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## Malaysia as a Forum for the Settlement of International Islamic Financial Disputes: Problems and Prospects

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**Abstract:** This paper is an attempt to assess the suitability of the Malaysian law and judiciary to resolve international Islamic financial disputes. In this connection, it will propose for the establishment of an International *Mu'amalat* Court in Malaysia to settle international Islamic financial disputes in a similar fashion of the Singapore International Commercial Court (SICC).

**Keywords:** *Shari'ah*; Islamic finance; choice of law; choice of forum; international dispute resolution

### 1. INTRODUCTION

According to the *Global Islamic Finance Report* (GIFR 2011), most of the Islamic financial contracts are governed by the non-*Shari'ah* laws and the international commercial parties particularly in the Middle East have commonly resorted to the English law or New York law to govern their Islamic financial contracts. Both of English and New York laws are respected, time-tested and efficient. They provide for effective enforcement procedures as well. However, a legitimate question still arises whether Islamic financial contracts should be subjected to secular laws for the dispute settlement specially when the chosen forum, which is also secular, does not readily accept *Shari'ah* law as the governing law between the contracting parties as happened in *Shamil Bank of Bahrain EC v. Beximco Pharmaceuticals Ltd and Others* (2004). This case was decided by the English Court of Appeal. Here, the contending parties chose "English law subject to Glorious *Shari'ah*" to govern an Islamic financial contract. But the Court disregarded the choice and settled the dispute according to English law because the *Shari'ah* law was not, as they understood, a State law in the sense of the then 1980 *Rome Convention* as implemented in the UK. The rejection of *Shari'ah* law was also reasoned on the ground that it was not codified nor was it uniform due to juristic differences between the schools of jurisprudence. A similar approach was taken in *The Investment Dar Co KSSC v. Bloom Developments*

*Bank Sal* (2009). However, the impasse to *Shari'ah* application is claimed to be removed with the recognition of non-State law in the Preamble of the *2008 Rome I Regulation*, which has replaced the *1980 Rome Convention* (Zahid and Hasani, 2013).

Despite the above recognition, *Shari'ah* is treated as foreign law in Western jurisdictions, which requires *Shari'ah* expert evidences for the disposal of cases involving Islamic finance. This is very much normal as the judges in secular jurisdictions are not familiar with the *Shari'ah* law and, therefore, face difficulty in deciding cases especially when *Shari'ah* expert opinions differ with each other. According to Aida Maita (2014), the lack of *Shari'ah* law governance over cross-border disputes is considered the Achilles Heel in the global acceptance and growth of Islamic finance. It necessitates a uniform application of *Shari'ah* law in cross-border disputes.

As an alternative to the English law and court, Mohamed and Trakic (2012) proposed Malaysian law and court to be considered as the law and forum of choice for Islamic financial disputes. Unlike the Western and non-Muslim countries, *Shari'ah* law is accepted as *lex loci* (law of the land) in Malaysia. This is confirmed by the Court of Appeal in *Ramab Taat v. Laton Malim Sutan* (1027). As part of the local law, expert evidence is not necessary. Section 45 of the *Evidence Act 1950* provides that expert opinion is only required for the determination of a point of foreign law. Nevertheless, in order to assist local judges in applying the correct *Shari'ah* principles to the Islamic financial disputes, the *Shari'ah* Advisory Council (SAC) was established by the Bank Negara Malaysia (Central Bank of Malaysia) as the sole authority to issue rulings on *Shari'ah* issues and such rulings are binding on the court. This model is sound and clear in terms of *Shari'ah*-compliance, governance framework as well as the certainty and predictability of dispute resolution outcomes (GIFR 2011).

At the backdrop of the above prelude, this paper is an attempt to discuss the suitability of the Malaysian law and judiciary in the resolution of international Islamic financial disputes.

## 2. MALAYSIAN LAW AS A CHOICE

### 2.1. Salient Feature of Malaysian Law- Shari'ah Combined with Common Law

Malaysia is an Islamic country. Officially, its religion is Islam (Article 3 of the Federal Constitution). *Shari'ah* is the law for conduct of Muslim affairs. Effective from 10 February 2015, the government is pursuing a policy of fulfillment of the objectives of *Shari'ah* (maqasid al *Shari'ah*) principally in eight areas, namely judiciary, economy, education, infrastructure and environment, health, culture, politics and society. It may be noted that the objectives of *Shari'ah* are basically to bring about welfare and development of people in a sustainable manner.

