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The Suitability of Arbitration and ADR to Resolve Financial Disputes: Islamic Finance and the Emerging Disputes in the Digitalised Financial Sector

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In the context of the cooperation and Memorandum of Understanding between the International Chamber of Commerce ('ICC') and the Union of Arab Banks ('UAB'), the ICC-UAB joint conference addressed, inter alia, the use of arbitration as a means of resolving disputes that may arise in the context of Islamic finance and the suitability of arbitration for resolving issues arising in the digitalised financial sector, such as smart contracts, automated trading, artificial intelligence, cyber security, and blockchain technology. Dr. Aline Tanielian Fadel and Christophe Dugué report.

Suitability of arbitration and ADR to resolve disputes arising from Islamic finance

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Taking stock of the increased offering of Islamic finance products, this panel discussed (i) to what extent arbitration, as an alternative mode of dispute resolution, can provide an adapted and effective resolution for disputes arising in Islamic finance; and (ii) the role of arbitration and ADR in preserving the integrity of the Islamic financial system.

The conference offered an introduction to Islamic finance and to the core principles to follow in order to ensure compliance with Sharia law such as the prohibition of *riba* (interest), *gharar* (excessive risk) and *maysir* (speculation). The panel also described the dominant modes of financing used by Islamic banks, including *murabaha* (cost-plus sale contract, involving an immediate delivery with deferred payment), *bay' al-inah* (a double sale used to avoid lending with interest), *tawarruq* (a sale with deferred payment followed by a repurchase of the same item in cash for a lower price through a third-party intermediary) and *ijarah* (leasing).

The discussions raised the need for Sharia-compliant arbitration,¹ whether in the choice of arbitration rules, the replacement of interest by compensation for late payment and penalty, or the use of third-party funding through an agreed-upon profit sharing formula, particularly with the rise of Islamic FinTech and cryptocurrency disputes.

The advantages of semi-secular arbitration to resolve Islamic finance disputes were examined, particularly when managing the Sharia risk (i.e. the uncertainty of compliance of the financial product with Sharia law) to

ensure the compliance of Islamic financial products with Sharia law over their entire life cycle. The panel shared examples of the failure of court litigation to properly address the Sharia risk causing enforcement issues in Sharia-compliant jurisdictions. Arbitration offers a better alternative, particularly if it combines conventional arbitration rules with a regional seat of arbitration, and a secular governing law with precise references to principles of the Sharia.

The panel then explored whether Islamic dispute resolution ('IDR') called for specific proceedings in comparison with alternative dispute resolution ('ADR'). While traditional IDR is essentially similar to ADR, Islamic arbitration centers are not widely used. The panel mentioned that IDR and ADR should consequently coexist to cater for different targeted markets, pointing out that the real issue was the Sharia risk that encouraged the major Islamic institutions to opt exclusively for secular governing laws for the disputes related to their Islamic financial product, leaving the compliance with the Sharia to the determination of a Sharia board (sometimes the Islamic institutions' very own Sharia board, putting into question its objectivity) certifying the Islamic product's compliance with the Sharia within the documentation offered to the investors to subscribe to such product.

The panel drew attention to the fact that disputes in the context of Islamic banking and finance should not be resolved, as is often the case, without verifying the compliance of the decision resolving the dispute with Sharia law. Instead of excluding the application of Sharia law as the governing law because of its uncertainty that may jeopardize the enforcement of the decision in many jurisdictions, the panel shared many

¹ See also the ICC Report on Financial Institutions and International Arbitration (2016), Section X 'Islamic Finance'. The Report of the ICC Commission on Arbitration and ADR was prepared by a Task Force co-chaired by Georges Affaki and Claudia Salomon.

examples where specific provisions of Sharia law could be adopted to govern the dispute, such as a specific Islamic Fiqh school,² or the standards of Bahrain based Accounting and Auditing Organization for Islamic Finance Institutions ('AAOIFI').³ In conclusion, the parties agreed that arbitration is more suitable to cater for Islamic finance disputes than litigation because of the flexibility it offers in the choice of the provisions of Sharia

² Such as *Hanafi*, *Shafi'i*, *Maliki*, *Hanbali*, *Ja'fari*, and *Isma'ili* schools.

³ See <https://aaoifi.com/newly-issued-standards/>, e.g. Financial Accounting Standard 33 'Investment in Sukuk, Shares and Similar Instruments'.

law, while ensuring the integrity of the Islamic financial system through an objective verification of compliance with Sharia law.

The panel comprised Amel Makhoulf (Independent Counsel, Amel Makhoulf Avocat; Research Associate, Centre of Islamic and Middle Eastern Law, SOAS University of London; Lecturer in Law, Sorbonne Law School, Paris), Gordon Blanke (Founding Principal, Blanke Arbitration); Aline Tanielian Fadel (Partner- Arbitrator, Lecturer, Faculty of Law, Saint-Joseph University, Beirut) and was moderated by Ahmad Ouerfelli (Attorney at law, Ouerfelli Attorneys and Counsels, Tunis; Member of the Supreme Council of Arbitration, Mediation and Arbitration Center, UAB).