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Contractual Enforceability Issues: Sukuk and Capital Markets Development
Michael J.T. McMillen*

I. Sukuk (Islamic Bonds and Securitizations): An Introduction

It is only in the last few years that capital markets access has been successfully achieved through the use of instruments that are compliant with the principles and precepts of Islamic Shari’ah. The Shari’ah-compliant instruments that have been most successfully used for that access are the sukuk. But the degree of access thus far achieved has been limited, and primarily restricted to issuances by sovereign entities. Thus, the development of a viable and robust Islamic capital market remains a vision, but it is beginning to take form. While primary capital markets access is developing, the development of Islamic secondary markets remains essentially nonexistent. The early sukuk issuances have been structured to allow trading of those instruments, but actual trading is minimal. Nonetheless, the potential of the sukuk as a backbone of Islamic capital markets, especially secondary markets, is recognized and acts as a further inducement to the already accelerating trend toward the use of sukuk as a primary financing vehicle for Shari’ah-compliant sovereign, corporate, project, and asset finance.

In common parlance, and particularly in light of recent issuances, sukuk are often referred to as “Islamic bonds.”1 They are actually more akin to “pass-
through certificates," two "equipment trust certificates," or "investment certificates" due to ownership attributes. Thus, a *sakk* represents a proportional or fractional undivided ownership interest in an asset or pool of assets.

There are two general types of *sukuk*: Islamic bonds and Islamic asset securitizations. Islamic bonds are based, ultimately, upon the credit of an entity—issuer, guarantor, or other credit support provider—that is participating in the transaction, rather than on specific assets and cash flows derived from those specific assets. Securitizations involve asset transfers from an originator into a trust or similar special purpose vehicle ("SPV") with *sukuk* issuance by that SPV and payments on the *sukuk* derived from the payments received in respect of those transferred assets. Most *sukuk* offerings to date have been of the bond type, and the ultimate credit in most of those bond offerings has been a sovereign entity. There have been very few, if any, true asset securitizations, largely because of the inability to obtain ratings from major international rating firms (ratings have been obtained for the sovereign bond issuances based upon the rating of the sovereign credit).

The Accounting and Auditing Organization for Islamic Financial Institutions ("AAOIFI") has issued the *Standard for Investment Sukuk* ("AAOIFI Sukuk Standard"). Under the AAOIFI Sukuk Standard, *sukuk* are defined as certificates of equal value put to use as common shares and rights in tangible assets, usufructs, and services or as equity in a project or investment activity.

formulations are a product of the "jurisprudence of transformation and adaptation" of modern Islamic finance that has emerged since the 1980s wherein the classical nominate contracts ("*uqud masammat*") are viewed as a set of building blocks rather than as complete and immutably static transactional formulations and structures in and of themselves. See Yusuf Talal DeLorenzo and Michael J.T. McMillen, *Law and Islamic Finance: An Interactive Analysis* in Rifat Ahmed Abdel Karim and Simon Archer, eds, *Islamic Finance: The Regulatory Challenge* 136-201 (Wiley 2006). This Article surveys the foundations of Islamic commercial law and then considers some of the primary factors that have influenced the evolution of that law in modern times. For other examples of the reconfiguration of the nominate contracts in recent times, see also Michael J.T. McMillen and Abradat Kamalpour, *An Innovation in Financing—Islamic CMBS*, in Andrew V. Peterson, ed, *Commercial Mortgage-Backed Securitization: Developments in the European Market* 382 (Sweet & Maxwell 2006); Abdulkader Thomas, Stella Cox, and Brian Kraty, eds, *Structuring Islamic Finance Transactions* (Euromoney 2005).


4 AAOIFI, *Shari'a Standards* 1425-6 H No 17 at 296 (AAOIFI 2004).

The AAOIFI Sukuk Standard carefully distinguishes sukuk from equity, notes, and bonds.\(^6\) It emphasizes that sukuk are not debts of the issuer; they are fractional or proportional interests in underlying assets, usufructs, services, projects, or investment activities. Sukuk may not be issued on a pool of receivables. Further, the underlying business or activity, and the underlying transactional structures (such as the underlying leases), must be Shari‘ah-compliant (for example, the business or activity cannot engage in prohibited business activities).

The AAOIFI Sukuk Standard provides for fourteen eligible asset classes. In broad summary, they are securitizations: (a) of an existing or to-be-acquired tangible asset (ijara, or lease); (b) of an existing or to-be-acquired leasehold estate (ijara); (c) of presales of services (ijara); (d) of presales of the production of goods or commodities at a future date (salam, or forward sale); (e) to fund construction (istisna‘a, or construction contract); (f) to fund the acquisition of goods for future sale (murabaha, or sale at a markup); (g) to fund capital participation in a business or investment activity (mudaraba or musharaka, or types of joint ventures); and (h) to fund various asset acquisition and agency management (wakala, or agency), agricultural land cultivation, land management, and orchard management activities.\(^7\)

Sukuk may be divided into those that bear predetermined returns and those that allow for sharing of profit and, in some instances, loss. To date, most issued sukuk have borne predetermined returns, and most such sukuk have been sukuk al-ijara, frequently at a predetermined rate of return. The sukuk al-musharaka and the sukuk al-mudaraba are examples of profit-sharing (and, in the case of the sukuk al-musharaka, loss-sharing) sukuk.

Both types of sukuk issuances—bonds and securitizations—access the capital markets and are necessary for the balanced growth of those markets. However, true securitizations have benefits that transcend those available from bond issuances alone. Securitizations allow, and often require, broad diversification of the assets in the securitized pool. The originator of the transferred assets uses the securitization to manage its balance sheet and capital structure. The originator transfers assets that generate deferred payments and receives an immediate cash payment from the capital markets in respect of that transfer. This enables the originator to immediately generate more assets and results in further diversification of the financing in respect of the transferred assets. It also allows the originator to access a broader financing base and obtain

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\(^6\) Adam and Thomas, eds, *Islamic Bonds*, Exhibit 2 and related text at 54 (cited in note 3).

\(^7\) The parenthetical in each of the foregoing indicates the relevant Shari‘ah structure.
lower cost funding. The securitization process allows greater management of risk and liquidity for all market participants. That process also presents regulatory and conduit funding arbitrage opportunities.\(^8\) At a broader market level, the securitization process has proven itself to be a critical backbone of capital markets and, in particular, the development, existence, and functioning of secondary markets.\(^9\) Given the immaturity of capital markets (particularly secondary markets) in jurisdictions within the Islamic economic sphere,\(^10\) and, given the recent enthusiasm for \textit{sukuk} issuances and securitizations, the legal and structural support for securitizations should be areas of primary focus for the entire Islamic finance industry.

In order for securitization to result in capital market development, significant market depth must be obtained. Program issuers are a critical component, and those issuers must generate considerable volumes of securitization issuances on a constant basis. Program issuers should include governmental organizations, government sponsored entities ("GSEs"), and private financial institutions. Historically, governments and GSEs have been critical to the development of securitization markets and related secondary markets. In the United States, institutions such as the Federal National Market Association ("FNMA" or "Fannie Mae"), the Federal Home Loan Mortgage Association ("Freddie Mae"), the Government National Mortgage Association ("GNMA" or "Ginnie Mae"), and the Student Loan Marketing Association ("SLMA" or "Sallie Mae"), among others, have been particularly effective in helping to establish broad secondary markets and in otherwise realizing the benefits of securitization. For example, the participation of these entities in the securitization markets has helped to develop the relevant legal and regulatory framework, fostered and overseen the development of standards and standardized documentation, and generated volume and depth in the markets. Governments and GSEs have acted as regulators, enablers, issuers, and

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\(^8\) See Nassar Hussain, \textit{The European CMBS Market} in Petersen, ed, \textit{Commercial Mortgage-Backed Securitisation} 25, 29 (cited in note 1).


\(^10\) Jurisdictions and economies that desire to use Shari'ah-compliant financing techniques as their primary economic form are referred to as the "Islamic economic sphere"; jurisdictions and economies that use primarily interest-based financing techniques as their primary economic form are referred to as the "Western economic sphere."
purchasers of securitized instruments and related securities, thereby profoundly affecting primary and secondary capital markets and monetary policy.

Securitization in the field of Islamic finance is subject to a range of inhibitors that will need to be addressed and with respect to which structural accommodation is necessary. One such inhibitor is the considerable fragmentation of the relevant markets. These markets are fragmented with respect to, among other factors: (a) countries; (b) currencies; (c) the state of legal and regulatory development; (d) the degree of elucidation of, and agreement on, applicable Shari‘ah standards; (e) the degree of incorporation of the Shari‘ah into applicable secular laws; and (f) the operation of both Islamic and conventional interest-based markets in the same space. Another inhibiting factor is the current lack of scale in the Islamic finance field. A third set of inhibitors relate to a range of uncertainties with respect to the legal and regulatory base for securitizations and capital markets generally. Consider, for example, the state of development of securities laws in many of the jurisdictions within the Islamic economic sphere as well as the variances with respect to the enforceability issues discussed in this Article. Additionally, with respect to fundamental market criteria, the markets within those jurisdictions are underdeveloped and characterized by illiquidity, excessive concentration of risks, and lack of specialization. Yet another inhibiting factor is the scarcity of human resources, such as qualified Shari‘ah scholars and experienced financial, legal, accounting, and other professionals of all types.

The absence of broadly accepted Shari‘ah-compliant hedging mechanisms that are equivalent to conventional currency or interest rate swaps, such as those approved by the International Swaps and Derivatives Association (“ISDA”), is yet another impediment to widespread use of asset securitization sukuk. Frequently, the viability of an issuance is significantly affected by the efficacy of these hedging mechanisms. The Shari‘ah-compliant hedging techniques that do exist have not yet achieved broad market acceptance. There are various initiatives (including an ISDA initiative) to develop viable and broadly accepted Shari‘ah-compliant hedging mechanisms. Given the Shari‘ah requirement that tradable instruments represent an ownership interest in tangible assets and the Shari‘ah prohibition on the sale and purchase of debt and similar instruments, this is one of the more challenging areas of Islamic finance.

If sukuk are to achieve their macroeconomic and microeconomic benefits, it is essential that asset securitization sukuk be issued and traded on a large scale. To achieve widespread issuance and trading, such sukuk will have to be rated by international rating agencies. At present, however, it is difficult to obtain ratings from major international rating agencies on transactions that are dependent, at any level, upon laws in most jurisdictions within the Islamic economic sphere. The main legal impediments relate to the inability to obtain satisfactory legal opinions with respect to a range of enforceability issues, including true sales of
assets and various bankruptcy law matters. There are general issues as to whether and to what extent the Shari'ah or Shari'ah-compliant transactions can be enforced in jurisdictions in which the Shari'ah is not incorporated to any extent in the secular law of the land ("purely secular jurisdictions"), as well as in jurisdictions in which the Shari'ah is incorporated to some extent in the secular law of the land ("Shari'ah-incorporated jurisdictions"). An examination of general principles of law, including case law and general legal opinion practices, provides helpful insight as to how to address these general issues. But it is also necessary to examine enforcement issues directly applicable to sukuk, including those pertaining to true sales, bankruptcy, and other aspects of enforceability.

