

**Shari'ah Standard No. (32)**

# **Arbitration**



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***IN THE NAME OF ALLAH, THE ALL-MERCIFUL, THE MOST MERCIFUL***

All praise be to Allah, the Lord of all the worlds, and blessings and peace be upon our master, Muhammad, and his household and all his companions

## **Preface**

This Standard aims to define Arbitration and indicate its conditions and scope. It also discusses the Shari'ah status of arbitrators, arbitration document and verdicts, methods of initiating and implementing arbitration, and how arbitration is implemented in Islamic financial institutions (Institution/Institutions).<sup>(1)</sup>

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(1) The word (Institution/Institutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

## Statement of the Standard

### 1. Scope of the Standard

This standard covers arbitration as practiced in financial transactions and other activities and relationships which take place among institutions, or between Institutions and their clients or employees or other parties; whether inside or outside the host country of the institution.

### 2. Definition of Arbitration

2/1 Arbitration is an agreement between two parties or more to designate an external party for resolving a dispute between them through issuance of a binding verdict.

2/2 Arbitration in this standard refers to (Islamic Arbitration) which observes the rules and conditions of Shari'ah.

### 3. Forms of Resorting to Arbitration and Arbitration Parties

3/1 Arbitration can be sought through agreement of the two parties at the time of dispute, or in fulfillment of a previous agreement between them to seek arbitration instead of resorting to law. Arbitration can also be legally imposed on the two parties.

3/2 Seeking Islamic arbitration should be stipulated in the agreements in which the two parties cannot be forced to resort to laws that contradict with Shari'ah.

3/3 Arbitration parties are the two (or more) conflicting parties who seek arbitration.

### 4. Permissibility of Arbitration

Arbitration is permissible whether it is sought by two natural or legal persons, or by a natural person and a legal person.

## **5. Shari'ah Status of Arbitration**

5/1 Arbitration is binding in the following cases:

- a) When it is stipulated as a condition in the contract
- b) When the two parties agree on seeking arbitration on dispute, and pledge to observe its verdicts.

5/2 Arbitration is not binding for an arbitrator who is not entitled to remuneration. Such an arbitrator can terminate himself after accepting the task. If the arbitrator is paid for his job, arbitration becomes binding for him. In this latter case, if the arbitrator terminates himself after accepting the task, he should bear any actual harm that may result from his act. [see Shari'ah Standard No. (34) on Hiring of Persons]

## **6. Basic Elements of Arbitration**

6/1 The basic element of arbitration is its form, which refers to the process of exchange of offer and acceptance between the two parties seeking arbitration, and the arbitrator.

6/2 Valid arbitration has to fulfill the following requirements:

- 6/2/1 Existence of dispute between two parties or more, around a permissible right.
- 6/2/2 Agreement between the two parties on arbitration, and their mutual consent on accepting the verdicts of the arbitrator.
- 6/2/3 Acceptance of the arbitrator to do the arbitration task.

## **7. Scope of Arbitration (What Should Be Resolved Through Arbitration in Shari'ah)**

7/1 Arbitration is permissible in whatever a party is entitled to relinquish his right in.

7/2 Arbitration is impermissible in the following cases:

- 7/2/1 What constitutes a right of Allah, Glory be to Him, such as Hudud (Shari'ah penalties).

7/2/2 Cases that entail proving or disproving of a verdict that concerns a third party.

7/3 When the arbitrator issues a verdict on an issue that should not be resolved through arbitration; his verdict is null and void.

## **8. Characteristics and Appointment of the Arbitrator**

8/1 An Arbitrator shall have the full eligibility for performing his task.

8/2 In principle, an arbitrator shall be a Muslim. However, a non-Muslim arbitrator could be appointed when acute need so requires, in order to arrive at a Shari'ah-accepted verdict (in this regard, item 11/1 below shall be observed).

8/3 It is permissible to appoint one arbitrator or more, and – preferably – the number of arbitrators is to be odd, otherwise, the two parties (the seekers of arbitration) may appoint a chairman for the arbitration panel, whose vote shall be the casting vote when other votes are equal.

8/4 Each of the dispute parties may appoint one arbitrator, and the appointed arbitrators may appoint a final arbitrator if they are permitted to do so by the disputing parties.

