

Islamic Finance and the English Court

BACFI

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Thank you

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This lecture

I. Introduction: UK Islamic finance deals

II. The cases

III. Concluding analysis

I. INTRODUCTION: UK ISLAMIC FINANCE DEALS



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Islamic Finance and the English Court

Other property deals

- Chelsea Barracks & Battersea Power Station
- Kings Reach Tower (ABC International Bank)
- Credit Suisse London HQ
- Shell Centre in Southbank development
 - joint venture with Canary Wharf
- Argos National Distribution Centre (Stratford)
- L'Oreal's UK logistics headquarters
- Gatehouse Bank: home finance in Midlands & Northwest (£700 m)

UK capital market

London Stock Exchange (LSE)

- 66 sukuk listed, US\$50 b
- IDB US\$1.25 b – largest by supranational in 2017
- 2014 sovereign sukuk (US\$200 m)
- 2016 sovereign guaranty of Emirates sukuk
- 7 shari'a compliant ETFs
- indices: FTSE Sharia Global Index, Shari'a Top 40 etc

➤ *Form of diversification* for increasingly wide **investor universe**

Sources: Financial Times and LSE, 'London Stock Exchange Welcomes in Islamic Development Bank Sukuk Bond – Largest Issuance by a Supranational in 2017) at LSE webpage, 12/4/2017

UK Islamic banks

- Islamic home purchase plans
 - *musharaka mutanaqisha* (diminishing partnership)
- 20 operating in UK, oldest since 2004 (IBB)
 - 14 Feb 2018: Al-Rayan bank debuts *shari'a compliant bond backed by UK mortgages*
- BoE fund-based shari'a compliant liquidity reserve

Sources: Financial Times and LSE, 'London Stock Exchange Welcomes in Islamic Development Bank Sukuk Bond – Largest Issuance by a Supranational in 2017) at LSE webpage, 12/4/2017

Volumes & demographics

- US\$2 t (2015) global assets, US\$3.2 t by 2021
 - *ICD-TR IF Development Report (2017)*
- UK: US\$4.5 b Islamic banking assets
 - *CityUK (2017)*
- Demographics
 - UK 2.7 m, 4.4 pc (2011 Census)
 - world: 1.6 b (2010) – 2.2 b (2030) (Pew)
 - 1.5 pc growth annual vs .7 pc non-Muslim
 - youthful: larger share 15-29



Why the English court?

- assets, parties, performance in GCC
- largest share of cross-border deals governed by English law
 - English contract & trusts law
 - offshore SPVs (both companies and trusts)
 - rule of law and judiciary
 - The City: time zone, exposure, allied professionals (cp Wall St)
 - transaction documents drafted by English lawyers
- relevant statutes, regs & reliefs
 - FAs, PRA/FCA, HMRC, HMT, UKLA rules; AFIB
 - SDLT relief – *Project Blue Limited* [2016] CA: Chelsea Barracks

II. THE CASES

1) *Islamic Investment Company of the Gulf (Bahamas) Ltd v Symphony Gems NV & Ors* unreported [2002] All ER 171 (QBD Comm Ct)

2) *Beximco Pharmaceuticals Ltd & Ors v Shamil Bank of Bahrain EC* [2004] 1 WLR 1784 (CA)

3) *The Investment Dar Company KSCC v Blom Development Bank* [2009] EWHC 3545 (Ch)

4) *Dana Gas PJSC v Dana Gas Sukuk Ltd & Ors* [2017] EWHC 1896 (Comm)

5) *Golden Belt 1 Sukuk v BNP Paribas* [2017] EWHC 3182 (Comm)

1) *ISLAMIC INVESTMENT
COMPANY OF THE GULF
(BAHAMAS) LTD V SYMPHONY
GEMS [2002]*

Facts and decision [2002]

- *murabaha*
 - in lieu of a loan, two sales contracts
 - i) bank purchases commodity or specific good for customer
 - ii) sells to customer on deferred/instalment terms
 - also: used as letter of credit, in title-based finance
- double governing law – Islamic law (recital) & English law
- shari'a dismissed, English law applied

***2) SHAMIL BANK OF BAHRAIN V
BEXIMCO PHARMACEUTICALS
LTD [2004]***



Facts

- *murabaha* and *ijara*
 - *ijara* = lease

- governing law clause:

‘Subject to the principles of the Glorious Shari‘a, this Agreement shall be governed and construed in accordance with the laws of England.’