The general structure of each of the relevant legal systems is also of primary relevance to the ability to effect and realize the benefits of securitizations. As a systemic matter, a primary issue for the transactional participants (and for obtaining ratings from major international rating agencies) is whether and to what extent an agreement among the transactional participants will be enforced. That, in turn, is dependent upon other structural elements of the legal system, including: (a) whether the relevant legal system is based upon a system of binding precedents; (b) whether legal and arbitral decisions—and the rationale for those decisions—are published and widely available; (c) whether the judicial structure is responsive to continuity, consistency, and transparency in the application of judicial precedents; and (d) the time frame for enforcement of remedies within the system.

While these systemic structural elements are not treated in detail in this Article, it will suffice to say that many of them are absent or insufficiently developed in jurisdictions within the Islamic economic sphere. The concept of binding precedent is often totally absent. Decisions are rarely published. In many jurisdictions, each case is considered de novo and without regard to other decisions that have been rendered in similar cases. Judges and other adjudicators are afforded wide and unfettered discretion in determining cases. And the time frame for enforcement is frequently so long that it precludes effective remedies in fast-moving markets such as the capital markets. Each of these factors is frequently cited by international securitization and capital markets institutions as a reason for their reluctance to engage in capital markets initiatives in the Islamic

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11 Examples of Shari'ah-incorporated jurisdictions include Egypt, Iraq, Jordan, Kuwait, Saudi Arabia, Syria, the United Arab Emirates, and Yemen. Examples of purely secular jurisdictions include the US, England, France, Germany, most other European jurisdictions, Japan, and South Korea.

12 This Article does not consider the important topic of the regulation of capital markets activities, such as securities issuance, standards applicable to investment companies, capital adequacy standards, prudential standards, trading activities, brokerage activities, and market manipulation regulations.
economic sphere. Each of these factors is also cited by major international rating agencies as problematic and among the primary reasons that securitization sukuk have not yet been rated. These are substantial impediments to the growth of the securitization markets (and thus the capital markets, including secondary markets) in these jurisdictions, warranting immediate focus on the removal, or a satisfactory alleviation, of these impediments.

Whatever the current structural deficiencies, enforcement remains the immediate practical issue. People will continue to transact business, and sukuk markets will continue to develop rapidly. Some market participants will choose to structure transactions in lower-risk jurisdictions, where certainty as to enforceability issues is greatest. Others will choose higher-risk jurisdictions, in which there is less certainty as to enforceability issues, as venues for these transactions. The market will price transactions accordingly, at least in the longer term. In any case, an understanding of enforceability issues is a necessity.

The movement toward asset securitization sukuk in jurisdictions within the Islamic economic sphere is likely to be gradual given the necessity of considerable legal reform as a prerequisite to the issuance of satisfactory legal opinions. However, there are organized efforts to define the necessary legal reforms. For example, the Islamic Financial Services Board ("IFSB") is undertaking a broad survey of trust laws, securities laws, capital markets laws, and bankruptcy laws in an effort to identify and suggest necessary legal reforms so as to facilitate the development and growth of capital markets, including sukuk issuances and secondary trading (which is an important first step in implementing the proposal set forth in this Article). Efforts of this type will ultimately facilitate the issuance of asset securitization sukuk in the Islamic economic sphere.

It seems probable that the initial asset securitization sukuk issuances will emanate from United States and European jurisdictions. There are likely to be securitizations of assets in those jurisdictions, rather than assets located in jurisdictions within the Islamic economic sphere. Some of the reasons for this include: (a) increased involvement in Islamic finance by international banks and investment banks; (b) those banks and investment banks have substantial Shari’ah-compliant assets (such as leased equipment and real estate) that are desirable investments for Shari’ah-compliant investors; (c) those banks and investment banks have significant securitization experience; and (d) importantly, those banks and investment banks can obtain the necessary ratings because the transactions can be structured entirely within jurisdictions where necessary legal opinions are readily obtainable. Unrated securitization sukuk may involve assets in jurisdictions within the Islamic economic sphere, but the issuers of those sukuk are likely to be located outside those jurisdictions in order to minimize true sale, bankruptcy, and other enforceability issues. The market for unrated
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sukuk, however, is likely to be dwarfed by the market for rated sukuk in the medium- to long-term.

Prohibitions on *riba* (interest) and on the sale of instruments that do not represent fractional undivided ownership interest in tangible assets present a seemingly insurmountable problem for securitization of many categories of conventional receivables, such as conventional mortgages, patent and other royalty payments, and credit card receivables. Many of these receivables will never be made Shari'ah-compliant in and of themselves, but it seems likely that bifurcated structures will be developed to securitize these assets, just as conventional interest-based financing is now used in most international Shari'ah-compliant real estate and private equity financings.

**II. ENFORCEABILITY OF THE SHARI’AH**

**A. EXPECTATIONS AS TO RISK ALLOCATIONS AND RESPONSIBILITIES**

Islamic finance in the modern era has passed through a period of “revival and recovery” to a period of “transformation and adaptation.” The current period of transformation and adaptation is characterized by a significant number of Islamic and conventional multinational banks and financial institutions as participants, participation by both Shari’ah-compliant and conventional participants, the development of significant practical experience by Muslim jurisprudents in an expanding range of financial and commercial transactions of increasing complexity, a growing discourse on Islamic finance in the English language, a movement toward consensus among Shari’ah scholars (*jima*), the acceptance and implementation of the concept that the nominate contracts may be thought of as building blocks rather than static formulations, increasing internationalization and globalization, a transactional base that entails conformity with both the Shari’ah and at least one body of secular law, diversification of Shari’ah-compliant products, and increased sophistication of those products.\(^{13}\)

These factors direct attention more immediately and more precisely to the issue of whether the principles and precepts of the Shari’ah will be legally enforced in any given circumstance or jurisdiction with respect to any structure,

product, or transaction.\textsuperscript{14} Of course, this is occasioned by the focus of all concerned with Shari’ah-compliant transactions—be they seeking such compliance or indifferent to such compliance—with the degree of certainty, consistency, predictability, and transparency of the Shari’ah-compliant structure, product, or transaction, and with the functioning of the relevant legal regimes as risk allocators.\textsuperscript{15} Much of the history of commercial law in the United States, England, France, and many other countries that have been successful in promoting commercial interests (essentially “exporting” their law as a governing law of commercial and financial transactions) relates to the certainty, consistency, predictability, and transparency of the legal system and legal determinations in respect of commercial and financial matters, as well as the principles of risk allocation, fairness, and justice.

Consideration of illustrative sukuk transactions will help sharpen understanding of issues pertaining to enforceability of the Shari’ah in different

\textsuperscript{14} Consider a few related questions. With respect to enforcement of the Shari’ah in purely secular jurisdictions (as herein defined), consider the following: How can a Shari’ah-compliant investor or a Shari’ah supervisory board considering the structure of, or documentation for, a Shari’ah-compliant fund or transaction in the Western economic sphere be confident that the Shari’ah will be enforced? Can there be a truly Shari’ah-compliant transaction at all in the Western economic sphere if the relevant courts in the jurisdiction within the Western economic sphere will be applying the secular law of that jurisdiction in the interpretation and enforcement of the documentation for that transaction? Will a court in the Western economic sphere or a purely secular jurisdiction ever enforce the Shari’ah? How would a court in a purely secular jurisdiction within the Western economic sphere know what the Shari’ah is with respect to any matter or dispute? How does the injection of the Shari’ah into the secular law context affect the certainty and predictability of the outcome that is essential to the effective operation of a legal system in the commercial context? Will financial institutions and non-Muslim transactional parties be willing to approve the enforceability of documents in accordance with the Shari’ah where they have essentially no knowledge of the Shari’ah and no confidence that there will be any contractual or economic certainty in a transaction where the Shari’ah is to be ascertained, interpreted, and enforced by a court in a purely secular jurisdiction within the Western economic sphere that likewise has no knowledge of the Shari’ah?

And with respect to a Shari’ah-incorporated jurisdiction (as herein defined) and the greater involvement of Western financial institutions in a wide range of transactions, including sukuk transactions, consider the following: What is the Shari’ah for purposes of any given jurisdiction? How will the Shari’ah be enforced in different jurisdictions? How will variances in enforcement of the Shari’ah affect transactional standardization and business practices?

\textsuperscript{15} See Peter L. Bernstein, \textit{Against the Gods: The Remarkable Story of Risk} 205 (John Wiley & Sons 1996). Mr. Bernstein makes note of the importance of contracts in the reduction of risk. In summarizing the explanation developed by Kenneth Arrow and Frank Hahn of the relationship between money, contracts and uncertainty, he states, “the past and the future are to the economy what woof and warp are to a fabric. We make no decision without reference to a past that we understand with some degree of certainty and to a future about which we have no certain knowledge. Contracts and liquidity protect us from unwelcome consequences . . . .” Id. The essence of these explanations and arguments as to the importance of contracts is predicated on a series of presumptions as to the stability and predictability of enforcement of those contracts.
jurisdictions. Assume the following: a sukuk issuance that is a securitization of assets located in a Shari’ah-incorporated jurisdiction; the asset originator is located in that same jurisdiction; the SPV sukuk issuer is located in a purely secular jurisdiction that allows for the choice of applicable law for financial transactions; and the sukuk is sold to both Muslim and non-Muslim investors throughout the world. The applicable laws will include those of the Shari’ah-incorporated jurisdiction, where the originator and the assets are located, particularly with respect to whether there has been a “true sale” of the assets by the originator to the special purpose issuer. The bankruptcy laws both of the jurisdiction where the originator and the assets are located and of the jurisdiction in which the issuer is located will be applicable to the transaction. Further, it is likely that the securities laws of the issuer’s jurisdiction as well as those of the various jurisdictions of the purchasers of the sukuk will be applicable in certain circumstances.16

In most transactions of this type, transactional risks are high and profit margins are thin. Transactional standardization is one of the methods of defining and reducing risk, reducing transaction costs, and preserving margins. Equivalent conventional securitization transactions are, for the most part, quite standardized in terms of (a) the relative rights and remedies of the parties, (b) the terms of many financial and commercial risk allocations, and (c) the legal documentation. For example, in non-Islamic transactions, the same forms of financing documents are used with minimal change from one transaction to the next. These documents have been used for many years and have been the subject of considerable interpretive litigation over the years. Thus, there is great certainty, consistency, predictability, and transparency regarding the interpretation and implementation of the transaction, any documentary

provision, and the rights, obligations, and remedies of all of the parties in a 
broad range of circumstances—in other words, with respect to risk allocations 
and responsibilities. Shari'ah-compliant transactions of this type have not yet 
obtained an equivalent degree of standardization or concomitant certainty, 
consistency, predictability, or transparency, especially as to enforcement of the 
Shari'ah. The Shari'ah-compliant investors and the Shari'ah supervisory board 
will have, as a central focus, the degree of certainty, consistency, and 
predictability of enforcement of the Shari'ah. The other participants in the 
transaction (especially non-Muslim Western participants) may well be indifferent 
to compliance with the Shari'ah, although they will undoubtedly not be 
indifferent to the effect that compliance with the Shari'ah will have on their 
respective rights, obligations, and remedies and on the degree of certainty, 
consistency, predictability, and transparency inherent in the Shari'ah-compliant 
transaction as a whole.

At the commencement of these Shari'ah-compliant transactions in the 
United States or Europe, all parties to the transaction will have moved away 
from the state of certainty and predictability to which they are accustomed. 
Nevertheless, the Shari'ah-compliant Muslim investors are likely to be more 
comfortable with the structure of the transaction at its inception since it will 
likely be a sukuk structure that the investor has worked with previously. These 
Shari'ah-compliant Muslim investors may also be quite familiar and comfortable 
with the applicable secular law. The non-Muslim participants, however, will be 
notably uncomfortable at this time: they will likely not know more than a few 
material points about the Shari'ah, and they will be using a structure that is 
unique to their experience, that is non-standard, and that is well outside their 
customary realm of certainty and predictability. Bankers, by nature and training 
being abhorrent of risks (particularly risks that they cannot control or 
understand, let alone risks that are unique to their experience) are usually the 
most uncomfortable participants in the transaction.