Whilst *Shari'ah* law is regarded as *lex loci* in Malaysia, the English common law is also accepted as part of the Malaysian law pursuant to the definition of 'law' under Article 160 of the Federal Constitution. Further, sections 3 and 5 of the Civil Law Act 1956 provide for the general application of the common law of England and the rules of equity particularly on commercial, banking and financing matters. Hence, the *Shari'ah* law co-exists with the common law as a source of Malaysian law. This feature may be of great assistance to the international contracting parties should they opt for Malaysian law as their choice of law to resolve the Islamic financial disputes. While other secular jurisdictions oust the religious based law from their legal system and insist on single governing law, Malaysia adopts a different stance by having both

Shari'ah law and common law within its legal system. The structure in Malaysian legal system appears to suit the need of those international contracting parties who want their contracts to be construed in accordance with Shari'ah law alone or a combination of domestic law and Shari'ah law. According to Colon (2011), the contracting parties to a Shari'ah-compliant transaction may choose one of the following three options to govern their contracts: (1) Shari'ah law alone, or (2) a state legal system, whether or not it is based on Shari'ah law; or 3) subject to a combined system that pairs a national legal system with Islamic principles. Malaysia qualifies for the first and third choice.

## **2.2. Islamic Financial Services Act 2013 (IFSA)**

Besides the reception of unwritten laws namely Shari'ah law and English common law, the statutes and written law enacted by the legislative body also constitute sources of the Malaysian law. Section 3 of the Interpretation Acts 1948 and 1967 (Consolidated and Revised 1989) defines 'written law' as to include the Federal Constitution, the Constitution of States, Acts of Parliament, Ordinances and Enactments passed by the State Legislature and subsidiary legislation. In the area of Islamic finance, Malaysia emerges as the pioneer to legislate the Islamic Financial Services Act 2013 (IFSA), which is the most comprehensive legislation for the purpose of Shari'ah-governance, Shari'ah compliance and supervision of Islamic finance industry. Part IX of IFSA provides for the standards on business conduct, consumer protection and duty of secrecy. The Bank Negara Malaysia is empowered under Part X of IFSA to specify standards or issue codes for the purposes of developing, or maintaining orderly conditions or the integrity of, and ensuring compliance with Shari'ah in the Islamic money market or the Islamic foreign exchange market. It may, however, be mentioned that IFSA does not codify the substantive Shari'ah laws applied to Islamic finance. Its main purpose is to provide for the regulation and supervision of Islamic financial institutions.

## **2.3. Shari'ah Advisory Council (SAC)**

As aforesaid, Bank Negara Malaysia established the SAC with the sole authority of ascertainment of *Shari'ah* law related to Islamic financial business. The law court and arbitrators in this area are required to refer any *Shari'ah* issues to SAC for rulings (section 56 to the *Central Bank of Malaysia Act 2009*). The SAC rulings are binding on courts and arbitrators. Their rulings also prevail over any *Shari'ah* committee or scholar's view. In this connection, it is worth mentioning that the fact that the court is bound by the ruling of the SAC does not detract it from the judicial functions and duties of disposal of disputes (*Tan Sri Abdul Khalid Ibrahim v. Bank Islam Malaysia Bhd*(2013)). The SAC does not perform any judicial function of decision making in litigations. Hence, it cannot be said to have usurped the judicial functions of the court.

## **2.4. Procedural Law**

The Malaysian procedural law of litigation is basically the same as English law inasmuch Malaysia adopted the *English Rules of Supreme Court 1965* model to its *Rules of Court 2012* (formerly *Rules of High Court 1980*). The Court of Appeal in the case of *Bank Kerjasama Rakyat Malaysia v Emcee Corporation*(2003) held that the same procedural law applicable to conventional financing will be applied to Islamic financing. The judge will make adjudication based on issues, facts, pleadings, affidavits and submissions as presented by counsels for both litigants. As such, it will not be difficult for litigants or counsels who are used to the common law system or adversarial system to have their disputes being adjudicated in Malaysian court. Malaysia does have a codified

statute, such as *Limitation Act 1953*, *Civil Law Act 1956*, *Evidence Act 1950* and other acts of parliament which serve as reference to judges and legal practitioners on the procedural law governing the litigation proceedings.

