The Constitutionality of Shariah Advisory Council of Bank Negara Malaysia (SAC) *vis-a-vis* JRI Resources Sdn. Bhd. v Kuwait Finance House (Malaysia) Berhad

Dr. Noor Suhaida Kasri

Brief Profile: Dr. Noor Suhaida Kasri is a researcher at the International Shariah Research Academy for Islamic Finance (ISRA). She can be contacted at noor@isra.my.

In a recent landmark case, *JRI Resources Sdn. Bhd. v Kuwait Finance House (Malaysia) Berhad*, the Federal Court, the apex court in the judicial system of Malaysia, decided that the ascertainment of Islamic law by the Shariah Advisory Council of Bank Negara Malaysia (SAC) is binding on the judiciary and is not tantamount to a judicial decision. Of the nine panel judges, four judges dissented, arguing against the legality and constitutionality of the SAC. The dissenting judges argued that the SAC has been vested with judicial power by section 57 of the Central Bank of Malaysia Act 2009; hence, this section is unconstitutional and invalid and needs to be struck down. This brief write-up will shed some light on key issues underlying this historic judgment. Before that, let us take a quick look at the impetus that spurred the establishment of the SAC.

The Impetus for the Establishment of the Shariah Advisory Council (SAC)

Before the setting up of the Shariah Advisory Council of Bank Negara Malaysia (SAC), Shariah governance and compliance issues were managed independently by Shariah Committees (SCs), which were established in all Islamic financial institutions including the Islamic windows of conventional banks. The role of the SCs is to ensure that the bank's Islamic banking products are Shariah compliant. However, due to the divergence of Shariah interpretations on similar matters by the respective SCs, Bank Negara Malaysia (BNM) in 1997 established a national Shariah Advisory Council to ensure uniformity and avoid inconsistency in Shariah rulings on the same issue.

At the initial stage of the SAC's establishment, the courts when dealing with matters pertaining to Islamic banking and finance did not refer to it for guidance despite their 'incompetence' in dealing with Shariah issues. To overcome this, amendments were made in 2002 and 2009 via the Central Bank of Malaysia Act 2009 (CBA), in particular sections 56 and 57, which empowered the SAC and elevated its status as the 'authority for the ascertainment of Islamic law for the purposes of Islamic financial business' (CBMA 2009, section 51). Due to this statutory amendment, the court or arbitrator shall take into consideration any published rulings of the SAC, and if there is none, to refer Shariah issues to the SAC for its ruling. The ruling arising from such reference binds the court and the arbitrator.

Manual for Reference by the Court and Arbitrator to the SAC

To ensure uniformity and clarity in making such reference, the SAC in 2012 issued a *Manual for Reference by the Court and Arbitrator to the SAC*. The Manual guides the court or arbitrator on the manner of referring Shariah issues to the SAC. It highlights that only questions concerning Shariah matters arising from the court proceeding may be referred to SAC. It is noteworthy to point out that 'question concerning Shariah matters' is defined in the Manual as:

> A Shariah question on a matter relating to Islamic finance involving matters that have not been determined by the SAC. Such questions include, but are not limited to, aspects of the Islamic finance business such as the structure of the business, products or services, implementation or operation, terms and conditions or documentation.

The Manual also emphasised that the SAC is only to ascertain Shariah rulings in regard to the issue forwarded. It has no jurisdiction to make findings on facts or to apply a particular ruling on the facts of the case and make a decision, as such are within the jurisdiction of the court and the arbitrator.

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Despite the obvious need to have a central Shariah advisory council, and despite the clarity of its framework, the courts in Malaysia have continued unabated with litigations questioning the validity and constitutionality of the SAC's rulings. The latest case is that of JRI Resources. In this case, Kuwait Finance House (KFH) sued its customer JRI Resources (JRI) for defaulting in settling an outstanding amount under an *Ijarah Muntahiah Bitamlik* facility. Under this facility, KFH leased shipping vessels to JRI. KFH bought these vessels at the request of JRI and thereafter leased them to JRI. JRI argued that the reason for failing to pay the rental was due to the failure of KFH to carry out major maintenance works on the vessels. As a result, JRI was not able to derive any income to pay the outstanding rental amount. JRI claimed that KFH, being the owner of the facility, was responsible to maintain the vessels. JRI specifically referred to clause 2.8 of the *Ijarah* Facilities Agreement and argued that it clashes with the Shariah. The clause provided that:

> Notwithstanding the above clause 2.7, the parties hereby agree that the Customer shall undertake all of the Major Maintenance as mentioned herein and the Customer will bear all the costs, charges and expenses in carrying out the same.

As such, the court (Court of Appeal) referred the following question to the SAC:

> Whether clause 2.8 of all the *Ijarah* Agreements (4 in total) between the Plaintiff (KFH) and its customer (JRI) is Shariah compliant, in light of Shariah Advisory Council resolutions made during its 29th meeting on 29.9.2002, the 36th meeting dated 26.6.2003 and the 104th meeting dated 26.8.2010.