QBD: facts and decision

Claimant:

- admit two laws cannot govern
- shari'a incorporated by reference

Expert witnesses:

- Islamic law confused (or confusing?)

Morison J:

- art 1.1 *Rome*: Islamic law not law of a country
- 'it is improbable in the extreme, that the parties were truly asking this court to get into matters of Islamic religion and orthodoxy' [54]

CA [2004]

Potter LJ (Laws and Arden LLJ concurring)

- in essence agreed with Morison J re *Rome*
- incorporation of Islamic law inadequate
 - though if sufficiently black letter could govern according to English contractual principles [*obiter*]

Court must:

- give effect to intention of parties
 - parties *knew* transactions were loans
- **substance over form**

Islamic law set aside, English law applied



3) *THE INVESTMENT DAR COMPANY KSCC V BLOM DEVELOPMENT BANK [2009]*



Facts

- governed by English law alone
- *wakala*
 - *wakala*=agency
- *Blom* (Lebanese bank) advanced funds to the Investment Dar (*TID*) which was acting as agent
- *TID* could not re-pay
 - Kuwaiti company
 - objects clause of company constitution mandates shari'a compliance

The issue at the High Court (Chancery)

TID said:

- *wakala* contract *ultra vires*
- non-compliant
 - unconditional obligation to pay
 - even if expected return not realised
- though own shari'a board had approved

The decision [2009]

J Purle:

- procedural decision, without full trial
 - no final determination on the *wakala* agreement
- **TID partially** successful
 - triable issue as to shari‘a compliance in view of *TID* objects clause
 - whether transaction *ultra vires* TID
 - if so, respondent must pay full amount
 - however even if *ultra vires*, restitutionary claim
 - principal only (not profit) – US\$10 m payable to *Blom*



A) Observations

Distinguish *Blom* from *Beximco*

- double barreled governing law clause absent in *Blom*, English law only
- *wakala* rather than *murabaha*
- shari‘a compliance issue arose due to objects clause under foreign company law
- not cast doubt on *wakala* agreements in general



B) Observations

Raises *ultra vires* spectre

➤ common element in *Beximco* & *TID*

Rupert Reed QC (in *Butterworth's* 2014, 577) :

- *TID* and *Beximco* (at the High Court only)

indicate willingness to adjudicate Islamic law

AGAINST

- *Symphony Gems* and *Beximco* at Court of Appeal

C) Observations

- danger of reliance on shari'a board opinions
 - even if both parties possess written *fatāwa*
- Norton Rose Fulbright advice to reduce *ultra vires* risk to obligees
 - recital or warranty that parties believe compliant
 - waiver re non-compliance
 - undertakings not to challenge, litigate
- Sensible, but ineffective in *Dana Gas...*

4) *DANA GAS PJSC V DANA
GAS SUKUK LTD & ORS [2017]*

Facts

- *mudaraba* sukuk [joint venture]
- asset: gas reserves in Iraq (Kurdish region) and Egypt
- issuer/obligor: *Dana Gas*, a Sharja (UAE) company
- investor protection: non-recourse; re-purchase agreement
- financial distress
 - investors seek to trigger re-purchase agreement
- *Dana Gas* claims contract non-compliant, *ultra vires*
 - contradicting fatwā
 - argument: effectively investor capital guaranteed – contrary to *mudaraba* allocation of risk

The central issue in dispute

- Multi-jurisdictional (BVI, English, UAE)
- Three agreements:
 - *mudaraba* agreement
 - purchase agreement
 - sale agreement

Agreements re shari'a governed by UAE Civil Code.
Purchase agreement governed by English law.