## 2.5. Conflict of laws Issues

Even though there are some advantages of having a combined legal system with various sources of law to cater for the needs of dispute settlement of Islamic financial disputes, it is undeniable that such situation may also lead to a potential conflict of laws. Muneeza (2015) finds that there are various legislative conflicts in Islamic finance in Malaysia. She presents a list of such legislations. As of today, the Malaysian law has yet to develop a mechanism of dealing with the conflict of laws issues. However, in practice, the law courts are handling them in a case-by-case basis. For example, in *CIMB Islamic Bank Berhad v. LCL Corporation Berhad & Anor* (2014), it was questioned if *Bai' Bithaman Ajil* transactions were in infringement of section 67 and 67A of the *Companies Act 1965* (Act 125). A similar issue was also raised in *Datuk Hj. Nik Mahmud Nik Daud v. Bank Islam Malaysia Bhd* (1998). In both cases, the courts upheld the legality of the *Bai' Bithaman Ajil* financing in favour of the Islamic financial institutions. In order to approach this issue in a uniform and orderly way, Bank Negara Malaysia has set up a Law Harmonisation Committee (LHC) to review existing laws with a view to harmonising them with *Shariah* principles of Islamic finance. This initiative is well commendable.

## 3. MALAYSIAN COURT AS A CHOICE OF FORUM

### 3.1. Dual system of justice

Malaysia has a dual judicial system: civil court and *Shari'ah* court systems. Article 121(1A) of the *Federal Constitution* stipulates that the civil court shall have no jurisdiction over matters falling under the jurisdiction of the *Shari'ah* court. *Shari'ah* court is constituted under the State law (except for the Federal Territories of Kuala Lumpur, Labuan and Putrajaya) and its jurisdiction is restricted to persons professing religion of Islam and to matters stated in paragraph 1 of the *State List, Ninth Schedule, Federal Constitution* such as the Islamic law relating to succession, betrothal, marriage, divorce, maintenance, adoption, legitimacy, guardianship, gifts, partitions and non-charitable trusts. The *Shari'ah* court, however, has no jurisdiction over Islamic financial matter. In *Mohd Alias Ibrahim v RHB Bank & Anor* (2011), the High Court held that the civil courts have the power to adjudicate on Islamic finance because financial matters are within paragraph 7 of the *Federal List, Ninth Schedule, Federal Constitution*. This decision has re-affirmed the earlier unreported decision in the case of *Bank Islam Malaysia Bhd v. Adnan Bin Omar (Civil Suit No: S3-22-101-91)*.

### 3.2. Competency of civil court judges and lawyers

It is commonly alleged that the civil court judges and lawyers are not competent in *Shari'ah* law, which is an important issue in the settlement of Islamic financial disputes. Most of them are common law or civil law trained and have minimal exposure to *Shari'ah* law. Former Chief Justice, Ariffin Zakaria (2013), admitted this problem. However, according to Yusuf and Salleh (2013), the main problem in the implementation of Islamic finance in Malaysia is the perceived uncertainty of applicable substantive *Shari'ah* law. This is mainly due to the uncodified nature of *Shari'ah* law of financial transactions. In the absence of substantive law, decisions and rulings are dependent very much on the individual judge's understanding of the Islamic legal literature and juristic opinions on the relevant issues. However, this issue is addressed now, to a great

extent, by the introduction of sections 56 and 57 of *Central Bank of Malaysia Act 2009*, under which the SAC assists the civil court judges and arbitrators in the application of the correct *Shari'ah* principles in the disposal of Islamic financial cases. This institutional arrangement should be reliable and encouraging for parties to international Islamic financial transactions to choose Malaysia as the forum for dispute settlement.

### **3.3. Mu'amalat Division**

In order to improve the adjudication process of Islamic financial cases, the then Chief Judge of Malaya, on 6<sup>th</sup> February 2003, issued a *Practice Direction No. 1 of 2003* whereby a Mu'amalat Division was set up at the Kuala Lumpur High Court to hear Islamic banking and finance cases. Subsequently, the said Practice Direction was replaced by *Practice Direction No. 4 of 2013* and supplemented by *Practice Direction Nos. 6 and 7 of 2013*. However, this is a division in the Kuala Lumpur High Court alone. There is no such division in the other High Courts of Malaysia nor is there any similar thing at the subordinate court level, such as the Sessions Court. This paper maintains that a Mu'amalat Division should be set up at all High Courts in Malaysia and the Division judges should be continuously trained in *Shari'ah* law of Islamic finance. Further, for the purpose of adjudication of international Islamic financial disputes, this paper would recommend for the establishment of a specialised Mu'amalat Court within the Malaysian civil court system.