17 There is widespread, and spirited, debate regarding the “need” for standardization in the Islamic 
finance field. This is certainly not a new debate for Muslim jurisprudents: witness the intellectual 
rigor of the debate over the centuries among Islamic jurists of even the four main schools of 
Sunni Islam: the Hanafi, Hanbali, Shafi'i, and Maliki schools. Recent English language works that 
highlight this debate, by way of a comparison of the positions of the different schools of Islamic 
jurisprudence with respect to specific matters, are Frank E. Vogel and Samuel L. Hayes, III, 
Islamic Law and Finance: Religion, Risk, and Return (Kluwer 1998), and Wahbah al-Zahayli, Financial 
Transactions in Islamic Law (Syria: Dar Al Fikr 2003) (Mahmoud A. El-Gamal, trans), which is a 
translation of Volume 5 of Al-Fiqh Al-Islami wa `Adillatuh, 4th ed (1997) and appears in two 
volumes. For examples of the current debate with respect to the need for standardization on a 
broader scale within the Islamic finance industry one need only attend any of the many Islamic 
finance conferences. See also Majid Dawood, Scholastic Congestion, 3 Islamic Banking & Fin 10 
(2004).
Each of the transactional participants will look to the "law" governing this transaction to determine whether the agreed-upon rights and obligations of, and remedies available to, each of the parties (in other words, the agreed-upon allocations of risks) will be sustained and enforced in a predictable, consistent, certain, and transparent manner. A primary function of law—including the Shari'ah as "law" for the purposes of this Article—in the commercial and financial realm is to provide the greatest degree of certainty, consistency, predictability, and transparency and to sustain and enforce the determinations of the parties in a given transaction with respect to risk allocations and responsibilities. These matters are a primary focus in examining enforceability issues.

Of course, certainty, consistency, predictability, and transparency are, to some extent, matters of individual perception based upon the past experience of the individual participants. For a range of reasons, the perceptions of most participants will be based upon financing techniques and structures that have been developed in the Western interest-based economic and legal system. Some of those reasons include: (a) the dominance of the Western interest-based economic system over the last few centuries; (b) the predominance of United States and European financial institutions, lawyers, and accountants in the development and refinement of the most widely used financing techniques; (c) the refinement and exportation of Anglo-American law; (d) the relative infancy of modern Islamic finance; (e) the lack of familiarity with the operation of legal systems in the jurisdictions of the Islamic economic sphere; and (f) the general lack of knowledge of, and familiarity with, the Shari'ah. Those perceptions are also influenced by the existence of "standardized" practices and structures, including "standardized" contracts, applicable to many of the activities that comprise a financing. Practices, structures, and contracts become "standardized" because of the economic efficiencies that they facilitate, particularly with respect to risk allocation, risk coverage, and minimization of transactional costs. Of course, most of those standardized practices, structures, and contracts were developed in, and have evolved within, a Western interest-based paradigm and reflect little, if any, sensitivity to the principles and precepts of the Shari'ah. Similarly, the contracts will be enforced in a legal system that has developed and evolved in response to the needs of an interest-based economic system.

Each of the participants will come to the financing transaction bound by their existing institutional perceptions and practices with respect to matters such as risk allocation, risk coverage, underwriting criteria, and accounting treatment. Each must continue to operate within an existing secular legal and regulatory framework, and that framework has probably shaped many of the embedded institutional practices. Each participant will have strong expectations, based upon past "best practices" within its realm of experience, as to the enforceability of the many contracts that comprise the financing transaction. Frequently, that
means that parties will desire to have the contracts governed by English or New York law, rather than the law of the host country, especially if the host country is a Shari'ah-incorporated jurisdiction or within the Islamic economic sphere.

Participants in Shari'ah-compliant transactions will include parties that proceed from, and are focused on, structures, methodologies, and documents prepared from a Western interest-based perspective. However, by definition, these transactions will also include participants that proceed from a different set of principles and precepts: those embodied in the Shari'ah. Thus, in many cases—and increasingly so—Shari'ah-compliant financings will utilize structures, methodologies, and documents that allow both Muslim and non-Muslim, particularly Western, parties to operate within a sphere of certainty, consistency, predictability, and transparency that is acceptable to those parties.

B. PUBLIC LAW AND PRIVATE LAW IN DIFFERENT JURISDICTIONS

Legal systems in the various countries of the Islamic economic sphere were, and are, primarily secular. Often, economic and legal structures were, and are, the product of legislation or royal decree, and some, if not most, of those structures remain unclear under, in conflict with, or contrary to the Shari'ah. Most of those legal systems have some provision or conception incorporating the Shari'ah into the legal structure, frequently as "a" or "the" paramount law or source of law. However, the degree to which the Shari'ah has been incorporated into the secular law of the various Shari'ah-incorporated jurisdictions varies widely. Historically, the Ottoman Empire adopted many aspects of the French commercial code by 1830, and thereafter adopted many other French codes. Civil law remained largely untouched by this Westernization process despite the compilation of the Majelle. The reference is to the entitled Majalat al-Ahkam al-Adaliyah, originally prepared by Ottoman scholars of the Hanafi school of Islamic jurisprudence for use throughout the courts of the Ottoman Empire circa 1839/1285 AH. This work was translated into the English language by an accomplished British jurist and scholar of Arabic, Judge C.A. Hooper, and was published in 1936. Entitled The Civil Law of Palestine and Trans-Jordan (Gaunt 2000), and long out of print, the work was again published, in installments, by the Arab Law Quarterly in 1986. The Majelle was a codification of civil law following a Western model, but the Majelle itself was comprised of, and based upon, the Shari'ah as interpreted by the Hanafi school of Islamic jurisprudence. Since 1949, Egypt and Syria have adopted Westernized codifications of certain laws, while retaining the influence of the Shari'ah in many substantive areas. In each of these jurisdictions, the Shari'ah is expressly designated as a source of law. In Egypt, the Shari'ah is to be consulted by a judge after considering the civil code and custom. In Syria, the Shari'ah is to be consulted prior to examination of custom. Similar concepts are found in the Civil Code of 1976 of Jordan. Kuwait and the United Arab Emirates are examples of nations that have incorporated significant portions of the Shari'ah into their codes. In certain jurisdictions, such as Saudi Arabia and Oman, there is no civil code and the role of the Shari'ah is predominant, including in respect of contracts. The Kingdom of Saudi Arabia recognizes the
and to what extent the Shari‘ah will be enforced even in Shari‘ah-incorporated jurisdictions within the Islamic economic sphere.

The distinction between Shari‘ah-incorporated jurisdictions and purely secular jurisdictions is important in addressing the issue of when, and under what circumstances, the Shari‘ah is an enforceable element of a contract under the laws of a specific nation or jurisdiction.\(^{19}\)

In the Shari‘ah-incorporated jurisdictions, provisions of the Shari‘ah are either literally incorporated into the text of the substantive law of the nation or incorporated as an interpretive matter by the courts or other enforcement bodies. In either case, a contract that is governed by the law of the Shari‘ah-incorporated jurisdiction will be enforced in accordance with the Shari‘ah to the extent that the Shari‘ah is so incorporated and applicable, whether or not the specific substantive legal provisions are referenced in the contract. Thus, in a Shari‘ah-incorporated jurisdiction, the parties cannot, by contract, alter the applicable Shari‘ah provisions, and it is not necessary for the parties to specifically incorporate applicable Shari‘ah provisions as they will be incorporated into the contract by operation of law.

In a purely secular jurisdiction, on the other hand, the governing law, by itself, will not specifically incorporate any of the Shari‘ah. In the form of the contract, sophisticated parties to a commercial financing transaction are permitted to write their own “law” for the transaction, and the contract itself is “the law of the land” with respect to that transaction.\(^{20}\) Thus, if the parties desire to implement the Shari‘ah, they will have to draft the contract in accordance with the relevant Shari‘ah principles.\(^{21}\) If New York or English law, or the law of

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\(^{19}\) For the purposes of this Article, the distinctions between the various Shari‘ah-incorporated jurisdictions are ignored unless otherwise indicated.

\(^{20}\) Assuming, of course, that the contract does not violate public policy or run afoul of other mandatory legal requirements.

\(^{21}\) In the author’s experience, virtually all of the contracts in Shari‘ah-compliant transactions are drafted so as to be governed by New York, English, German, French, or other secular law. Those contracts are drafted so as to embody, and be compliant with, the Shari‘ah as defined by the
any other purely secular jurisdiction, is chosen as the governing law of a contract, the court will enforce the contract subject to that law, in accordance with the contract's terms. If the contract in question is drafted in accordance with the Shari'ah (for example, to include, as text but without a designated reference to the Shari'ah, the relevant Shari'ah principle), the New York or English court, applying the relevant local law, will enforce the Shari'ah provisions as written in the contract. Alternatively, but with less certainty and predictability, the parties to a contract in a purely secular jurisdiction could choose to apply the law of a Shari'ah-incorporated jurisdiction, and thereby ensure that the contract would be enforced in accordance with the Shari'ah to the extent that the Shari'ah is incorporated in, or comprises a part of, the laws of such Shari'ah-incorporated jurisdiction.

In analyzing the issues pertaining to enforceability of provisions of contracts in Shari'ah-compliant transactions under the Shari'ah, it is necessary to consider a number of factors, including: (a) existing law, including relevant case law; (b) current transactional practice relating to the construction and drafting of contracts in Shari'ah-compliant transactions in different jurisdictions; (c) current transactional practice with respect to legal opinions; and (d) to the extent accessible, the matters of certainty, consistency, and predictability in Shari'ah-compliant transactions in different jurisdictions. In considering these factors, this Article makes the assumption that the transactions discussed have been structured and documented in accordance with the Shari'ah and that such structures and all documentation have been reviewed and approved by a Shari'ah supervisory board.

III. ENFORCEABILITY OF THE SHARI'AH: CASE LAW

A. SHAMIL BANK V BEXIMCO: A RECENT ENGLISH COURT DECISION

Focusing on enforceability issues in purely secular jurisdictions, such as England, other European jurisdictions, and the United States of America, litigation of a Shari'ah-compliant transaction using the law of the purely secular jurisdiction as the governing law will raise questions of whether, when, and under what circumstances a secular court will apply the Shari'ah in interpreting

Shari'ah scholars supervising the individual transactions, and the contracts make no mention of the Shari'ah. That is not the exclusive approach, however, as evidenced by the contracts involved in the cases discussed in section III of this Article; the "or" in the related sentence is of significant import in this context.

22 For an example of some of the incorporation and choice of law requirements, see *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd*, 1 WLR 1784 (CA 2004) (UK), as discussed in section III of this Article.
the contracts involved in that transaction. A recent appeals court decision in an
English case, *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd*, focuses on
the enforceability issue of a Shari‘ah-compliant transaction in which the
governing law provisions of the relevant legal contracts indicate that the
contracts are governed by the laws of England, subject to the Shari‘ah. This case
provides a good starting point for achieving an understanding of how
enforceability issues are addressed in a purely secular jurisdiction.

