bank Islam Malaysia Bhd v Adnan bin Omar\(^ {22}\).

The facts of the case are that the plaintiff extended a financing facility of RM583,000 to the defendant, on the security of the charge of a parcel of land. The underlying contract of the transaction was BBA as agreed upon between the parties. In addition, the modus operandi of the agreement includes the execution of three simultaneous transactions between the contracting parties.

\(^{21}\) A binding judgment from a court defining the legal relationship between parties and their rights in the matter before the court. A declaratory judgment does not provide for any enforcement, however. In other words, it states the court’s authoritative opinion regarding the exact nature of the legal matter without requiring the parties to do anything. See, Legal Information Institute, \url{http://www.law.cornell.edu/wex/declaratory_judgment} (20 November 2014).

That is, the sale of a property by the defendant to the plaintiff for the price of RM265,000, and the spot payment of the money to the defendant and, the simultaneous sale of the property back by the plaintiff to the defendant at the price of RM583,000 on the basis of deferred instalment payments, which was divided into 180 units. More so, a term was inserted in the contract that the plaintiff would be entitled to sell the charged parcel of land in the situation whereby the defendant defaulted.

However, unfortunately, the defendant defaulted and the plaintiff filed an originating summons under O 83 of the Rules of High Court 1980 ('the RHC 1980') and prayed for an order for the sale of the charged land to recover the debts. However, the defendant challenged the right of the plaintiff to such relief under the same O 83 of the Rules of High Court 1980. It was claimed that the *Bai’ Bi-thamanin ‘Ajl* agreement did not comply with the provisions of r 3(3)(a)-(c) of O 83 of the RHC 1980 as a loan contract. Thus, the question before the appellate court was that, since the defendant only received RM265,000 of the total loan of the sum of RM583,000, whether the additional part which is RM318,000 is not an interest which is prohibited by Islamic Law. However, the appellate court upheld the decision of the lower court that the contract is a valid sale contract, and that the respondent has the right to sell the security.

Similarly, the question of the validity of the same contract of *BBA* was raised in *Dato’ Haji Nik Mahmud bin Daud v Bank Islam Malaysia Bhd*. The fact of the case was that the plaintiff, on 6 May 1994, executed two agreements, that is, ‘property purchase agreement’ (PPA) and ‘property sale agreement’ (PSA) with the defendant under the defendant’s *BBA* property financing facility for the purchase of properties (‘the said land’) at the price of RM520,000. The property was resold through the latter’s agreement to the plaintiff at the price of RM629,200. The agreements were signed contemporaneously, and the plaintiff’s attorney executed two charges of the said land in favour of the

---

23 Originating summons: is one of two modes of commencing a civil action; the other mode being the writ of summons. An action is commenced by way of originating summons when: (a) required by statute; or (b) a dispute is concerned with matters of law where there is unlikely to be any substantial dispute of fact. See, eLitigation, https://www.elitigation.sg/getready/os-a.html (5 August 2014). Generally, it is faster and easier disposed of than writ, as no witnesses are called. For those actions based mainly on construction of written law and documents (such as contracts and wills), see, Reading Law http://readinglaw.wordpress.com/2009/12/15/commencing-an-action-in-a-malaysian-court/ (7 August 2014).

24 O 83 r 3(3)(a)-(c) of the RHC 1980.

defendant as securities for a loan of RM629,200, which was purportedly granted under the Islamic banking concept of BBA.

However, the plaintiff subsequently applied for an order that the agreement be declared null and void and of no effect on the ground that the execution of the property purchase agreement, the property sale agreement and the charge documents amount to an exercise to defeat the very purpose and intention of the ss 7 and 12 of the Kelantan Malay Reservations Act 1930, (the Enactment) and s 340(2)(b) of the National Land (the Code). The motion, inter alia, relied on the indefeasibility of the charges under s 340 of the Code and the interpretation of the Enactment, vis a vis BBA transactions. The motion was dismissed with costs and the plaintiff appealed.

However, the appellate court disallowed the appeal, and ruled that, notwithstanding, the provision of s 7(i) of the Kelantan Malay Reservations Act 1930 which prohibits the transfer or vesting of any right or interest of a Malay in reservation land to or in any person not being a Malay, the case will stand, this is due to the fact that when the property purchase agreement was signed, the right that was acquired by the defendant was a right to a registrable interest which right was yet to crystallise into a registrable interest. Thus, it was only upon registration that the title to the said land would vest in the defendant and it was only when the defendant became the registered proprietor that its title would be in defeasible. Since there was no evidence for a change in the registered proprietorship of the said land pursuant to the execution of the property purchase agreement, the plaintiff remains the registered proprietor of the said land. Therefore, there was no effected transfer and proprietorship still remained with the plaintiff. The court included that the contemporaneous execution of the property purchase agreement and the property sale agreement constituted part of the process that was required by the Islamic banking before the plaintiff could avail himself of the financial facilities provided by the defendant under the BBA contract. In summation, the court concluded that both parties have received what they bargain for.