### **3.4. Language of the court proceedings**

In Malaysia, it is not disputed that most of the civil court judges and lawyers are well trained in English language. The grounds of judgment by the court and submission by the counsels particularly at appellate level are prepared in English language. However, pursuant to Article 152 of the *Federal Constitution* and section 8 of the *National Language Acts 1963 and 1967*, it is mandatory for all pleadings, affidavits and cause papers to be prepared in Malay language, which is the national language. The parties may provide English translation if they wish to conduct their case in English. Should the parties fail to file the pleadings and documents in Malay language, such non-compliance will be regarded as nullity which will invalidate the whole proceedings. In the case of *Dato' Seri Anwar Ibrahim v. Tun Dr Mahathir Mohamad (2010)*, the Court of Appeal held that the importance of Malay language as national language cannot be taken lightly. Due to non-compliance by the appellant to file memorandum of appeal in Malay language, the Court of Appeal concluded that no memorandum of appeal had been filed at all and the appeal was accordingly dismissed. This decision was later upheld by the Federal Court. This paper views that this position may not be suitable for international disputes should the parties opt to submit to the jurisdiction of Malaysian court. As such, an additional proviso should be inserted to section 8 of the *National Language Acts 1963 and 1967* to allow international parties to have their disputes being fully litigated in English language.

## **4. PROPOSAL FOR ESTABLISHMENT OF INTERNATIONAL MU'AMALAT COURT OF MALAYSIA (IMCM)**

In the present world, Malaysia is a hub of Islamic finance. In addition, it has modern infrastructures, conducive court rooms and application of electronic system in the Malaysian civil court. These factors are most likely to convince the parties to international Islamic financial contracts to choose Malaysia as their forum. This requires a rethink of the existing system of adjudication. It would be more attractive for the international financial businessmen and investors if Malaysia has a Mu'amalat Court for the purpose of



adjudication of international Islamic financial disputes. That is why this paper hereby argues for the establishment of such a court, which may be named as the International Mu'amalat Court of Malaysia (IMCM). It may be formed as a division under the High Court of Malaya and be located either at the Palace of Justice, Putrajaya or the Kuala Lumpur Court Complex.

The above proposal is modeled on the newly formed Singapore International Commercial Court (SICC). It was officially launched on 5<sup>th</sup> January 2015 to adjudicate on high-value, complex, cross border commercial cases. It is a division of the Singapore High Court and is recognised as a superior court. Following the amendments made to the *Constitution of the Republic of Singapore*, the SICC is housed with international judges in addition to locals (Singapore International Commercial Court Committee, 2013).

In order to encourage international parties to choose Malaysian court as forum for adjudication of international Islamic financial disputes, Malaysia must be ready to liberalise its judicial service by allowing the appointment of foreign judges who are qualified in both Islamic law and secular laws. It will not be far-fetched for liberalisation of the judicial services to cater for appointment of foreign judges on *ad hoc* basis since Malaysia has recently liberalised the legal services industry. On 3<sup>rd</sup> June 2014, Part IVA of the *Legal Professional Act 1976* has come into force whereby foreign lawyers and foreign law firm are allowed to practice in permitted practice areas such as Islamic finance. Hence, the proposal for establishment of IMCM seems to be timely. Malaysia may also need to conduct study whether or not it should ratify the *2005 Hague Convention on Choice of Court Agreements*, which basically provides that a court of the any Contracting States chosen by the parties to a dispute as having the exclusive jurisdiction shall not decline to decide the case on the ground that the dispute should be decided by a court of another State.

In the event that the proposed IMCM is formally established, this paper would recommend the following model clauses to be incorporated in the agreement between the contracting parties:

**“Governing Law:** This Agreement shall be governed by and construed in accordance with the laws of Malaysia and the parties hereby agree that the ruling by Shari’ah Advisory Council of Bank Negara Malaysia on any Shari’ah issues shall be final and binding on the court and the parties.”

**“Jurisdiction:** With respect to any dispute, controversy or differences arising out of or in relation to this Agreement, including any question regarding its interpretation, breach, termination, enforceability or validity thereof, each party hereby unconditionally and irrevocably submits to the jurisdiction of the International Mu'amalat Court of Malaysia and waives the right to object on the ground that International Mu'amalat Court of Malaysia does not have any jurisdiction over the relevant party.”

## 5. CONCLUSION

As conclusion, it is hoped that a special committee will be formed to develop the framework for IMCM and propose the relevant amendments to the *Federal Constitution*, the *Courts of Judicature Act 1964* and other relevant statutes. MIMC may be able to strengthen the Malaysian position as the leader in Islamic finance dispute resolution.

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