In 1995, two companies in the Beximco group of companies ("Beximco
Companies") executed a *murabaha* agreement ("1995 Murabaha Agreement") with
Shamil Bank pursuant to which Shamil Bank advanced funds to the Beximco
Companies for the purchase of specified goods. The 1995 *Murabaha*
Agreement was guaranteed by two directors of the Beximco Companies and by the parent
company of the Beximco Companies ("Guarantors"). One of the Beximco
Companies made several payments under the 1995 *Murabaha* Agreement in
accordance with a payment schedule to that agreement. In 1996, the Beximco
Companies entered into a second *murabaha* agreement ("1996 *Murabaha*
Agreement") with Shamil Bank, and funds were advanced pursuant to the 1996
*Murabaha* Agreement. The second of the Beximco Companies made various
payments to Shamil Bank pursuant to the 1996 *Murabaha* Agreement and its
related payment schedule.

By late 1999, both Beximco Companies were in admitted default under the
1995 *Murabaha* Agreement and the 1996 *Murabaha* Agreement (collectively,
"*Murabaha* Agreements"). In 1999, the Beximco Companies entered into two
Exchange in Satisfaction and User Agreements with Shamil Bank, which were
later amended in 2001 and 2002 (as amended, "*Ijara* Agreements"). Pursuant to
the *Ijara* Agreements, certain assets of the Beximco Companies were transferred
to Shamil Bank in satisfaction of the *Murabaha* Agreements. The Beximco
Companies were granted the right to use those transferred assets, and the
Beximco Companies agreed to make payments to Shamil Bank in respect of
such use. Each of the *Ijara* Agreements was guaranteed by the guarantors.

Pursuant to the constitutional documents of Shamil Bank, the Shamil Bank
Shari‘ah Supervisory Board was charged with ascertaining that the "investments
and activities" of Shamil Bank conform to the Shari‘ah. The Shamil Bank
Board of Directors had the responsibility, pursuant to the constitutional
documents, to “ensure that all the investments and other business transactions
[of the Bank] ha[d] been referred” to the Shari‘ah supervisory board. It is not
clear from the reported decision whether or not the Shamil Bank Shari‘ah

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23 Id.
24 Id ¶ 7 (quoting Clauses 35 and 36 of the Articles of Association of Shamil Bank).
25 Id ¶ 7 (quoting Clause 36 of the Articles of Association of Shamil Bank).
Supervisory Board reviewed the precise transactions, and related documentation, pertaining to the Murabaha Agreements, the Ijara Agreements, and the related guarantees. This presumably would be a factual matter to be determined at a trial.

In mid-2002, both of the Beximco Companies were in default under the Ijara Agreements and defined “termination events” had occurred thereunder. Shamil Bank provided notices of default and made claims for approximately $49.7 million on the Ijara Agreements and the guarantees provided by the guarantors. The lower court awarded judgment to Shamil Bank for approximately $49.7 million. The lower court determined that it was not necessary to concern itself with Shari‘ah principles.26

The governing law provision of each of the Ijara Agreements reads: “Subject to the Glorious Sharia’a, this Agreement shall be governed by and construed in accordance with the laws of England.”27 The governing law provision of each of the guarantees reads that such guarantee “is governed by and shall be construed in accordance with English law” (there being no reference to the Shari‘ah).28

The critical issue at the appellate court level, as well as at the lower court level, was whether the governing law clause in the Ijara Agreements required the consideration of the Shari‘ah. The appellate court, like the lower court, determined that the governing law clause did not require consideration of the Shari‘ah.29

The appellate court opinion begins by noting that an English court must interpret a contract in accordance with the commercial purpose of the parties and the contract, and must thus take cognizance of “the genesis of the transaction, the background, the context, the market in which the parties are operating” and similar factors.30 In the instant case, this requires recognition of the fact that the contracts at issue (in other words, both the Murabaha Agreements and the Ijara Agreements) were intended to provide working capital financing with long-term repayment provisions and were to be binding upon the parties to those contracts.31 Further, and in accordance with that same principle in respect of commercial purpose, the court noted that:

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26 Id ¶ 38.
27 Id ¶ 1.
28 Id ¶ 23.
29 Id ¶ 55.
30 Id ¶ 46 (quoting Lord Wilberforce in Reardon Smith Line Ltd v Yngvar Hansen-Tangen, 1 WLR 989, 995–96 (HL 1976) (UK)).
31 Id ¶ 47.
In so far as each of the clauses provides in clear terms that “this agreement shall be governed by and construed in accordance with the laws of England,” the proviso that such provision shall be “subject to the principles of the Glorious Sharia’a” should be approached on a basis which is reconcilable with the purpose evident from the words which follow, rather than operating to defeat such purpose.\(^\text{32}\)

Turning to the governing law issues, the court noted that there can be only one law governing enforceability of the provisions of the contracts at issue.\(^\text{33}\) By concession in this case, that law is the law of England and not both English law and the Shari’ah. The opinion notes that the Rome Convention has the force of law in the United Kingdom,\(^\text{34}\) and that the Rome Convention allows the parties to a contract to choose the law applicable to that contract,\(^\text{35}\) but that the law so chosen must be the law of a country.\(^\text{36}\) The court also notes that Article 1.1 of the Rome Convention “is not on the face of it applicable to a choice between the law of a country and a non-national system of law, such as the lex mercatoria, or ‘general principles of law,’ or as in this case, the law of Sharia’a.”\(^\text{37}\) Concurring with the lower court, the appellate court characterizes the Shari’ah as a set of “Islamic religious principles”\(^\text{38}\) and “religious and moral codes,”\(^\text{39}\) rather than laws of a nation.

The opinion then addresses the concept that the law of a nation (such as England) may govern a contract, but that contract may incorporate provisions of another foreign law or a set of rules as terms of the contract whose enforceability is to be determined by such national law. The opinion cites examples that are discussed in a leading text on conflicts of laws, Dicey & Morris, as put forth by the Beximco Companies:

\[\text{Id \S 47.}\]
\[\text{Id \S 48.}\]
\[\text{Id \S S 40 (relating to the lower court decision and noting that the Rome Convention has the force of law in the United Kingdom by virtue of section 2(1) of the Contracts (Applicable Law) Act of 1990). Id \S 42-43 (noting that the Beximco Companies accept the principle of a single governing law based upon the Rome Convention).}\]
\[\text{Id \S 48 (citing Article 3.1 of the Rome Convention: “A contract shall be governed by the law chosen by the parties.”) (emphasis omitted). See also id \S 40 for a summary of the lower court’s similar finding.}\]
\[\text{Id (citing Article 1.1 of the Rome Convention: “The rules of this Convention shall apply to contractual obligations in any situation involving a choice between the laws of different countries.”). See also id \S S 40, 42-43 for a summary of the lower court’s similar finding on this issue of interpretation.}\]
\[\text{Id \S 48 (emphasis omitted).}\]
\[\text{Id \S 54. For the lower court’s characterization of this matter, see id \S 40.}\]
\[\text{Id \S 55. For the lower court’s characterization of this matter, see id \S 40.}\]
It is open to the parties to an English contract to agree, e.g. that 
the liability of an agent to his principal shall be determined in accordance 
with the relevant articles of the French Civil Code. In such a case the 
foreign law becomes a source of law upon which the governing law may 
draw. The effect is not to make French law the governing law of the 
contract but rather to incorporate the French articles as contractual terms 
into an English contract. This is a convenient "shorthand" alternative to 
setting out the French articles verbatim. The court will then have to 
construe the English contract, "Treading into it as if they were written into 
the words" of the French statute.

It often happens that statutes governing the liability of a sea carrier, 
such as the former Harter Act in the United States, or statutes implementing 
the Hague Rules . . . are thus "incorporated" in a contract governed by a 
law other than that of which the statute forms a part. The statute then 
operates not as a statute but as a set of contractual terms agreed upon 
between the parties. The parties may make an express choice of one law 
(e.g., English law) and then incorporate terms of a foreign statute. In such a 
case the incorporation of a foreign statute would only have effect as a 
matter of contract.40

Turning to the instant case, the opinion finds that the generality of the 
incorporation of contractual terms, if any, pursuant to the phrase "[s]ubject to 
the Glorious Shari'ah" is insufficient to identify specific black letter provisions of 
the Shari'ah, and thus ineffective.41

The general reference to principles of Sharia in this case affords no 
reference to, or identification of, those aspects of Sharia law which are 
intended to be incorporated into the contract, let alone the terms in which 
they are framed. It is plainly insufficient for the defendants to contend that 
the basic rules of the Sharia applicable in this case are not controversial. 
Such "basic rules" are neither referred to nor identified. Thus the reference 
to the "principles of . . . Sharia" stands unqualified as a reference to the 
body of Sharia law generally. As such, they are inevitably repugnant to the 
choice of English law as the law of the contract and render the clause self-
contradictory and therefore meaningless.42

Finally, so far as the "principles of . . . Sharia" are concerned, it was the 
evidence of both experts that there are indeed areas of considerable 
controversy and difficulty arising not only from the need to translate into 
propositions of modern law texts which centuries ago were set out as 
religious and moral codes, but because of the existence of a variety of 
schools of thought with which the court may have to concern itself in any 
given case before reaching a conclusion upon the principle or rule in 
dispute. The fact that there may be general consensus upon the proscription

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40 Id ¶ 50 (citing Albert Venn Dicey and John Humphrey Carlile Morris, 2 The Conflict of Laws §§ 32-
086–087 (Sweet & Maxwell 13th ed 2000)).

41 Id ¶¶ 51–52.

42 Id ¶ 52 (emphasis omitted).
of Riba and the essentials of a valid Morabaha agreement does no more than indicate that, if the Sharia law proviso were sufficient to incorporate the principles of Sharia law into the parties' agreements, the defendants would have been likely to succeed. However, since I would hold that the proviso is plainly inadequate for that purpose, the validity of the contract and the defendants' obligations thereunder fall to be decided according to English law. It is conceded in this appeal that, if that is so, the first and second defendants [i.e., the Beximco Companies] are liable to the bank.43

B. DISCUSSION OF SHAMIL BANK v BEXIMCO

Before moving to other aspects of enforceability in the context of a Shari'ah-compliant transaction, it is worth noting a few aspects of the reasoning in the Shamil Bank v Beximco case.

First, in accordance with conceptions of national sovereignty and the concepts of nations, the near universal principle is that the law governing a contract (and most other matters) is the law of a nation as precisely defined in that nation. This law will include both substantive legal principles, such as with respect to the nature of contracts and their interpretation, and procedural laws, such as with respect to how a given claim brought in the courts of that nation is enforced under the laws of that nation. As noted in this Article, certain jurisdictions—in other words, the Shari'ah-incorporated jurisdictions—do incorporate the Shari'ah into the national law, either generally or in specific instances. However, even in Shari'ah-incorporated jurisdictions, the degree of incorporation varies considerably and is often general rather than specific. As a general—and near universal—matter, national law will govern the interpretation of contracts.

