Public policy in the Saudi kingdom is derived from three principal sources: Shari′a; royal power, which is itself drawn from Shari′a with an emphasis on public customs and public interest within the framework of Shari′a's prescriptions; and public morals. At the outset, it should be noted that, historically, Muslim scholars have distinguished between Shari′a and Islamic jurisprudence, or fiqh. The concept of Islamic law was not in use at the time of the Muslim classical scholars – it began to develop as a reaction to Western influence. The concept of Shari′a is broader than jurisprudence – jurisprudence comes within, as along with other concepts of Islam such as Islamic creed and Quranic sciences, the umbrella of Shari′a. Shari′a, or Ash-Shari′a, literally means 'the pathway' or a way to be followed, the way that a Muslim has to walk in life. In its original usage, the term Shari′a meant the road to the watering place or the path leading to the water, i.e., the way to the source of life.[144] Arab lexicographers developed this to mean 'the law of water' and in time it has extended to cover all aspects of Muslim life, both spiritual and those pertaining to the exigencies of everyday life.[145] Shari′a is best translated as the 'way of life' and Ash-Shari′a as the 'way of the Muslim life' which is wider than the mere formal rites and legal provisions. Islamic law may be defined as the entire system of law and jurisprudence associated with the religion of Islam.

The primary sources of Shari′a are the Quran and the Sunna and there exist a number of other secondary sources or methods for adducing appropriate normative behaviour in response to new incidents and unregulated circumstances. These secondary sources are ijma′, ijtihad, qiyas and urf (public interest and custom). The methods of ijma′, ijtihad and qiyas are employed in the light of current circumstances in order to shed light on and analyse the Quran and the Sunna. The sustained use of these secondary sources led to the creation of a body of law known as fiqh. Western scholars tend to use 'fiqh' to describe Shari′a and Islamic jurisprudence interchangeably. The aforementioned distinction between the two should become clear and receive scholarly attention, given that Shari′a is the foundation of all doctrines formulated and developed under fiqh, whereas fiqh represents a human understanding and analysis of Shari′a sources. The term 'Saudi law' is more comprehensive than Shari′a and encompasses Islamic law and the codes and regulations adapted from other laws within the general framework of Shari′a principles. There are a few exceptions to this rule, particularly as regards Saudi legislation that is unrelated to Islamic teachings and principles. One example is the Banking Control Law, because it regulates some activities that are clearly prohibited under Islamic Law.

In Saudi Arabia, the primary sources of Shari′a – the Quran and the Sunna – have supremacy over all laws and man-made regulations or normative instruments. In the 1920s, King Abdul-Aziz attempted to codify the teachings of the four Islamic

144 Ibid.

145 See, generally, the Quran 45: 18 and 5: 48. See also C. Mallat, 'From Islamic to Middle Eastern Law: A Restatement of the Field (Part 1)', *American Journal of Comparative Law*, 51 (2003), pp. 699–719.

schools in a manner similar to that by which the Majalla codified Hanafi fiqh. Despite his best efforts, this project was vociferously opposed by certain radical scholars and did not materialize. In combination with his codification project, the King ordered Shari′a judges not to be bound by the rules of one school of fiqh, with the aim that the prevalence of one school should not have the result of abrogating another.[146] At the same time, however, some Ulama had their own agendas; they not only opposed the King's reform plans, but also sought to exert pressure on judges in all Saudi courts with a view to applying exclusively Hanbali fiqh under the teachings of the late scholar Ibn Taymiyyah. The main reason for their opposition rested in their fear that the expansion of civil codes could eventually culminate at the expense of Shari′a and ultimately lead to the promulgation of secular laws with little or no connection to Shari′a. In practice, although the Saudi legal system is premised on Shari′a on the basis of Hanbali teachings, judges have the freedom to apply any of the four schools of fiqh. This judicial latitude granted to Saudi judges is the direct result of the aforementioned order of King Abdul-Aziz to Shari′a judges.[147] Saudi judges currently rely on a number of legal commentaries – authored by recognized Islamic legal scholars – in the delivery of their judgments, but it should be noted that a codification of these dispersed commentaries is expected in the foreseeable future. Apart from Ibn Qodamah, the majority of scholars who authored these commentaries follow the teachings of the Hanbali scholar Ibn Taymiyyah.[148]