The Question of the validity of al-Istisna’ contract

In another development, the question of the validity of al-Istisna’ contract came up in Tahan Steel Corp Sdn v Bank Islam Malaysia Bhd. The facts of the case are that the plaintiff secured financing facility of RM97m from the defendant bank on the basis of an al-Istisna’ contract. The financing was for the
development and construction of Steckel Hot Strip Mill Plant to produce hot rolled coils. The said project was to be carried out on a piece of land of approximately 119 acres which is a leasehold property\(^\text{27}\) and was free from legal encumbrances. The property was purchased at the price of RM128m. Under the agreement, the defendant bank purchased the property at the price of RM97m. However, one of the three tranches of the money which was to be disbursed to the plaintiff for the financing of the project was refused due to its failure to fulfill some of the conditions which were contained in the al-Istiana’ purchase agreement. That is, to secure facilities of approximately USD80m from EXIM bank. The plaintiff thereafter filed a writ\(^\text{28}\) by the way of an interim injunction\(^\text{29}\) together with the statement of claim against the defendant for breach of contract.

The court dismissed the application. It was held that the conditions precedents\(^\text{30}\) imposed on the plaintiff, that is to obtain EXIM loan were neither whimsical nor belligerent; they were established on a sound commercial basis. Rather, it was the plaintiff that exhibited a lackadaisical attitude towards the express term and essential condition of securing the EXIM bank loan, and that the plaintiff was not entitled to depart from the requirement of the EXIM bank loan without the written and signed consent of the defendant. Therefore, the defendant was within its rights to refuse the disbursal of the third tranche of the facility to the plaintiff since the plaintiff has failed to secure the EXIM loan. The court stated that, the defendant was certainly entitled to insist on strict compliance with the al-istisna’ facility agreements’ and that when the defendant was signing the agreement, it was fully aware of the nature and effect of the contract. Therefore, al-istisna’ is a valid contract.

\(^{27}\) A leasehold estate is an ownership of a temporary right to hold land or property in which a lessee or a tenant holds rights of real property by some form of title from a lessor or landlord. See http://www.realproperty.my/freehold-vs-leasehold-properties (20 November 2014).

\(^{28}\) The order that is issued by a court requiring that something be done or given authority to do specified act. See, legal Dictionary, http://legal-dictionary.thefreedictionary.com/writ (20 November 2014).

\(^{29}\) ‘interim injunctions are a separate action within a larger claim, but they can be essential in circumstances where a party wishes to preserve the status quo — often ensuring that money remains in a bank account — until the dispute has been resolved ... ‘ See, Out-Law, http://www.out-law.com (20 November 2014).

\(^{30}\) ‘Condition precedent refers to an event or state of affairs that is required before something else will occur. In contract law, a condition precedent is an event which must occur, unless its non-occurrence is excused, before performance under a contract becomes due, ie, before any contractual duty eructs’. See, Legal Dictionary, http://legal-dictionary.thefreedictionary.com/condition+precedent (2014).
Furthermore, the question of the validity of al-istisna’ contract was also raised in the United Kingdom case of Sanghi Polyesters Ltd (India) v The International Investor KCSC (Kuwait). In the contract, the parties agreed to settle any dispute that occurred from the transaction through arbitration at the ICC. The disputing parties appointed a qualified attorney who is also a scholar of Shariah law as the arbitrator. This is due to the fact that, the contract contained a choice of ‘law clause’ which stipulated that the agreement will be governed by the Laws of England except to the extent it may conflict with Islamic Shariah, which shall prevail.’ Thus, the arbitrator applied the procedure to the letter. However, the losing party challenged the judgment in the English courts under the claim that the Shariah procedure which was used by the arbitrator invalidated the contract and prevented the investment from returning its capital. However, unfortunately, the court granted its claim.

Question of the validity al-Ijarah contract

Another frequent case is the case of al-Ijarah. For instance, in Tinta Press Sdn Bhd v Bank Islam Malaysia Bhd, the major cause of action, inter alia, was whether the Islamic banking contract of al-Ijarah ‘lease’ is not similar to the conventional banking loan arrangement. The facts of the case are that, the respondent, that is, the ‘lessor’ entered into al-Ijarah agreement with the appellants, ‘lessees’ on the lease of certain printing equipment. The lease agreement was made under the letter of credit financing facility of the respondent. However, the appellants defaulted on the payment of the monthly rentals, and the respondents instituted an action against them to recover the leased equipment in addition to the rent arrears. The respondent then sought an ex parte mandatory injunction to dissolve the contract. However, the action was contended by the appellants. They claimed that the contract was void ab initio because it is similar to the conventional interest based loan contract.