8/5 When any of the two parties refrains from appointing an arbitrator from his own side as per the contract, the other party has the right to resort to the judiciary for appointing an arbitrator to represent the refraining party, provided that the arbitration condition in the contract does not specify another way for appointing such arbitrator.

8/6 The arbitrator has no right to appoint an alternate arbitrator to replace him, without the permission of the party that appointed him, because he has been accepted as an arbitrator in person. However, the arbitrator could have this right if arbitration is assigned to an Institution or an arbitration committee whose members are appointed with due consideration for its declared conditions of selection.

8/7 An agent or a Mudarib does not have the right of accepting arbitration, except with the consent of the principal for the agent and the owners of



the capital for the Mudarib, or on the basis of a clause in the Mudarabah conditions such as conditions in investment accounts. No one should become part of the arbitration on behalf of an institution that has a legal personality except its official representative.

## **9. Arbitration Document**

- 9/1 The arbitration document originates from agreement of the two parties of the dispute on arbitration, and acceptance of the arbitrator to perform the task, and is called (the arbitration contract) or (the arbitration agreement).
- 9/2 The arbitration document should include the names of the two parties of the dispute, the name of the arbitrator, the overall subject of dispute, the date specified for arbitration and the fees payable to the arbitrator if any.
- 9/3 The arbitration condition is the commitment of the two parties of the arbitration contract or agreement to resolve their disputes through arbitration. If such condition is stipulated in any agreement or contract, there will remain no need for agreement on arbitration at the time of dispute.
- 9/4 The arbitrator should apply the rulings of Shari'ah. If he is obliged to apply a certain law, he should still not violate the rulings of Shari'ah.
- 9/5 The two parties of the arbitration have the right to impose any permissible limitation on the arbitration so as to serve a permissible purpose of their own. Permissible limitations may include, for instance: issuance of the verdict within a specific time limit or in view of a certain School of Fiqh or a certain law that does not contradict the Shari'ah; or consultation with experts specified in name or by description. In the latter case, however, the arbitrator is not bound to accept the viewpoints of the experts.
- 9/6 When the period specified for arbitration expires without issuance of the verdict, the arbitrator becomes terminated, unless the two parties agree on extending the period. The arbitration period starts at the

time when the arbitration document has been signed by all the parties seeking arbitration, and ends up at the time when the arbitration verdict has been signed by all these parties.

9/7 It is permissible to conclude a verbal arbitration contract, however, Institutions should document the arbitration verdict in writing.

9/8 Acceptance of arbitration does not require attestation in the arbitration document, though such attestation is preferable.

#### **10. Methods of Judgment, Procedures and Proving in Arbitration**

10/1 The arbitrator is free to use any legally accepted method of judgment, such as confession, evidence (attestation), oath taking, or refraining from oath (Nukul), while he should not make judgment on the basis of his own opinion. When the arbitrator rejects an attestation, his rejection should not constitute a reason for denial of that attestation in other arbitrations or in the judiciary, unless the same attestation is also rejected by the judiciary.

10/2 The arbitrator has the right to request all the documents and proofs relating to the dispute, or copies of such documents verified in comparison to originals. He has to show such documents to the two parties so as to seek their opinions on them. The arbitrator has also the right to request verbal or written statements from the two parties of the dispute or the witnesses, and to consult experts if needed.

10/3 The Arbitrator is neither required to follow the procedural rules of the judiciary, nor is he obliged to observe laws, unless such laws are part of public order.

10/4 The arbitrator is not supposed to stick to the legally stipulated rules of evidence. Instead, he has the right to make use of any other evidence, provided that the acceptance of that evidence does not contradict with the rules of Shari'ah.

10/5 The arbitration verdict is issued by consensus or majority and in the case of equal votes the party which includes the chairman is considered to have the casting vote, unless some other arrangements are proposed in the arbitration document or the rules of the arbitrating entity.