Second, the laws of many nations allow the parties to a contract to choose the law which will be applicable to the enforcement of that contract. The Rome Convention that is cited in the Shamil Bank v Beximco opinion is one of the most significant embodiments of that principle. In most legal systems, there are "conflicts of laws" and "choice of laws" concepts that address the circumstances in which different governing laws may be chosen and enforced. Again, there are variations in this concept, especially with regard to enforcement of foreign judgments obtained in foreign courts or under foreign law and with regard to the concept of "public policy" of a given nation as it relates to the structuring and enforcement of contracts.44

Third, as a general matter, the laws of many nations allow the parties to a contract to incorporate foreign laws, codes, and rules into a contract governed

43 Id ¶ 55 (emphasis omitted).
44 See, for example, McMillen, A Rahn'Adl Collateral Security Structure at 1199–1203 and sources cited therein (cited in note 13).
Contractual Enforceability Issues

by the laws of such nations, although they also require some degree of specificity to effect that incorporation. Any such incorporation is usually considered to be an incorporation of specific contractual terms, rather than a modification of the governing law provision itself. The ruling in *Shamil Bank v Beximco* is consistent with those principles. The court in *Shamil Bank v Beximco* implied that it would have no objection to the incorporation of specific aspects of the Shari‘ah—analogous to the incorporation of the French Civil Code, the Hague Rules, or the Harter Act—if the terms to be incorporated were adequately specified. This is consistent with the laws of state jurisdictions in the United States and the laws of most other European jurisdictions.

Fourth, the laws of most nations allow the parties to a contract, particularly a commercial contract between sophisticated parties, to agree to such contractual terms and conditions as the parties deem appropriate. Of course, there are certain limitations, such as those pertaining to illegal acts or acts contrary to public policy, which cannot be the subject of a valid and enforceable contract. Another set of limitations relates to contractual contravention of a paramount law, such as a constitution or, in certain Shari‘ah-incorporated jurisdictions, the Shari‘ah itself. Similarly, there are unwaivable and mandatory legal provisions in the laws of most nations, particularly in respect of matters where the sophistication and bargaining power of the parties are disparate. Examples of the latter type of provisions include certain consumer protection, environmental protection, landlord-tenant, and public policy laws that may not be altered or waived by contract.

The foregoing would seem to allow express incorporation of the Shari‘ah into a contract governed by the national law of a purely secular jurisdiction if the incorporation is sufficiently specific and is structured as an incorporation of contractual terms rather than use of the Shari‘ah as a blanket governing law provision. The difficulty, at present, is that an adequate degree of specificity may be difficult to achieve given the absence of compilations of Shari‘ah principles and precepts. The development of “model laws” for each of the main nominate contracts and transactional structures would address the incorporation issue in terms of specificity.\(^4\) An alternative, and one that seems dominant in current practice, is to avoid incorporation of, or direct reference to, the Shari‘ah, but to draft the relevant contracts so that they are Shari‘ah-compliant in the opinion of the relevant Shari‘ah scholars while using secular national governing law clauses.

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IV. TRANSACTIONAL PRACTICE: LEGAL OPINIONS ON ENFORCEABILITY

A. LEGAL OPINIONS IN FINANCING TRANSACTIONS GENERALLY

In almost every financial transaction, including Shari'ah-compliant transactions, the parties will require that their counsel or opposing counsel provide a series of legal opinions. One set of legal opinions will address the due formation and valid existence of the participating entities under relevant applicable law. This threshold set of opinions is generally referred to as the “entity authority” set of opinions. Another set of opinions, and those that are the focus of this Article, will address the validity, binding effect, and enforceability of the relevant documents. This set of opinions is generally referred to as the “enforceability” or “remedies” set of opinions.

B. THE “ENFORCEABILITY” OR “REMEDIES” OPINION

“A remedies opinion deals with the question of whether the provisions of an agreement will be given effect by the courts.”46 The essence of this opinion is that each of the “undertakings”47 in the contracts is enforceable under the designated governing law, and the standard formulation is that the agreements are valid and binding obligations of the subject company (“Company”), enforceable against the Company in accordance with their terms. This opinion is customarily delivered at the closing of the transaction, and its delivery is usually a condition precedent to that closing.


47 The TriBar Report notes that all undertakings in the agreements with respect to which the enforceability opinion relates are covered by the opinion. TriBar Report, 53 Bus Law at 621 (cited in note 46). The TriBar Report notes that coverage of all undertakings is based upon New York custom and practice, and that not all jurisdictions so interpret opinions. The variance noted in note 69 is that of the Committee on Corporations, 1989 Report of the Committee on Corporations of the Business Law Section of the State Bar of California Regarding Legal Opinions in Business Transactions, 45 Bus Law 2169 (1990). That report endorses a narrower definition of the scope of the enforceability opinion, limiting the coverage of the opinion to only “material” provisions of the agreements that are the subject of the enforceability opinion. It is important to be familiar with the scope of the enforceability opinion in the governing law jurisdiction.
As noted in the TriBar Report, the remedies opinion covers three distinct, but related, matters:

(a) it confirms that an agreement has been formed;
(b) it confirms that the remedies provided in the agreement will be given effect by the courts; [and]
(c) [it] describes the extent to which the courts will enforce the provisions of the agreement that are unrelated to the concept of breach. 48

Exceptions and exclusions to the opinion are appropriate in various circumstances, and those exceptions and exclusions are set forth in the opinion itself. For example, one or more exceptions may be required in respect of the portion of the opinion described in clause (b) above if either: (i) “under applicable law the opinion recipient will not have a remedy for a breach of any ‘undertaking’ by the other party to the agreement” or (ii) “a remedy specified in the agreement will not be given effect by the courts under the circumstances contemplated.” 49 An example of the latter circumstance is the concept of “specific enforcement” as being a remedy under a contract. As noted in the TriBar Report, this means “as a practical matter, that a court will consider whether to provide specific performance as a remedy” and not that the court will grant specific performance. 50

The types of “undertakings” to which the remedies opinion relates may be categorized into three groups. The first group (“obligations provisions”) are those provisions of the agreement that obligate the Company to perform an affirmative act, but say nothing about what will happen if the Company fails to perform those acts. An example from an ijara-based transaction is the requirement in the ijara that the lessee pay rent. As applied to these provisions, the enforceability opinion “means that a court will either require the Company to fulfill its undertakings as written or grant damages or some other remedy in the event of a breach.” 51

The second group (“available remedies”) are those provisions that specify a remedy if the Company fails to perform particular undertakings. The stated remedies may be affirmatively stated (for example, the requirement to pay liquidated damages) or, more frequently, set forth as the right of a party to take action (for example, reduce the interest of a defaulting partner in a partnership, exercise a put option, or sell certain property). “For those provisions, the

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49 Id.
50 Id at 620 n 64.
51 Id at 621. Note that a “representation” in a contract is not an “undertaking.”
remedies opinion means that a court will give effect to the specified remedies as written. 52

The third group ("ground rules provisions") are those provisions that establish the basic rules for interpreting or administering an agreement and settling disputes under that agreement. Examples include the statements with respect to the choice of governing law (which are actually undertakings of both parties), the forum for dispute resolution (for example, the New York courts or by arbitration), the manner in which notices are effectively given or binding amendments effected (for example, by a writing), or the waiver of rights (for example the waiver of the right to jury trial). "Unless excepted from the opinion, these provisions are covered by the remedies opinion, which is understood to mean that a court will give effect to the provision as written and require the Company to abide by its terms." 53

C. ENFORCEABILITY OPINIONS IN SPECIALIZED FINANCING TRANSACTIONS

Enforceability or remedies opinions in specialized financing transactions are subject to considerations that are not applicable to other enforceability opinions. 54 The TriBar Specialized Financing Report does not specify the types of transactions that are "specialized financing transactions." The examples given are leveraged leases and sale-leaseback transactions, and other "reasoned" transactions. 55

A good argument can be made that many Shari'ah-compliant transactions in a purely secular jurisdiction should, and would, qualify as "specialized financing transactions" for purposes of the TriBar Specialized Financing Report (and the "Accord," as defined therein, of the American Bar Association). These transactions involve: (a) a significant degree of structuring; (b) the use of multiple agreements to effect the structure; (c) the necessity of considering the entire set of project documents and financing agreements to clearly understand the agreement of the parties; (d) the disregard of certain of the entities involved for the purposes of some laws (such as the disregard of the funding company

52 Id at 621. If the remedy is one that a court in the governing law jurisdiction will not enforce, the opinion will, and must, make an exception for the enforcement of that remedy.
53 Id.
55 Id at 1726.
special purpose vehicle used in many of these transactions as a taxable entity); and e) multiple characterizations of the transaction.\textsuperscript{56}

Because of the similarities of most Shari'ah-compliant transactions with the stated concept of "specialized financing transactions" in purely secular jurisdictions, various legal issues in respect of enforceability should be explicitly addressed as contemplated by the TriBar Specialized Financing Report.

V. SPECIFIC LEGAL ISSUES PERTAINING TO SUKUK

A. LEGAL INFRASTRUCTURE: SPECIFIC LEGAL ISSUES

Realization of the benefits of securitization for Islamic finance and the Islamic economy will require continuous issuances of asset-based sukuk by the private sector. That cannot be achieved without having those issuances rated by the major international rating agencies. Obtaining those ratings, in turn, is dependent upon obtaining the requisite legal opinions from prominent law firms engaged in these issuance transactions. These observations indicate that consideration of the ratings analysis used by the major rating agencies is a useful paradigm for studying the legal issues that will affect the development and growth of the capital markets—particularly the secondary markets—insofar as those markets are influenced by sukuk issuances. The analytical framework and criteria used by the major rating agencies are well developed and highly refined.\textsuperscript{57}

As a generic matter, and in its simplest form, a securitization involves: (a) an originator of assets; (b) an SPV issuer; (c) a parent of the issuer; (d) a payer or payers in respect of the assets being securitized; and (e) a purchaser-holder of the sukuk. The originator of the assets transfers, by sale, the assets to be securitized to the issuer. The issuer sells a sukuk to the purchaser and uses the proceeds of that sale to pay the originator for the transferred assets. Over time, the payer or payers make payments to the issuer who then transfers those payments to the sukuk holder. The issuer provides collateral security over the assets to the sukuk holders to secure the payment of the sukuk.

\textsuperscript{56} For example, the tax matters agreement used in many of these transactions will state that the transaction as a whole is a loan transaction for purposes of the federal income tax laws of the US—and possibly for purposes of certain environmental laws that allow a lender a “safe harbor” in financing transactions—and a lease for purposes of the Shari’ah.

\textsuperscript{57} Other areas of the legal infrastructure are not considered in this Article, largely because of the tremendous diversity of applicable law in different jurisdictions. These include tax law, real estate law, competition law, and corporate law, among many other areas of applicable law. See Judith O'Driscoll, Standard & Poor's Rating of CMBS: Legal and Structural Considerations, in Petersen, ed, Commercial Mortgage-Backed Securitisation 60–72 (cited at note 1), for a discussion of the analytical framework and criteria in conventional commercial mortgage-backed securitizations.
In determining whether and how to rate a securitization, rating agencies examine: (a) the credit quality of the securitized assets (and, at least as a statistical and underwriting matter, the payers with respect to those assets) and any other available credit support; (b) the structure of the securitization transaction; and (c) the legal opinion as to the structure and its key elements. As a general matter, the securitized assets must be isolated for the benefit of the sukuk holders. In the simplest case, the two critical elements are that all right, title, interest, and estate in and to the securitized assets are transferred by the originator to a bankruptcy-remote SPV and that the SPV grants a first priority perfected (or perfectible) security interest over those assets to secure payments on the sukuk and other claims of the sukuk holders.

The foregoing requires careful examination of the transfer of the assets from the originator to the SPV and the priority, perfection, and enforceability of the security interests granted in the securitized assets provided as collateral for the benefit of the sukuk holders. This examination is made through review of the documentation and obtaining a legal opinion that addresses all of the transactional issues. Looking to the primary substantive legal opinions, the following are the primary areas addressed by the legal opinions: (a) true sale of the securitized assets; (b) non-consolidation of the assets in bankruptcy; (c) bankruptcy remoteness; (d) the collateral security structure; (e) enforceability of the transactional documents; (f) choice of law; and (g) enforcement of judgments and awards.