According to article 7 of the Saudi Basic Law, the ruling regime derives its power from the Holy Quran and the Prophet's Sunna, which have supremacy over all state laws.[149] Accordingly, the imposition of public policy restrictions within the kingdom cannot be relied upon to violate Shari′a principles under any circumstances. The Basic Law even emphasizes that even a temporary state of emergency during turmoil cannot violate article 7, which renders Shari′a the only source of regulation in the kingdom.[150]

Just like Saudi law, the kingdom itself as a political entity is inseparable from religion.[151] Regardless of his considerable regulatory authority, the King lacks the power to legislate in the very extensive field that has already been regulated by Shari′a, in respect of which he is bound by the same duty of obedience as are all

146 G. Sfeir, 'The Saudi Approach to Law Reform', *American Journal of Comparative Law*, 36 (1988), pp. 729–44.

147 Ibid., p. 732.

148 These books are: *Almoghni* by Ibn Qodamah; *Asharh Alkabeer* by Ibn Qodamah; *Sharh Zad Almustaqna'* by Albahouti and Alhajjawi; *Sharh Montaha Al Eradat* by Alfoutohi and Albahouti and; *Manar Assabeel* by Meri'e Alhabnali and Ibn Douawan.

149 See article 7 of the Saudi Basic Law, Royal Decree No. (90/A) dated 28/06/1412 H. (1992).

150 Ibid., articles 1 and 7.

151 D. Karl, 'Islamic Law in Saudi Arabia: What Foreign Attorneys Should Know', *Geo Wash J Intl Law & Economics*, 25 (1991), p. 131.

of his subjects.[152] Consequently, it can be said that the separation of law from religion is impossible in most aspects affecting public life in Saudi Arabia. Given the kingdom's political structure as an absolute monarchy, the King is endowed with authority to promulgate regulations by issuing such royal decrees that supplement existing Shari′a rules with a view to adapting to new circumstances, especially in relation to trade and commerce. 'In doing so, the Government tries to balance traditional prospects against modern needs.'[153] Royal decrees can also be considered a codification of some aspects of Shari′a law. This codification is achieved with the assistance of foreign laws and international practices that do not necessarily violate Shari′a principles. The decisions of judicial bodies have little impact on public policy because in Islamic legal practice they merely offer an interpretation of Shari′a and relevant royal decrees and are, moreover, subordinate to these.

What exactly constitutes public morals, interests and customs is not clearly delineated in Saudi law. What is abundantly precise, however, is that anything that is deemed as violating Shari′a would certainly fall outside acceptable public policy constraints. When discussing Saudi society in search of public morals and interests, it should be noted that the terms '*deen*', which means religion, and '*adat*', meaning custom, have been used interchangeably. The reason for this lies in the fact that some customs and traditions have been either derived from religion or upheld by it. This observation, however, may produce the result of restricting the enforcement of foreign arbitral awards in cases where the outcome of an arbitral award is contrary to Saudi public customs. The determination of the concept of public interest under Shari′a is derived through the use of the method of istihsan. The term '*istihsan*' may be translated as 'juristic preference'.[154] Another scholar preferred to translate it as 'public interest'. Conceptually, istihsan may be defined as the process of selecting one acceptable alternative over another, on the grounds that the first appears more suitable for the situation at hand, even though the selected solution may be technically weaker than the rejected one. Equally, istihsan has been viewed as a process for selecting the best solution for the general public interest as a form of ijtihad.[155] Istihsan allows judges and scholars some flexibility when interpreting the law to allow for the infusion of elements deemed useful. In other words, istihsan constitutes a permit for the spirit of the law to prevail over its letter.[156] Slight divergences exist between the various schools. Hanbali scholars call it '*istislah*', which may be translated as 'equity' or 'public

152 J. Schacht, 'Problems of Modern Islamic Legislation', *Studia Islamica*, 12 (1960), p. 133–36.

153 Supra n. 150, Karl, p. 142.

154 H. Fadel, 'The Islamic Viewpoint on New Assisted Reproductive Technology', *Fordham Urban Law Journal*, 30 (2002), pp. 148–50.