During this process, both KFH and JRI submitted expert opinions to the SAC. However, these expert opinions conflicted with one another. JRI's expert opinion claimed that clause 2.8 did not comply with the Shariah while KFH's expert opined that the non-compliance was not material and hence did not invalidate the *ijarah* facilities agreement.

The SAC then forwarded its ruling to the court on the Shariah principles that it had ascertained. The SAC decided in principle that the maintenance cost relating to the ownership of *ijarah*'s asset is the responsibility of the owner while the cost relating to the usufruct of the rental is the responsibility of the lessee. However, the SAC allowed certain variant arrangements:

1 The owner of the asset can delegate to the lessee to bear the maintenance cost of the asset, and the amount of that cost will be fully deducted in the sale and purchase of the asset at the end of the lease period; or

2 The owner and the lessee may negotiate and agree to decide which party will bear the maintenance cost of the asset.

Having received the SAC ruling on the Shariah position on clause 2.8 before the start of the full trial, JRI appealed to the Federal Court, seeking that the court determine whether sections 56 and 57 of the CBA, under which the SAC gave its ruling, were constitutionally valid.

The court deliberated on four contentious issues that are briefly explained here. The first relates to the issue of ascertainment of Islamic law. On this issue, the court accepted the argument of the second intervener (Bank Negara Malaysia), which submitted that the word 'ruling' that is made binding by section 57 is not for 'determination' of dispute between the parties but for the ascertainment of the applicable Islamic law 'for the purposes of Islamic financial business'. In line with this argument, the court found that 'ruling' does not conclude or settle the dispute between the parties arising from the Islamic financing facility. It does not

'determine' the liability of the customer under the facility. The determination of the customer's liability under any banking facilities lies with the presiding judge and not the SAC.

Secondly, JRI argued that sections 56 and 57 of the CBA confer on the SAC a judicial function that is traditionally vested with the judiciary. This is because the SAC has been given a role in legal proceedings relating to Islamic finance business. This conflicts with the doctrine of separation of powers. The court rejected this submission and argued based on the feature of judicial power. Judicial power is exercised in accordance with the judicial process of the judicature. It is exercised impartially and in accordance with fair and proper procedures for the purpose of determining the matter at issue by ascertaining the facts and the law and applying the law as it is to the facts. Based on this, the court found that the SAC does not have any of these characteristics. The ruling made by the SAC is solely confined to Shariah issues. This is because the presiding judge who made reference to the SAC would still have to exercise their judicial power and decide the case based on the evidence submitted before the court. Since no judicial power has been vested in the SAC, the SAC does not usurp the judicial power of the court.

Third is the issue of the binding effect of the SAC ruling. JRI argued that the court is precluded from deciding the law applicable to the case as the SAC has been given the court's power to interpret and apply the law to the case. The court disagreed with this contention and cited an Australian case where it held that the mere fact a decision was binding did not mean that there was an exercise of judicial power. The court further argued that the Malaysian Parliament is competent to vest the function of ascertainment of Islamic law in respect of Islamic banking in the SAC and that such ascertainment is binding on the court. It was likened to the legislative power in prescribing the minimum sentence to be imposed by the court on a convicted person. The function of the SAC is merely to ascertain the Islamic law for Islamic banking, and it is for the court to apply the ascertained Islamic law to the facts of the case. The ascertained Islamic law does not settle the dispute between the parties before the court. The SAC did not determine or pronounce an authoritative decision as to the rights and/or liabilities of the parties before the court. It did not convert the court into a mere rubber stamp. The court even added that civil courts are not sufficiently equipped to make findings on Islamic law. These judicial views echoed the earlier cases decided in favour of the SAC, namely

- Tan Sri Abdul Khalid bin Ibrahim v Bank Islam Malaysia Berhad [2012] 7 MLJ 597,
- Mohd Alias bin Ibrahim v RHB Bank Bhd,
- Bank Islam Malaysia Bhd v Lim Kok Hoe & Anor [2009] 6 MLJ 839.

The final issue pertains to the court's reliance on expert opinion. The court envisaged that if the parties were to be allowed to lead expert evidence, it would fall upon the civil courts to ascertain the applicable Islamic law for Islamic banking and then apply the ascertained laws to the facts of the case. This could be complicated further by each expert giving an opinion based on a different school of jurisprudence. The court found that the civil courts are not in a position to appreciate and determine the divergence of opinion among the experts and to decide based on Shariah principles.

Summary

We have yet to see the battle against the constitutionality of the SAC settled at this juncture. Having said this, the litigations of Islamic finance cases in the courts have helped the industry to learn from the Shariah risks that they have faced. Interpretation of Shariah and its application must be harmonious with the objectives of the Shariah. This will hedge Islamic finance against unexpected legal battles in the future. I-FIKR