## **11. Issuance of the Arbitration Verdict**

- 11/1 A valid arbitration decision should lead to a verdict that conform to the rules of Shari'ah.
- 11/2 The final arbitration decision should resolve all points of dispute and lead to fair specification of the rights of the arbitration parties. When arbitration ends up with partial resolution of the points of dispute, arbitration is incomplete since it has not enabled the disputing parties to avoid resorting to legal suing. In this case, the disputing parties have the right to demand a further decision from the arbitrator so as to resolve the remaining points of dispute.
- 11/3 Arbitration should not go beyond the subject matter of dispute, because tackling of any further issue does not fall within the mandate of the arbitrator, unless the two parties of the dispute agree to add it.
- 11/4 The arbitrator has the right, subject to his own discretion or on request of the disputing parties, to issue a commentary on the arbitration decision, or introduce corrections for any material mistakes that might be involved therein.
- 11/5 The arbitrator can issue his decision in a number of preparatory or partial decisions, or identify the responsibility without estimating indemnification.
- 11/6 It is preferable that the Shari'ah or basis of the arbitration decision be mentioned (reasoning), yet this does not constitute a condition for valid arbitration, unless the law so requires.
- 11/7 In principle the arbitration decision is to be issued in a session attended by the arbitrators if they are many (or most of them, after invitation). It can also be issued by circulation among members after being prepared by the final arbitrator, or the chairman of the arbitration panel, or any other authorized member. In the case of issuance by circulation, consensus among members should be reached.

- 11/8 The arbitration decision is to be issued under the signature of all members of the arbitration panel (when they are many) including those who raise objections against it, and objecting members should be allowed to state their objections on the document. The arbitration decision may also be issued under the signature of most of the members, after indicating the reasons that made some members refrain from signing. Nevertheless, the decision has to be issued at the knowledge of all members as per the minutes of the session convened for that purpose.
- 11/9 The arbitration decision includes: the text of the verdict; names, identities and addresses of the two parties of the dispute; reference to the date and number of the arbitration document; summary of the subject matter of dispute; claims of the two parties of the dispute and the supporting documents; names of witnesses and experts whose help was sought if any; names of arbitrators, date and place of issuing the verdict; signatures of arbitrators; signatures of the parties of dispute if possible; and reasons of the decision reached unless the arbitration document comprises exemption from such reasoning and there is no legal condition to that effect.
- 11/10 The arbitration decision should not necessarily be issued in the presence of the two parties of the dispute, although it is better to be so for shortening the procedure of communicating it to them.
- 11/11 It would be better to include in the conclusion of the arbitration decision a request or a recommendation to the judiciary or the concerned legal authorities to use every permissible means for its implementation.
- 11/12 The arbitration decision should not necessarily meet the consent of the two parties of the dispute. It should spontaneously be binding to them, unless it is revoked for being counter to the rules of Shari'ah or public order.
- 11/12 The arbitration decision can be issued on the basis of reconciliation as prescribed by Shari'ah or on the basis of consensual agreement.

## **12. Communication and Validity of the Arbitration Decision**

- 12/1 The arbitration decision shall be communicated to the two parties of the dispute through the normal procedures, unless a specific way of communication is identified in the arbitration document or by any other legal authority.
- 12/2 The validity of the arbitration decision does not require attestation of witnesses on communication of the decision to the two parties of the dispute or the consent of these parties to it, although such attestation is recommendable for avoiding conflict.
- 12/3 The validity of the arbitration decision does not require its official registration or submission to the concerned court, yet this has to be done if it is required for legitimizing the implementation of the decision. In that case, the date specified for finalization of such procedure should be observed.
- 12/4 If the arbitration decision is written in more than one language, the language to be adopted in case of dispute should be specified.
- 12/5 A signed copy of the arbitration decision shall be handed over to each of the two parties of the dispute, while each one of the arbitrators (if many) shall retain a signed copy as well.

## **13. Implementation of the Verdict (the Form of Implementation), or Its Revocation**

- 13/1 In principle, the two parties of the dispute should implement the arbitration verdict willingly. In case one party refrains from doing so, the other party has the right to present the verdict to judiciary for execution. Therefore, arbitration should not be resorted to if its verdict cannot be implemented.
- 13/2 For legitimizing the execution of the arbitration verdict, it is permissible to approach courts that do not observe the rules of Shari'ah.
- 13/3 The arbitrator does not have the right to retreat from his verdict, unless when he declares that he has committed a mistake in it.