- two possible characterisations
 - as a single process
- OR
- as three distinct processes

Interim injunction ordered (July 2017) in HC, FL – Waksman J

- three agreements forming ***one purchase process***
- *Ralli* principle: that English court will not enforce contract if its performance unlawful where performed
 - the *mudaraba* agreement as (prima facie) unlawful under UAE law

Strengthened:

- *ultra vires* defence of *Dana Gas*
- view that Islamic law justiciable or at least binding upon the English court

November [2017] Legatt J

- overturns Waksman J
 - three **distinct**, discrete processes
 - *Ralli* inapplicable as the agreement at issue is ONLY the purchase agreement
 - governed by English law
 - rejects all *Dana Gas* submissions that purchase agreement unenforceable
-
- *ongoing litigation in BVI and Sharja*
 - *appeal expected here*



5) GOLDEN BELT 1 SUKUK V BNP PARIBAS [2017]

Facts

sukuk: investment certificate

ijara sukuk: sale-leaseback-(re-purchase)

i) investors purchase sukuk

ii) sukuk SPV purchases land from obligor

iii) obligor

a) receives capital (for land)

b) leases land *back*

c) pays SPV/investors rent

d) undertakes to re-purchase land, returning value of subscription (effectively)

Facts

US\$650 m, ten year tenor

Land in KSA

Investor protection:

- Non-recourse
- Guaranteed by UHNW KSA national
 - documented as promissory note
 - art 87 Law of Negotiable Instruments 1964 (KSA)

Facts and decision (QBD) [2017]

- *Golden Belt* financial distress
- Two NY hedge fund ('funds') buyout
- Promissory note formalities not complied with, investors not compensated
- inconclusive, ongoing restructuring talks

Males J:

- arranger BNP Paribas had, and breached, DoC to investors, i.e. to funds
- failure to see to proper execution of promissory note

Observations

- distinct from earlier cases
 - Shari‘a board, *ultra vires* defence and Islamic contracts not at issue
- as in *Dana Gas* and *TID*, complexities relating to multiple jurisdictions (England, Bahrain, KSA)
- breach of DoC relating to KSA law

Questions: increases DoC for securities arrangers -- whether specific to:

- foreign jurisdictions (or these in particular)?
- Islamic finance or any?

III. CONCLUDING ANALYSIS

Judicial learning curve

- steep and relatively swift
- significant advance in
 - familiarity and understanding of Islamic finance
 - from low base in *Symphony Gems* and *Beximco*
- trite Islamic legal contracts no longer treated as idiosyncratic, incomprehensible
- modernisation:
 - focus on industry standards
 - replacing antiquarian concerns about Islamic jurisprudence

Familiarity ≠ willing to adjudicate

- Guidance from firms offered post-*TID* **did not prevent** *ultra vires* defence in *Dana Gas*
 - individually rational for distressed obligors
 - in short-term
 - collectively sub-optimal as sukuk less attractive
 - near to long-term
- *Dana Gas* (July injunction) **echoes previous judicial flirtation** with Islamic legal issues (in *TID v Blom*)
- neither consummated; *status quo* restored
 - arguably good constitutional reasons

Industry reception

Established: we will not see Islamic law appearing as governing law

- **favourable:** market participants do not want English judges issuing fatwas

Sukuk structured so that shari'a compliance issues **cordoned off**

- advantageous for investor protection
- and therefore for investment
 - FDI and portfolio
 - inward foreign investment -- into UK

Islamic Finance and Brexit

Impact of **Brexit** on Islamic banking and cross-border finance with a UK nexus

- post-EU diversification; Commonwealth
 - human and economic capital, trade
- reduced energy prices increases GCC borrowing (corp and sov)
- weak pound attracting inward investment
- softening high end London property market

Islamic Finance, the City & the Bar

Islamic banking and finance as sources of legal work

- City solicitors & the English Bar

MY CENTRAL CLAIM:

- **incorporation of Islamic law as T&Cs** of English contract (*Beximco*)
 - superior to precautionary measures attempted in *TID* and *Dana Gas*
 - AAOIFI, IFSB, *Majella* bench book possible
 - maximise value of English law & legal system for Islamic finance (and vice versa)

international operations of SRA and Bar Council