---

31 Sanghi Polyesters Ltd (India) v The International Investor KCSC (Kuwait) [2000] All ER (D) 93. Istina’a is a form of contract where one party, paid in advance, is contracted to manufacture something. The practice is widely accepted as valid under Shariah, although there has been and continues to be debate among Muslim scholars on the contract’s legality due to the Islamic prohibition of selling items which you either do not yet own or whose possession is uncertain. See generally Al-Bashir & Al-Amine (describing the application of istina’a in Islamic banking transactions).


33 [2000] All ER (D) 93.

Although the court ruled in favour of the plaintiff, nevertheless, the ruling was administrative in nature, instead of addressing questions of law. The court concluded that the evidence, from the documents and the affidavit, shows that the agreement in the case was a lease agreement and not a loan agreement as claimed by the appellants. The court pointed out that the facts and circumstances of the case are evident on this. In short, the appeal court refused the appeal ‘administratively’ rather than its normal practice of ruling on the ‘question of law.’

**Question of the validity of Bai’ al-’Inah contract**

Furthermore, the question of the validity of the contract of bai’ al-’Inah was brought up in *Light Style Sdn Bhd v KFH Ijarah House (M) Sdn Bhd*. However, the court upheld the contract as a valid contract under Islamic law. It also accepted the operational mechanisms of the contract and allowed the plaintiff’s application order for sale. The facts of the case are that the defendant granted the plaintiff an Islamic revolving tradeline facilities of up to the sum of RM5,600, which the plaintiff utilised in different seventeen occasions and in each of the occasion the plaintiff undertook to purchase the goods from the defendant resulting in seventeen Murabahah sale agreements. However, the plaintiff defaulted in nine of the occasions. Such occurrence prompted the action.

The matter was brought before the court by the plaintiff for an interim injunction under the allegation of illegality and invalidity of the agreements, contravention of the Banking and Financial Institutions Act 1989 (the BAFIA), Islamic Banking Act 1983 (the IBA) and the Moneylenders Act 1951 (the MLA) and that, the transaction was in fact money lending, and that the defendant was not licensed under the said Acts for such activities. However, the court dismissed the application of the plaintiff and ruled that the plaintiff willingly signed the agreements in full knowledge of the mechanism of the financing facilities, and that such claim is inequitable.

Moreover, the Ba’ al-’Inah contract was upheld as a valid contract in *Majlis Amanah Rakyat (Sebuah Perbadanan Yang Ditubuhkan di bawah Akta Majlis*...
Amanah Rakyat) v Bass bin Lai. The case is about Bai’ al-’Inah facility which was secured upon a third party charge. Thus, the facts of the case are that the plaintiff agreed to sell some assets to the customer at the price of RM24,137.81 on deferred payment basis and then repurchased the same assets backed by the spot cash payment at the price of RM21,000. However, the customer defaulted the payment and the plaintiff applied for the foreclosure of the property under s 148 of the Sarawak Land Code (‘the SLC’).

However, the defendant, that is (the chargor), objected to the application. He argued presumably, that the facility is involved in the prohibited interest based transaction ‘riba’ under Shariah law. Notwithstanding that it is a Shariah compliant transaction, the plaintiff requested the court to apply the principles that are applicable in conventional banking facilities. It also asked the court to follow the principle of Arab-Malaysia Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors (Koperasi Seri Kota Bukit Cheraka Bhd, third party) [2008] 5 MLJ 631 and invoke s 66 of the Contracts Act 1950 and, grant the relief pursuant to the principle of Malayan Banking Bhd v Ya’ kup bin Oje & Anor [2007] 6 MLJ 389. Ultimately, the court allowed the plaintiffs’ originating summons and ordered for the sale of the property.

Question of the validity al-Murabahah contract

In the same vein, in the case of Bank Kerjasama Rakyat Malaysia v Sea Oil Mill Sdn Bhd & Anor the court decided that the hybrid contract of al-Murabaha and al-’Inah as practiced by the defendant does not contravene the BAFIA, IBA and MLA. The facts of the case are that the plaintiff granted a revolving credit facility to the defendant basis of the contract of Bai’ al-’Inah. However, the defendant defaulted on the payments and the plaintiff applied for a summary judgment to be entered for the defendant. The defendant claimed that the buy-and-sell-back transactions under the contract of Bai’ al-’Inah are null and void, because it was a mere lending transaction with interest. However, the defence was rejected.
However, although the appellate court allowed the plaintiff to enter a summary judgment for the defendant, it equally upheld the financing facility under the contract of Bai’ al-‘Inah as valid. Thus, the court ruled that, since the defendant willingly entered into the contracts, and knowingly agrees to its terms and conditions, it will be unfair for the defendant to thereafter deny liability. Although, the contract of bai’ al-‘Inah was also upheld as a valid contract in the case, nevertheless, the fact remains that, the decision was purely administrative.39