155 J. Makdisi, 'Legal Logic and Equity in Islamic Law', *American Journal of Comparative Law*, 33 (1985), pp. 63–66.

156 Supra n. 153, Fadel, p. 150.

interest', whereas Maliki scholars refer to it as 'almasaleh almursalah', which denotes a departure from strict textual adherence in favour of public welfare.[157] The principal precondition for the validity of istihsan is its compliance with the principles of Shari′a. Nonetheless, there are situations where the non-application of a Shari′a rule is more beneficial for public interest than strict textual application. For instance, in the field of finance and commerce the application of Shari′a may obfuscate socio-economic development, as is the case with the so-called '*istisna"* contracts.[158] As a general rule, the object of the contract must exist at the time when the contract becomes binding upon the parties. The requirement of the existence of the object at the moment of the conclusion of the contract was made to protect the parties from assuming any risk through a hazard or uncertainty likely to harm party interests.[159] Public interest, therefore, required a relaxation of strict contract rules. This was done by Prophet Muhammad himself when he allowed Muslims to conclude contracts with future objectives under certain circumstances, even though the general rule required otherwise. At present, public interest is determined by reference to specific suitable options within the framework of the main principles of Shari′a.

The kingdom maintains a negative list of activities excluded from foreign investment. This is a fine example of activities prohibited for the benefit of public interest.[160] When it comes to the protection of public interest, Saudi authorities consider Shari′a at first instance, as well as the will of its population. King Abdullah ben Abdul-Aziz, in one of his speeches to the Shura Council, underlined the fundamental tenets of Saudi policy, stating that 'we will work in the interest of the religion, homeland, our citizens and our traditions'.[161]

In assessing a legal system that is fundamentally different to the types of legal system Western lawyers are used to, one must necessarily examine the underlying

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157 Supra n. 154, Makdisi, p. 73.

158 Istisna′ contracts are derived originally from slam contracts, wherein one party paid a year in advance for crops of a particular weight at the time of harvest. Istisna′, or sale by manufacture, is a contract to manufacture a particular good not yet in existence, for an agreed price. The buyer need not pay for the goods until its acceptance and both parties may revoke their agreement at any time before delivery. Some scholars distinguish between the slam and istisna′ contracts, but both seem to be based on the same theory; however, the slam is used mainly in respect of crops and carries a greater risk of a future discounted price. Istisna′ contracts, on the other hand, are more common in construction and manufacturing and are more flexible in that they serve as financing and hedging tools.

159 N. Comair-Obeid, 'Particularity of the Contract's Subject-Matter in the Laws of the Arab Middle East', *Arab Law Quarterly*, 11 (1996), pp. 331–36.

160 The Saudi Arabia General Investment Agency (SAGIA), 'Negative List: Activities Excluded from Foreign Investment'. Available online at <http://www.sagia.gov.sa/en/business-environment/investment-laws/negative-list.html> [accessed 14 November 2008].

161 King Abdullah ben Abdul-Aziz, speech to the Shura Council in Riyadh, 14 April 2007.

reasons for such diversity. In the case of Saudi arbitration law, it is evident that two reasons are particularly prevalent. The first concerns the kingdom's troubled past, during which some of the arbitral tribunals that determined cases to which it was party rejected Islamic law as the law governing its contractual relations with third parties, even though this law was clearly stipulated in the relevant contracts. The frustration and embarrassment caused as a result had an impact far greater than merely downgrading the law of a particular country under the pretext that it was undeveloped and backward. Given that Islamic law pervades not only all aspects of normative conduct, but also all other social and public conduct within Muslim societies, those arbitral awards were perceived as having broader implications about Islam and Muslim states. Moreover, Saudi Arabia is a very conservative country in every respect, whose official policy strives to strike a balance between tradition and modernization.[162]