B. True Sale

The true sale opinion addresses the issue of whether the SPV that is the issuer of the sukuk owns the transferred assets; in other words, whether there was a valid transfer. The transfer must be such that it cannot be recharacterized by a court or other body as a secured loan or otherwise avoided in a bankruptcy or insolvency proceeding involving the originator of the assets (such as pursuant to a fraudulent transfer in anticipation of bankruptcy or a preference payment). The bankruptcy or insolvency of the originator should not affect the assets that have been transferred to the issuer SPV. This, in turn, means that the issuer will be able to enforce collection and other rights against the payer without hindrances resulting from the bankruptcy or insolvency of the originator.

Further aspects of the true sale doctrine relate to the nature of the title transferred to the issuer. Many securitizations involve an unperfected transfer of an equitable interest in the assets (in some cases, so as to avoid legal

58 Entity organization opinions are critical, and they are obtained; such opinions, however, are not discussed in this Article. These opinions address the formation of relevant entities, due authorization of the transaction by all entities, and due execution of all documentation.
requirements pertaining to notification of the payer). The transfer must then be perfectible at the election of the issuer. Shari’ah scholars have differing views on the permissibility of separation of legal and equitable title to assets, and these raise impediments to effectuation of securitizations in certain unperfected transfer structures. If separation of legal and equitable title is not permissible, legal title would have to be transferred in a manner that satisfies all of the applicable perfection requirements (including notification of the payer).

Another aspect of the sale analysis (although technically not having an effect on whether a true sale exists) pertains to whether the assets are transferred free and clear of all prior overriding liens. This also will be considered in the relevant legal opinions and is a critical ratings criterion.

C. NON-CONSOLIDATION

A second legal opinion analysis focuses on the bankruptcy of two entities: the originator and the parent of the issuer SPV. In brief, the requirement is that the securitized assets held in the issuer will not be consolidated with the assets of the originator or the issuer parent in a bankruptcy or insolvency of either of those entities. The “separateness” covenants discussed in the next section pertain to the non-consolidation opinion as well as bankruptcy remoteness.

D. BANKRUPTCY REMOTENESS

Another area of the ratings criteria relates to the remoteness of the bankruptcy of the issuer SPV. The focus is on a reduction of the possibility of an issuer bankruptcy. The main reason for concern is that, in many jurisdictions, if there were a bankruptcy of the issuer, the assets of the issuer would be distributed in accordance with the law or a court order rather than in accordance with the contractual arrangements involving the issuer. Further, there would likely be mandatory stay provisions during the pendency of any issuer bankruptcy, which would interfere with timely payment of the sukuk. Therefore, the transaction is structured to make initiation of a bankruptcy proceeding against the issuer as unlikely as possible.59

The first set of documentary provisions relating to bankruptcy remoteness restricts the purpose and activities of the issuer SPV. This is accomplished by restricting the business purpose of the issuer exclusively to the sukuk transaction.

59 In addition to the bankruptcy remoteness provisions discussed in the text of this Article, there are also requirements for provisions limiting recourse for payments and indemnities to only the securitized assets (and applicable credit enhancements), provisions mandating that the priority of payments set forth in the documents shall govern in all cases, and provisions to the effect that, after full realization on all securitized assets (and credit enhancements), all payment and indemnity claims are extinguished. These provisions are not discussed in this Article.
Correlative provisions prohibit various activities. Rating agencies frequently require that these provisions be included in both the constitutive documents of the issuer and the transactional documents for the sukuk transaction. The required legal opinion will then have to indicate that the constitutive document provisions will be binding upon third parties.

Separateness covenants will be required to further ensure bankruptcy remoteness (as well as non-consolidation). Most major rating agencies suggest covenants that require the issuer to:

(a) maintain a separate office;
(b) keep separate corporate records;
(c) hold separate board of directors meetings in accordance with specific schedules and legal requirements;
(d) not commingle assets with any other entities;
(e) conduct business in its own name;
(f) provide financial statements that are separate from other entities;
(g) pay all liabilities out of its own funds;
(h) maintain strict arm’s-length relationships with parent and affiliated entities;
(i) not issue any guarantees;
(j) use its own stationary, invoices, checks, and other documents and instruments;
(k) not pledge its assets for the benefit of any other entity; and
(l) hold itself out as separate from its parent and affiliates.

Securitization counsel often interpret rating agency guidelines to require that the foregoing covenants be included in the constitutive documents of the issuer, as well as in the transactional documents. In ijarə-based transactions, this requirement has been problematic as the conventional forms of separateness covenants often do not fit the Shari`ah structure without some modification.60 Further, inclusion of the separateness covenants in the constitutive documents

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60 In an ijarə-based transaction, the funding Company lessor (which will be the sukuk issuer) is often, by intention, a disregarded entity for tax purposes and makes no decisions or determinations of its own accord—it is an entirely passive entity that undertakes a borrowing and acts as a lessor of the property in which a Shari`ah-compliant investment is made. In such a structure, many, if not most, of the separateness covenants are not true on their face. Assets of the funding Company and the project Company are commingled. Frequently, the financial statements of the project Company (the entity of substance) are combined with those of the funding Company. The funds of the project Company are used to pay all liabilities, including those of the funding Company. And the assets of the funding Company and the project Company are pledged to secure the obligations of each and both. These aspects of the standard ijarə-based transaction need to be modified where a sukuk issuance is contemplated. However, these modifications have significant adverse tax consequences in Shari`ah-compliant transactions.
Contractual Enforceability Issues

E. COLLATERAL SECURITY STRUCTURE

Consideration of the collateral security structure is a critical factor under both the ratings criteria and legal opinions. The focus is on the security interests provided for the benefit of the sukuk holders. Those security interests must be first priority (there can be no prior claims and no subsequent claims) and perfected (or perfectible). The legal opinions must address the nature of the security interest, the enforceability of the security interest against third parties, and perfection requirements (such as notices, registration, and recordation). The effects of bankruptcy on perfection must also be considered and opined upon.

A number of significant issues arise in jurisdictions within the Islamic economic sphere. First, rahn (mortgage and pledge) concepts in certain of these jurisdictions are possessory in nature (pursuant to the Shari`ah). This makes perfection a particularly difficult issue in these jurisdictions. Second, in many jurisdictions, including those within the Islamic economic sphere, and without regard to rahn concepts, perfection and priority regimes are not well developed. Third, bankruptcy laws and regimes are not well developed in these jurisdictions. To date, law firms have found it impossible to render satisfactory opinions on the priority and perfection in most of these jurisdictions.

F. ENFORCEABILITY OF DOCUMENTS

Ratings criteria require that enforceability opinions be rendered on all transactional documents. As discussed in section IV of this Article, the form of

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61 This issue of director liability is not exclusive to Shari`ah-compliant transactions.
such an opinion is that the transaction documents are valid and binding obligations of the relevant entities, enforceable against such entities in accordance with their respective terms. The nature of the exceptions and qualifications to enforceability opinions in New York include such matters as: (a) the effects on enforceability of bankruptcy laws and general principles of equity and (b) the enforceability of indemnification rights, waivers of rights and remedies, agreements to agree, provisions requiring performance of obligations in contravention of law, provisions pertaining to submission to jurisdiction (such as where subject matter jurisdiction is not available), set-off provisions, liquidated damages provisions that constitute penalties, and provisions with respect to the availability of equitable remedies. These exceptions and qualifications, in their customary forms, will not preclude the issuance of a rating.

To date, legal opinions in jurisdictions within the Islamic economic sphere have included a number of other, much broader, exceptions and qualifications. These relate to:

(a) the fact that the Shari'ah is comprised of general principles rather than specific legal requirements, and, as such, it is difficult to ascertain how the Shari'ah will be applied in any specific transaction;\(^\text{62}\)

(b) the fact that different schools of Islamic jurisprudence interpret relevant Shari'ah principles and precepts differently and inconsistently, resulting in similar uncertainties as to the application of Shari'ah to any given transaction;

(c) the lack of uniform statements of relevant Shari'ah principles and precepts;\(^\text{63}\)

(d) the lack of binding precedents and published decisions, further exacerbating uncertainties as to application of even agreed-upon Shari'ah principles and precepts;

(e) the great degree of discretion given to a court in these jurisdictions;

(f) the uncertainty of remedies within these jurisdictions; and

(g) the fact that many of these jurisdictions will not enforce foreign judgments, and even where they will enforce foreign arbitral awards, they may infuse the Shari'ah into a review of that award pursuant to public policy doctrines.\(^\text{64}\)

To date, the rating agencies and the lawyers who have been asked to provide enforceability opinions have recognized that there is insufficient predictability,

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\(^{62}\) Consider, for example, section III of this article and the Shamil Bank case discussed in that section with respect to the exceptions noted here in a–c.

\(^{63}\) See McMillen, \textit{Enforceable in Accordance with Its Terms} (cited in note 45).

\(^{64}\) For a discussion of the enforcement of foreign judgments and awards, see McMillen, 24 Fordham Intl L J at 1199–1203 and the sources cited therein (cited at note 13).
consistency, certainty, and transparency to permit the rendering of reliable enforceability opinions in Islamic economic sphere jurisdictions.

G. CHOICE OF LAW

Choice of law opinions are also required in connection with the ratings review. The opinion must be to the effect that the choice of law will be upheld as valid by enforcing authorities in at least: (a) the jurisdiction whose law has been chosen as governing the transactional documentation; (b) the jurisdiction(s) whose law governs the formation of each of the entities involved in the transaction; and (c) the jurisdiction in which the assets are located. These are complex legal opinions, and any analysis is beyond the scope of this Article. It is sufficient to say, for present purposes, that the laws of many jurisdictions within the Islamic economic sphere are, at best, unclear as to choice of law principles. Thus, obtaining the choice of law opinions has been difficult and, in some cases, impossible.

H. ENFORCEABILITY OF JUDGMENTS AND AWARDS

Another requirement of the ratings criteria is a legal opinion to the effect that the judgment of each court or arbitral authority of relevance to the transaction, which include foreign courts and arbitral bodies, will be enforced in each of the jurisdictions involved in the securitization transaction. As noted in the previous section, there are often numerous jurisdictions involved, and they will vary from transaction to transaction. Some jurisdictions within the Islamic economic sphere will not enforce foreign judgments and arbitral awards. Some will enforce foreign arbitral awards, but not foreign judgments. In some jurisdictions, the extent and degree of enforcement of foreign judgments and awards is not entirely clear.

Particular difficulties arise in connection with Shari'ah-compliant transactions. Consider, for example, enforcement of a foreign judgment or award that was rendered or obtained in a purely secular jurisdiction and enforced in a Shari'ah-incorporated jurisdiction, and vice versa. Will the judgment or award be reviewed de novo in whole or in part upon attempted enforcement in the Shari'ah-incorporated jurisdiction? Will a purely secular jurisdiction decline to enforce a judgment or award rendered in a Shari'ah-incorporated jurisdiction where the basis of the judgment or award is a Shari'ah interpretation of terms not included in the relevant contract? Will a court in a Shari'ah-incorporated

65 Consider the discussion of the Shamil Bank v Beximco case in section III of this Article.

66 For a discussion of enforcement mechanisms in the Kingdom of Saudi Arabia, see McMillen, 24 Fordham Ind L J at 1195-1203 and the sources cited therein (cited at note 13).
jurisdiction infuse the Shari`ah into the foreign arbitral award as a matter of public policy and pursuant to the public policy exception of the relevant treaties?