More so, the same question of the validity of al-Murabahah contract also surfaced in the United Kingdom case of Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd and others,40 by the appellate court. The facts of the case are that Beximco Pharmaceuticals acquired an asset that cost $US/49.7m on the basis of al-Murabahah (cost-plus-profit) sale contract from Shamil Bank of Bahrain.41 However, the agreement included the term ‘subject to the principles of the Glorious Shariah, this agreement shall be governed by and construed in accordance with the laws of England’. Thus, when Beximco defaulted on payments, Shamil Bank instituted an action for the recovery of the debts. However, Beximco raised the defence that the contract was invalid due to the fact it is an interest based contract which is not in conformity with the dictates of Shariah law. However, the appellate court surprisingly accepted the defence on the basis of the clause that was contained in the contract that ‘subject to the principles of the Glorious Shariah that it is ...’ that the term is a valid choice of law clause which governed the contract. Thus, Beximco succeeded on the basis of the Shariah risk that was created in the agreement.42

SHARIAH QUESTIONS IN ARBITRATIONAL TRIBUNALS

The challenges of the lack expertise and competency of decision on cases with Shariah question is not peculiar to the civil court. Its problem is also available in the arbitration tribunals. Thus, the procedural requirement of reference to the Shariah council for answer on Shariah questions as enshrined in the CBMA 2009, should be adopted as a mandatory procedural requirement across the glob. Instances of the cases that necessitate this proposition are given below.

42 Ibid at para [40]; [2004] 1 WLR at pp 1795–96.
Most arbitrators are only experts in either the civil or common laws, or both. Arbitrators with expertise in Islamic law are very scanty. For instance, in *Petroleum Development (Trucial Coasts) Ltd v Sheikh of Abu Dhabi*, the arbitrator who is only versed in the civil law rejected the application of the principle of Shariah law, on the basis of his perception that Shariah law is too primitive, and that it is not sophisticated enough to form the basis of modern complex commercial transactions. He asserted that ‘it would be fanciful to suggest that in this very primitive region, that is, the Arab region,’ there is any settled body of legal principles applicable to the construction of modern commercial instruments. The arbitrator decided the case on the basis of the principle of English law, despite the insertion of a clause that Shariah law is the chosen law for dispute resolution, in the contract.

In the same vein, in the case of *Ruler of Qatar v International Marine Oil Co Ltd*, the arbitrator arrived at the same negative conclusion due to his lack of knowledge of the Shariah law. The arbitrator uttered a general statement that the Shariah law does not ‘contain any principles which would be sufficient to interpret the contract’. The arbitrators should have declared their lack of expertise and incompetency in the divine law, and seek the assistance from the qualified Shariah scholars and jurists who can answer questions that brought before them on Shariah law. In short, the new procedure about the reference of courts and arbitrators to Shariah Council for Shariah questions as required by Central Bank of Malaysia Act 2009, should be applicable to all the arbitration tribunals that decide cases of Islamic banking and finance, across the world.

**CONCLUSION**

summation, the foregoing is a discussion on the new judicial procedure that is introduced in Malaysia. That is, reference to Shariah Council by courts and arbitrators for answers on Shariah questions. The procedure is enshrined in the ss 56–57 of the Central Bank of Malaysia Act 2009, and the principle which

45 *Trucial Coast*, 1 Int’l & Comp LQ at p 251.
46 *Ruler of Qatar v International Marine Oil Co Ltd* 20 ILR 534 (1953).
47 *Trucial Coast*, 1 Int’l & Comp LQ at p 247.
was created by Tan Sri Abdul Khalid Ibrahim’s case. The procedure was initially viewed as an encroachment on the constitutional function of the court. However, this was settled in the above case. It has been made clear that the SAC is not tasked with a judicial or quasi-judicial function by the Act, and nor did it encroach or usurp the judicial function of the court. The new task of the SAC is to answer Shariah questions on the operations of the Islamic financial institutions. Therefore, the court remains the sole and ultimate arbiter in the cases. It is believed that since the procedure was able to resolve the problem of absence of Shariah expertise in the judicial system that exercise blanket jurisdiction over the entire financial institutions, in Malaysia, if it is introduced to another jurisdiction, it will solve the same problem. Thus, since the problem is universal, the current article advocates for the adoption of the new procedure by all the countries that practice Islamic finance and suffer from similar problem.

49 [2013] 3 MLJ 269.