The result in the kingdom's contemporary arbitral law and judicial practice is hardly surprising. Disputes conducted in Saudi Arabia, or containing Saudi elements, are governed by the kingdom's *lex arbitri*, which requires not only that the arbitration clause and *compromis* be submitted to a designated competent authority for approval, but also that the proceedings be supervised by the said competent authority throughout their duration, save where conflict of laws rules permit the parties to refer to a foreign jurisdiction. Western lawyers may at first glance find these restrictions unduly compromising in terms of the benefits of arbitration, but closer examination reveals that equivalent procedures exist in developed arbitral fora. For one thing, both in Europe and in North America the arbitration clause may be subject to scrutiny, either by the tribunal itself or by reference to the courts of the *lex arbitri*. Equally, the parties are not generally free to turn to the civil courts during the course of the arbitral proceedings; institutional arbitration is to some degree monitored by relevant institutions, and, where significant improprieties occur, whether in terms of corruption or other, the parties may approach the courts of the *lex arbitri*. Finally, some Western arbitral legislation provides that the award requires ratification by the courts before enforcement proceedings can be undertaken.[163] As with Western public policy dictated by reference to local laws and perhaps social customs, so it is with Saudi Arabia that Shari′a is the benchmark in respect of public policy. In light of this, Saudi arbitration law does not seem to differ much from that of its Western contemporaries. Why, then, is it deemed problematic? The primary reason is obvious; where a Saudi element is involved, the parties cannot escape being subject to Saudi *lex arbitri*. They can,

162 'Some countries have sacrificed the soul of their culture in order to acquire the tools of Western technology. We want the tools but not at the price of annihilating our religion and cultural values'. Statement made by Bakr Abdullah Bakr, the Head of King Fahd University of Petroleum and Minerals Cited by W. Ochsenwald, 'Saudi Arabia and the Islamic Revival', *International Journal for Middle East Studies*, 13 (1981), pp. 271–72.

163 See, generally, A. Redfern and M. Hunter, *Law and Practice of International Commercial Arbitration* (3rd edn., Sweet and Maxwell, 2003), especially Chapters 9 and 10.

of course, choose to arbitrate outside the kingdom and avoid the difficulties, but their award would be unenforceable subsequently in Saudi Arabia. Furthermore, although in most countries there exists a consistent judicial practice that embraces the supervisory authority of civil courts over arbitral proceedings, in Saudi Arabia the situation is problematic. Despite the fact that the Saudi competent authorities (particularly the *Diwan*) do offer some jurisprudence as to their reasoning for either accepting or rejecting arbitration clauses – and the validity of the proceedings and compliance with public policy – there is no sense of precedent.[164] The judges decide on the basis of their personal opinions and are not obliged to adhere to any precedent, even if a decision of the Review Committee of the *Diwan* exists on a particular matter. Moreover, these cases are not generally accessible and it is telling that this is only the first instance in which a compilation has been made with a view to their examination. As a result, arbitration remains a very speculative business since the parties and their lawyers navigate through legal uncertainty. From an international law point of view, it may be argued that the decisions of all competent authorities are an expression of state practice on the basis that they are organs of the state. Thus, even if their decisions carry no binding precedent within the Saudi legal system, at least the said decisions reflect the will of the kingdom and bind it in its international relations. In any event, there is no doubt that a Hanbali arbitration law does exist, which itself informs Saudi arbitral law. The analysis in this chapter has demonstrated that this Hanbali corpus of law is in fact more flexible than Saudi law, particularly on the grounds of interpretative techniques. This finding should dismiss the notion that Shari′a is an archaic and backward-looking institution.

Parties intending to draft arbitration clauses and undertake arbitral proceedings in Saudi Arabia, or elsewhere in cases where a Saudi element is involved, should ensure that they are fully compliant with Shari′a law and Saudi public policy. Given the requirements regarding the status of arbitrators, foreign lawyers dealing with such disputes must constantly be alert as to reliable arbitrators that fulfil these exact criteria.