Lawyers are uncertain as to the answers to the foregoing, and many other similar queries pertaining to the enforceability of judgments and awards. As a result, the exceptions and exclusions proposed in legal opinions have rendered those opinions insufficient for ratings criteria purposes.

VI. THE MODEL CODE CONCEPT

A. AN ENDEAVOR TO ENHANCE ENFORCEABILITY OF THE SHARI`AH

This Article has focused on the sukuk as instruments that may be beneficial to the development of capital and secondary markets. This examination, in turn, has led to a consideration of the role of the law in enhancing certainty, consistency, predictability, and transparency in a manner that will allow and foster the development of the capital markets, with particular consideration of issues pertaining to the enforcement of contracts related to sukuk issuances. Discussion has focused on both case law and legal opinion practice, with occasional references to the importance of statutory law and other codifications. The implication is that it should be a goal of nations, governments, multi-lateral and multinational organizations, business people, and concerned organizations to structure their laws—and the enforcement of those laws—in a manner that will enhance certainty, consistency, predictability, and transparency. That endeavor becomes increasingly difficult as internationalization and globalization proceed at an ever-increasing pace and as Shari`ah-compliant structures and products become more sophisticated and are offered and used in a wider range of business environments and cultures. Thus, it is important to define a course of action to achieve the aforementioned goals, at least provisionally, and to identify institutions that will be able to take the lead in such an endeavor.

B. MODEL ISLAMIC ACTS: A PROPOSAL

1. General Statement of the Proposal

In summary, this Article proposes that “model acts” be prepared for each of the primary areas of relevance to, or subjects of, Shari`ah-compliant banking, finance, commerce, and securities regulation—essentially model acts or codifications of the principles of the nominate contracts and widely accepted transactional forms. These model acts would serve as basic guidelines and would be amenable to modification for different purposes. The model acts could be structured in a form that could be adopted by different nations as the substantive law of the land with respect to the area that is the subject of that
model act, with such modifications as the adopting jurisdictions shall elect. Of course, adoption would have the greatest relevance to Shari'ah-incorporated jurisdictions. The model acts would also serve as the base source for text defining the law, as well as a source for relevant structural principles and documentary text that should be included in enforceable contracts relating to that substantive area. This would enable drafting of contracts in compliance with the Shari'ah in purely secular jurisdictions and include widely accepted text to ensure enforceability of the relevant Shari'ah principle or precept in those jurisdictions. Again, the model act, as incorporated in any given contract, could be modified by the parties to give effect to desired variances, such as those to give effect to the position of a specific school of Islamic jurisprudence or the interpretive proclivities of specific parties.

Thus, for example, in accordance with the priorities and determinations of the preparing body, model acts could be developed for:

(a) the nature of *ijara* and transactions using the *ijara*;
(b) the nature of *istisna’a* and transactions using the *istisna’a*;
(c) the nature of bay and sales transactions of different types;
(d) the nature of *murabaha* and transactions using the *murabaha*;
(e) the nature of *salam* and transactions using the *salam*;
(f) the nature of *mudarabah* and transactions using the *mudarabah*;
(g) the nature of *al-sharika* and transactions in which the *al-sharika* participates;
(h) the nature of *hiba* and transactions using *hiba*;
(i) the nature of *arriya* and transactions involving *arriya*;
(j) the nature of *arboon* and transactions involving *arboon*;
(k) the nature of *musharaqah* and transactions involving *musharaqah*;
(l) the nature of *ja’ala* and transactions involving *ji’ala*;
(m) a long and comprehensive list of other structures and concepts relating to Islamic banking, finance, and regulatory practices.

This proposal is far-reaching. Realization of this effort will likely take decades (rather than years), will involve a broad range of participants, and will have to be carefully staged and managed. For example, it may be that only the text of each model act should be prepared in the first instance, without commentary or any of the other structural components discussed in the next section of this Article. Undoubtedly, only a limited number of “model acts” (say, two or three) would be in progress at any given time. Over time, some model acts would be in a more advanced stage of development (all structural elements mentioned in the next section would be implemented), while others might be in the very earliest stages of development.

The magnitude of the undertaking should not preclude the undertaking itself. As discussed in the next section of this Article, there is ample precedent
for the realization and completion of complex legal undertakings of similar magnitude and complexity by governments and bodies that are as diverse as those represented in the IFSB.

2. The Uniform State Laws and the Conference on Model Laws

The Shari'ah is not a "standardized" set of principles and precepts. Given the diversity of Islamic history and thought, the Shari'ah is not capable of standardization in a common language sense. Such standardization, many argue, is contrary to the essential nature of Islam itself with paramount respect given to the relationship between Allah and the individual Muslim. The concept of the ummah, as a broad community of Muslims, encompasses an incredible diversity of peoples and cultures, and this diversity will affect the implementation of any model compilation. Further, the degree of integration of the Shari'ah into the fabric of the laws of any given nation will likely also require modification of any model act in that nation, if only because of the integration of the concepts of custom as applicable in any specific jurisdiction or area. Legitimate differences of opinion among eminent Shari'ah scholars will also ensure modifications of any model act formulation, as will the uses to which such acts are put by contracting parties in different circumstances.

The structure and experience of the United States is analogous to the broad Muslim community, in certain aspects, particularly those relating to jurisprudential diversity. Governmentally and legally, the United States is comprised of fifty constituent states, the District of Columbia, several territories, and a federal government. Each of the states and other entities comprises a separate and distinct legal system—a separate country for most purposes. Each state is free to structure, interpret, and enforce its laws without fetter or compulsion by another state or the federal government, subject to certain constitutional limitations and restrictions. For example, adoption of laws, even proposed model uniform acts, is voluntary and within the discretion of each

67 Of course, the US is not the only jurisdiction that is similar in these regards. The government of Canada is also quite similar, and the European Union has increasing similarities with respect to component legal structures and conflicts of law (and related harmonization) issues. The US and the Conference on Model Laws (as hereinafter defined) have been singled out as analogous because of, among other things, (a) their long experience (114 years) with a range of issues quite similar to those faced by the Islamic finance community; (b) the breadth and depth of that experience; (c) the similarity of the Conference on Model Laws to the IFSB in terms of membership and procedures, compositional diversity, and the diversity of juristic opinions and constituency; and (d) the considerable successes and achievements of the Conference on Model Laws in the face of diversity, debate, and the competing objectives of more than fifty state governments (which, the author risks averring, correlates with the diversity, debate, and competing objectives of the billion-plus Muslims and many jurisdictions comprising the Islamic economic sphere).
state, which may result in rejection of the proposed act (by failure to adopt rather than affirmative rejection) or modification of any proposed model uniform act. The states and the federal government, judicially and legislatively, have had to address issues of diversity and conflict that are quite akin to the diversity and conflict seen in Islamic jurisprudence, including in the important aspects of commerce and finance.

One of the entities that has been established to address legal and jurisprudential issues of common interest and application in the face of seemingly (and potentially) chaotic state diversity is the National Conference of Commissioners on Uniform State Laws ("Conference on Model Laws"). This Article asserts that the Conference on Model Laws is similar in many respects to the IFSB, including with respect to composition, capacity, and legitimacy.

The Conference on Model Laws was founded in 1892 "to promote uniformity in the law among the several states on subjects as to which uniformity is desirable and practicable, by voluntary action by each state government." Its mandate recognizes the importance of the effort to obtain

68 A similar organization, the Uniform Law Conference of Canada, was established in Canada in 1918 "to harmonize the laws of the provinces and territories of Canada, and where appropriate the federal laws" of Canada. The Uniform Law Conference of Canada, through its "Commercial Law Strategy," aims "to modernize and harmonize commercial law in Canada, with a view to creating a comprehensive framework of commercial statute law which will make it easier to do business in Canada." See <http://www.ulcc.ca/en/cls> (visited Jan 15, 2007) and related links for the Commercial Law Strategy.

For purposes of the Conference on Model Laws, there are more than fifty "states" because the term includes not only the fifty states of the US, but also the District of Columbia, the Commonwealth of Puerto Rico, and the US Virgin Islands.

69 20 Uniform Laws Annotated (West Master Ed 2003). The Master Edition of the model Uniform State Laws comprises approximately sixty-five volumes as of the date of this Article and covers the more than 200 proposed model laws. See also Constitution and Bylaws of the Conference on Model Laws, art 1, § 1.2, available online at <http://www.nccusl.org/Update/DesktopDefault.aspx?tabindex=3&tabid=18#Article1> (visited Jan 15, 2007). The web site also contains the various uniform state laws that have been proposed by the Conference on Model Laws and other related materials.

Another entity in the US that promulgates model acts is the American Bar Association. For example, the Section on Business Law of the American Bar Association, through the Committee on Corporate Laws, has promulgated the Model Business Corporation Act Annotated, which includes the Model Business Corporation Act with Official Comment and Reporter's Annotations and the Model Close Corporation Supplement and Model Professional Corporation Supplement, in a multivolume set.

The American Law Institute has also issued numerous Restatements of the Law with respect to different substantive areas of the law, including agency, contracts, foreign relations law of the US, judgments, the law governing lawyers, property with respect to landlord and tenant, property with respect to donative transfers, property with respect to wills other than donative transfers, property with respect to mortgages, property with respect to servitudes, restitution, suretyship and guarantee, torts, torts with respect to apportionment of liability, torts with respect to products
clarity, certainty, consistency, predictability, and transparency, while also reflecting the diversity of the states, including in respect of their legal systems and cultures. The Conference on Model Laws is state-supported and attempts to provide services that no individual state could otherwise afford or duplicate. Members of the Conference on Model Laws must be appointed by a state government and must be lawyers who are qualified to practice law, including practitioners, judges, legislators, legislative staff, and law professors. Each state determines the method of appointment and the number of commissioners. The Conference on Model Laws drafts and proposes specific statutes in the areas where uniformity between the states, to greater or lesser degree, is desirable and practicable. However, no model law is effective until, and only as, adopted by a specific state in the discretion of that state. The Conference on Model Laws works cooperatively with various other organizations and entities. For example, the signature and most well known work of the Conference on Model Laws, the Uniform Commercial Code, was a cooperative effort with the American Law Institute that took ten years to complete and fourteen years to enact throughout the states of the United States. The Conference on Model Laws is analogous in almost every important respect to the IFSB.

The IFSB\textsuperscript{70} was inaugurated in 2002, opened in 2003, and has been granted the immunities and privileges of an international organization and diplomatic mission by the government of Malaysia pursuant to the Financial Services Board Act of 2002. The IFSB is an international body comprised of regulatory and supervisory agencies of governments. The objectives of the IFSB include: (a) establishing various standards pertaining to the soundness and stability of the Islamic financial sector and recommending these standards for adoption by governments and other appropriate agencies and entities; (b) providing supervisory and regulatory guidance to institutions offering Islamic financial products and developing industry criteria for identifying, managing, and disclosing relevant international standards; (c) encouraging cooperation among member jurisdictions in developing the financial services industry; (d) facilitating training and personnel development of relevance to that industry; (e) undertaking research and publishing studies and surveys of relevance to the Islamic financial services industry; and (f) establishing databases of participants in that industry. Recently, securities laws and capital markets initiatives have been added to the mandate of the IFSB.