The New Arbitration Act

Among the set of legal reforms in Saudi Arabia, there is a foreseeable redrafting for the Arbitration Act and the Implementing Rules. The long-awaited law is expected to be a mixture of the Egyptian arbitration law and the arbitration rules of Dubai International Arbitration Centre which are heavily inspired by the similar rules of the London Court of International Arbitration. The prospective law should benefit from legal precedents and judicial practices and should, as a result, restrict the

164 Nonetheless, as has been demonstrated, the *Diwan* is not opposed to the parties themselves introducing foreign judgments or arbitral awards as evidence backing up their particular claims.

scope of judicial review exercised by the *Diwan*. However, public policy issues might not be touched upon – women, for instance, might still not be welcomed as arbitrators and Shari′a will remain the sole applicable law in domestic arbitration. It can be assumed that even a new act might not facilitate the enforcement of foreign arbitral awards owing to the vast scope of public policy restrictions but it is likely that the practice will experience more relaxation and flexibility. Nonetheless, bureaucracy, lack of clear procedural rules and lack of manpower in the *Diwan* are the real elements that impair arbitration in Saudi Arabia. The enactment of a new law will not necessarily mean the end for these existing problems.

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Chapter 6
Arbitration for the Settlement of Banking Disputes in Saudi Arabia

In all legal systems around the world, contradiction of public policy is a great threat to the arbitral process. The banking and general legal systems of Saudi Arabia are structured in quite a strange manner owing to the obvious conflict between Shari′a principles and the way in which conventional banks function. This conflict has created a gap between Shari′a and the statutes within the Saudi legal system in various fields, especially where the dispute involves an unacceptable element under Shari′a, such as the imposition of interest, hereinafter '*riba*', which is the primary motive of the conventional banking system.

As discussed in the previous chapter, this conflict has proved to be a fatal legal tactic against banks by those defaulting debtors trying to avoid serving their debts, at least in part, and to lengthen the time of the disputes, which render the loan practically 'interest free'. After examining arbitration as a general mechanism of settling commercial disputes, this chapter examines the issues related to arbitration as a mechanism for the settlement of banking disputes in Saudi Arabia and will discuss the following points: the arbitrability of banking disputes; the arbitration clause in financial transactions; the concept of duality in the Saudi legal system; and alternative remedies when arbitration fails to serve its objectives. The study will be conducted in a comparative way between Shari′a, the statutes and current practice, and in some parts will compare Saudi law with the laws of some of the countries neighbouring Saudi Arabia, such as Egypt and the UAE. The reason for comparing Saudi law with Egyptian law is that Egyptian law is practically one of the sources of Saudi legislation. On the other hand, the UAE is a growing economic power in the region with close business ties with Saudi Arabia.

Banking Disputes under the Law of Saudi Arabia

Before proceeding to discuss the nature of banking disputes in Saudi Arabia, the scope of the word 'banking' under Saudi law should be determined in order to give a clearer vision of banking activities. The Banking Control Law of 1966 defined 'banking' as:

> the business of receiving money on current or fixed deposit account, opening of current accounts, opening of letters of credit, issuance of letters of guarantee, payment and collection of cheques, payment orders, promissory notes and

> similar other papers of value, discounting of bills, bills of exchange and other commercial papers, foreign exchange transactions and other banking business.[1]

This latter definition may bring up a few questions regarding the scope of banking business and consequently banking disputes; however, the most important question relates to the reason behind the absence of money-lending operations in the definition of banking business under the Act, when it should be considered as the core of banking business. Saudi legislators broadened the scope of the definition by inserting the following sentence 'and other banking business', by which it can be assumed that the Saudi legislators wanted to allow the practice to encompass controversial matters under Shari′a. For instance, the drafters of the Act were unable to include explicitly the activity of money lending with interest, or '*fawaied*', in the Act because riba is clearly prohibited under the constitution of the country, bearing in mind that the Act was drafted in 1966, at a time when the concept of banking and the imposition of interest was totally unacceptable to the majority of Saudis owing to its obvious violation of Shari′a. In a similar way to other GCC countries, Saudi society has been experiencing rapid changes following the first oil boom of the 1970s, when the business sector began to accept what it formerly used to reject, as well as transforming its attitude toward banking interest. One may expect that if Saudi Arabia were to redraft its Banking Act, the law would not differ from any banking statute anywhere in the world and interest might not be the dilemma that it used to be.