\textsuperscript{70} For further information and informational updates regarding matters discussed in this Article, see <http://www.ifsb.org> (visited Jan 15, 2007).
The IFSB is comprised of three categories of membership: (1) full members; (2) associate members without voting rights; and (3) observer members without voting rights. Full membership is available to the lead financial supervisory authority of each sovereign country with respect to Islamic financial services (including banking and securities), and to certain intergovernmental international organizations that have an explicit mandate to promote Islamic finance and markets. The associate members are central banks, monetary authorities, and financial supervisory organizations or international organizations involved in setting or promoting standards for the stability and soundness of international and national monetary and fiscal systems and securities markets. The observer membership is available to: (a) national, regional, or international profession or industry associations; (b) institutions that offer Islamic financial services; and (c) firms and organizations that provide professional services, including accounting firms, law firms, rating agencies, and research or training services that provide services to institutions within the ambit of the associate membership.

Many of the nations that are founding members are Shari`ah-incorporated jurisdictions that have extensive and invaluable experience with the application of the Shari`ah in contemporary and evolving legal systems. That experience encompasses all schools of Islamic jurisprudence. They are also the jurisdictions that will consider adoption of the text, possibly in modified form, as elements of substantive national law. They will oversee enforcement of the model acts, in whatever form adopted, which will enhance the likelihood that enforceability issues such as those discussed in this Article are addressed in a sophisticated manner that is responsive to the needs of varying nations and cultures. They will bring national prestige and authority to the undertaking, thereby enhancing the validity of the resulting product. The expertise, experience, and legitimacy of the multinational entities that are members of the IFSB will also do much to ensure comprehensive consideration and the success of the undertaking. It is apparent

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71 At the time of this writing, the full members are: Bahrain Monetary Agency; Bangladesh Bank; Ministry of Finance, Brunei; Central Bank of Egypt; Bank Indonesia; Central Bank of the Islamic Republic of Iran; Islamic Development Bank; Central Bank of Jordan; Central Bank of Kuwait; Bank Negara Malaysia; State Bank of Pakistan; Qatar Central Bank; Saudi Arabian Monetary Agency; Monetary Authority of Singapore; Bank of Sudan; and Central Bank of the United Arab Emirates.

72 Eight entities hold associate memberships at the time of this writing: International Monetary Fund; World Bank; Bank for International Settlements; Dubai Financial Services Authority; The People’s Bank of China; Banque du Liban; Bangko Sentral ng Pilipinas; and Qatar Financial Centre Regulatory Authority.

73 There are sixty-four observer members at the time of this writing, including many of the most prominent banks and financial institutions in the Islamic finance industry and at least one multi-country, regional development bank.
that, in many ways, the IFSB is similar in composition to, and has the beneficial characteristics of, the Conference on Model Laws that has been so successful in addressing a very similar undertaking in the United States.

3. Specific Structure of the Compilations

The proposal is that each of the “model acts” be structured to have nine component elements when finally completed. In the early stages of the model acts project, it is likely that the IFSB itself will have to implement most of these component elements. If implementation were successful at the IFSB level, it should be possible to induce a commercial legal reporting or publishing entity to undertake preparation and maintenance of many of these components. The components of each model act would ideally include:

(a) Model Acts. The IFSB would first determine which model acts would be prepared and in what order. The IFSB would also determine which of the aforementioned components would be undertaken with respect to each model act and the time frame of preparation of those components. This would be best accomplished through Standing Committees and Special Committees. The relevant committee (such as a “Standing Committee on Scope and Program”) would receive proposals for model acts. That committee would investigate the proposal and report to the “Executive Committee for Model Acts” on whether the subject is appropriate for attention at that time, pursuant to established criteria. If the subject of a proposal is accepted, a “Special Committee for Drafting” would be appointed to research that subject and prepare a series of drafts of the model act. Tentative drafts would be discussed and considered, section by section, by the entirety of the relevant Executive Committee For Model Acts and ultimately, the entire Executive Committee of the IFSB. Promulgation of a model act would be pursuant to a vote by the voting members of the IFSB.

(b) Official Comments. The notes or comments prepared by the Special Committee for Drafting would explain a particular model act and would be added to the compilation of the model act under a prefatory note preceding the text of the model act. Notes and comments explaining specific sections of a model act would be included in the relevant sections of the model act. These notes and comments would provide, for example, explanations of the text of the section or notations of variances in interpretation due to differences in jurisdictions or schools of Islamic jurisprudence.

(c) Table of Adopting Jurisdictions. This section would indicate which jurisdictions have substantially adopted that model act and describe the enacting legislation or decree, the effective date of adoption, and the legal citation of the model act. There will be instances when a model act is “substantially adopted,” because different jurisdictions will likely adopt different portions of the model act and may modify the model act as adopted in that jurisdiction. A committee of the IFSB or its editorial staff will have to make a professional judgment as to
the nature of the adoption and exercise judgment in describing that adoption. Amendments to the model act or provisions thereof (as adopted in each adopting jurisdiction) and changes in legal references will have to be monitored on an ongoing basis.

(d) General Statutory Notes. The general statutory notes relating to each model act will precede the text of that model act. They will provide information relating to the enactment or adoption of that model act by different jurisdictions. Among the information that will be contained in the general statutory notes is information on sections in the adopting jurisdictions that are additional to the official text of the model act, and the text of such additional sections will be set forth in full. In addition, the general statutory notes will set forth information with respect to jurisdictions that are not listed in the Table of Adopting Jurisdictions because, for example, they have repealed the model act or have modified their provisions so extensively that the version adopted in the specific jurisdictions can no longer be considered a "substantial adoption" of the model act. Other similar information may also be provided.

(e) Action in Adopting Jurisdictions. The action in adopting jurisdictions would indicate variations between the official text of the model act and the corresponding section of the model act as actually adopted in a given jurisdiction.

(f) Jurisdictions Adopting the Model Act In a Manner Precluding Comparative Notes. Many times a jurisdiction will adopt the major provisions of a model act but depart from the official text in a manner that precludes clear indication of the variations (deletions, substitutions, and additions) in the general statutory notes. This section will then contain descriptions of those matters.

(g) Annotations on Fatawa and Decisions. This section will be a particularly useful section of the compilation for each model act. This will cover and cite all known fatawa as well as known court, administrative, and arbitral decisions relating to each specific section of the model act and to the model act in general.

(h) Articles and Commentary. This section will contain citations to informative articles and discussions on that model act and its provisions, application, and enforcement. This section will also contain library references for the model act and specific sections of the model act.

(i) Index to Text. This is a separate alphabetical descriptive-word index to the text of the model act.

VII. THE ROLE OF THE SHARI`AH SUPERVISORY BOARD

It is anticipated that the role of Shari`ah scholars and the Shari`ah supervisory boards for the many institutions involved in Islamic banking and finance would continue to be critical. It is likely that their role would expand with the promulgation and adoption of the Model Acts. Scholars and supervisory boards would obviously be critical to the development of effective
Model Acts. They would also have a critical role in the adoption of those Model Acts in different jurisdictions, particularly where jurisdictions were seeking to tailor the Model Acts to a particular nation or school of Islamic jurisprudence.

The role of Shari’ah scholars and the Shari’ah supervisory boards in structuring transactions would be unaltered in scope and complexity, although it is hoped that the greater availability of information concerning the nature of the Shari’ah as applicable to banking and financing transactions would lead to an increase in Shari’ah-compliant transactions and thus a broader and more extensive involvement of Shari’ah scholars and supervisory boards in banking and financial transactions, both generally and specifically. Similarly, their role in the implementation of the Model Acts in particular transactions would be critical in both Shari’ah-incorporated jurisdictions and purely secular jurisdictions. To ensure the adequacy of compliance and to enhance the certainty, consistency, predictability, and transparency of enforcement, they would structure, assist in the drafting of, and approve the documentation for, Shari’ah-compliant transactions to ensure the adequacy of compliance and to enhance the certainty, consistency, predictability, and transparency of enforcement. Their participation would ensure, for example, that the contracts in a purely secular jurisdiction, which would be subject to the governing law of that jurisdiction, would not meet the fate of *Shamil Bank v Beximco* because the contracts would be structured to precisely and adequately incorporate the relevant Shari’ah provisions, either by textual incorporation or by virtue of incorporative reference to the relevant Model Acts themselves (with such modifications as the scholars would determine appropriate for the individual transaction or jurisdiction).

Scholars and supervisory boards would also have a significant role in the enforcement of contracts and arrangements in Shari’ah-incorporated jurisdictions that have adopted the Model Acts or in purely secular jurisdictions that have incorporated provisions of the Shari’ah as set forth in the Model Acts. One Shari’ah scholar with whom the author has had discussions regarding this proposal is focusing on the potential for the creation of arbitral bodies comprised, at least in part, of Shari’ah scholars.

**VIII. SUMMARY AND CONCLUSION**

This Article has attempted to provide some background for understanding how the law—particularly enforceability of the law—affects the development of Islamic capital markets (including secondary markets) through its influence on *sukuk* issuances, one of the primary vehicles for capital market development.

To ensure to all the benefits of integration of the Islamic financial sphere with the Western financial sphere in a globalized economy, there must be Shari’ah-compliant transactions in purely secular jurisdictions in which the governing law will take cognizance of the Shari’ah as a matter of substantive and
procedural law. Enforceability of the Shari’ah can be achieved by incorporating the Shari’ah into the law of the land, and then choosing the law of the Shari’ah-incorporated jurisdiction as the governing law of the relevant transaction. However, in the purely secular jurisdictions, as illustrated by the Shamail v Beximco case, the governing law of the purely secular jurisdiction will take cognizance of and enforce the Shari’ah, if the Shari’ah can be precisely and effectively incorporated into the contracts being enforced.

The proposal set forth in this Article is designed to encourage the development of a system and platform that can be used to achieve greater and more precise enforcement of the Shari’ah in both Shari’ah-incorporated jurisdictions (which can adopt the Model Acts, with such modifications as the adopting jurisdiction shall determine appropriate) and purely secular jurisdictions (where the relevant contracts can incorporate language from the Model Acts in enforceable contracts or make reference to the Model Acts themselves to effect incorporation of relevant Shari’ah principles). It is asserted that the implementation of this proposal will significantly enhance certainty, consistency, predictability, and transparency, thereby significantly reducing transactional risks and enhancing integration of commercial and financial activity while allowing coextensive functioning of divergent economic systems. Implementation of this proposal will significantly increase knowledge of the Shari’ah among both Muslims and non-Muslims, and should have the effect, simply by virtue of increased knowledge and awareness, of demystifying Islamic banking and finance and providing a greater integration of the Western interest-based finance of the Western economic sphere with the Islamic finance of the Islamic economic sphere. This should not only increase the number and types of transactions, but allow for a freer flow of funds and capital—in both directions—between the Islamic economic sphere and the Western economic sphere. There will, of course, be economic benefits to individuals in both spheres. In addition, there should be significant political, legal, and other non-economic benefits to individuals in both spheres.

The IFSB is uniquely situated and uniquely qualified to effect the development and implementation of the Model Acts given the diversity and experience of its membership and the breadth of knowledge that its members can bring to such an endeavor. In so doing, the IFSB and its members will contribute significantly to the certainty, consistency, predictability, and transparency of both the Shari’ah and secular law as applied to Shari’ah-compliant transactions in both Shari’ah-incorporated jurisdictions and purely secular jurisdictions, and thus significantly enhance the growth of the Islamic economy and the integration of the Islamic economy with the Western economy.