The banking activities quoted in the above definition, in addition to money lending, which has constituted an accepted practice of the commercial banks under the supervision of the Government, are the primary subject matters of banking disputes in Saudi Arabia. The question of which competent authority should settle banking disputes in Saudi Arabia carries an even greater deal of ambiguity. Despite the recent law reform, Saudi Arabia does not possess proper commercial courts. The competence of settling commercial disputes in general is therefore devolved among several semi-judicial committees, making it understandable that in many cases a great conflict of authority is manifested.[2] In any event, even the creation of specialized courts entrusted with the settlement of commercial disputes would not solve the problem, especially if the disputed case related to 'banking business', as these prospective courts would work under the supervision of the Ministry of Justice, which itself would never tolerate any violation of Shari′a.[3]

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1 See article 1.b of the Banking Control Act of Saudi Arabia. Royal Decree No. M/5 dated 22/02/1386 H. (1966). *Umm Alqura Gazette*, issue No. 2126 dated 05/03/1386 H. (1966).

2 Examples for such cases can be found in the cases of cheques and negotiable instruments disputes involving the payment of interest.

3 See, in general, the Law of Judiciary and the Law of the Board of Grievances of Saudi Arabia. Issued by Royal Decree No. M/78 dated 19/09/1428 H. *Umm Alqura Gazette*, issue No. 4170 dated 30/09/1428 H. (12/10/2007).

In addition to arbitration, disputes relating to banking business can be settled through one of the following two committees in accordance with the subject matter of the dispute, irrespective of whether it relates to negotiable instruments or concerns other banking activities:

- the Committee for the Settlement of Banking Disputes under the Saudi Arabian Monetary Agency (SAMA), which is competent to settle disputes arising as a result of pure banking activities only, such as the opening of current and deposit accounts, letters of credit, money exchange, foreign transfer, money lending, etc;[4]
- the Committee for the Settlement of Disputes Involving Negotiable Instruments, which functions under the auspices of the Ministry of Commerce and Industry and possesses the jurisdiction to settle disputes related to cheques and other negotiable papers only. The Committee for Negotiable Instruments is also known as the Negotiable Instruments Office.

Arbitrability of Banking Disputes

The doctrine of arbitrability generally relates to the question of whether the applicable law allows a matter to be resolved by arbitration. All legal systems exclude some matters from the scope of arbitration and the non-arbitrable matter is referred to litigation even if the parties to the dispute agree to arbitrate.[5] As in other areas of Saudi commercial law, arbitration in general has not received sufficient attention from legislators, who prefer to rely on the classical Shari′a teachings and, in some cases, oppose modernizing the legal system even if the said modernization proffers to exist within the scope of Shari′a. This attitude has resulted in a great deal of ambiguity in Saudi day-to-day affairs, especially when a prohibited or disputed element is the subject matter of a dispute. Saudi law is relatively vague when providing an answer to the question of arbitrability. Under Saudi law, whether a dispute is arbitrable is answered by reference to the Arbitration Act and its Implementing Rules. According to article 2 of the Arbitration Act, arbitration is permitted in disputes where conciliation is permitted.[6] Therefore, the Act excludes some criminal disputes, as will be seen below, and disputes concerning public policy, which themselves are encompassed under the jurisdiction of Shari′a courts and the *Diwan Almazalim*, in addition to disputes relating to national sovereignty.

With regard to banking disputes, a few opinions exist under Shari′a as to whether to allow the use of conciliation. The reason for the difference in opinions

4 See Royal Order No. 4/110 of 1409 H. (1989) and Ministry of Finance Circular No. 17/5583 dated 19/09/1409 H. (1989).

5 M. Paul, 'Arbitrability of Copyright Disputes: *Desputeaux v. Les Editions Choutte* (comments)', *Canadian Business Law Journal*, 38 (2003), pp. 125–49.

6 Article 2 of the Arbitration Act of 1983.