However, in case of committing a mistake, the arbitrator can cancel or amend his verdict in view of the rules of the Islamic Shari'ah and in the way that would ensure justice.

#### **14. Arbitration Expenses and the Arbitrator's Fees**

14/1 It is permissible for the arbitrator, if he is not a volunteer or a government employee designated for doing arbitration, to receive fees for the task. The amount or percentage of such fees should be indicated in the conditions of arbitration in case of Institutional arbitration, or agreed upon in the arbitration document.

14/2 When the arbitration process leads to incurring of any expenses, such as transportation expenses for the arbitrator, witnesses and experts, or typing expenses, or fees payable to the arbitrator, the arbitration decision must specify the party that should bear them. It should be noted here that the expenses pertaining to the application of any of the disputing parties should be borne by that party alone, whereas common expenses are to be shared by the dispute parties, unless it is proved that one party has been deliberately intending to cause harm to the other through such expenses. In this latter case, the party that has been intending to cause harm should bear such expenses. All these preceding points hold true in the absence of a prior agreement which assigns the payment of the expenses to a specific party or to the condemned party.

#### **15. Date of Issuance of the Standard**

This Standard was issued on 30 Sha'ban 1428 A.H., corresponding to 12 September 2007 A.D.



## **Adoption of the Standard**

The Shari'ah Board adopted the Standard on Arbitration in its meeting No. (19) held on 26-30 Sha'ban 1428 A.H., corresponding to 8-12 September 2007 A.D., in Makkah Al-Mukarramah, Kingdom of Saudi Arabia.

## **Appendix (A)**

### **Brief History of the Preparation of the Standard**

On 12 Rajab 1427 A.H., corresponding to 6 August 2006 A.D., the Shari'ah Board decided to issue a standard on Arbitration.

On 21 Sha'ban 1427 A.H., corresponding to 14 September 2006 A.D., a joint meeting of the Shari'ah Standards Committees (1) and (2) was held in the Kingdom of Bahrain, and discussed the study. The meeting requested the consultant to introduce necessary amendments in the light of the discussions and observations of the joint committee members. The meeting discussed also the Standard on Arbitration which was ready in the same session, and introduced necessary changes in it, in the light of the discussions that took place.

In its meeting No. (17) held in Makkah Al-Mukarramah, on 27 Shawwal – 1 Dhul-Qadah 1427 A.H., corresponding to 18-23 November 2006 A.D., the Shari'ah Board discussed the changes in the standard which had been made by the joint meeting of Shari'ah Standards Committees (1) and (2), and introduced changes that it deemed necessary.

The Secretarial General of AAOIFI held a public hearing in the Kingdom of Bahrain on 18 Safar 1428 A.H., corresponding to 8 March 2007 A.D. More than 30 participants attended the session as representatives of central banks, institutions, and accounting firms. The session was also attended by Shari'ah scholars, university teachers and other interested parties. Several observations were made in the session, and duly responded to by the members of the Shari'ah Standards Committees (1) and (2).



In its meeting No. (19) held in Makkah Al-Mukarramah, on 26 Sha'ban – 1 Ramadan 1428 A.H., corresponding to 8-12 September 2007 A.D., the Shari'ah Board discussed the amendments that had been suggested in the public hearing, introduced changes that it deemed necessary and adopted the Standard.

## **Appendix (B)**

### **The Shari'ah Basis for the Standard**

- In one sense, arbitration seems like agency on behalf of the two parties, although it also seems to involve private custodianship in another sense.
- According to Shari'ah arbitration could take place verbally, yet it is preferable – for Institutions in particular – to document it in writing. In order to be legally accepted, arbitration needs to be written and signed by the arbitrators and the parties of the dispute.
- In principle, selection of arbitrators should be subject to the same Shari'ah conditions for selection of judges including non-partiality. In case of necessity, some of these conditions could be dropped such as the condition that the arbitrator should be a Muslim. Nevertheless, a non-Muslim arbitrator should not issue a verdict that contradicts with Shari'ah.

## **Appendix (C)**

### **Definitions**

#### **Sulh (Reconciliation)**

It refers to a request of relinquishment of what the arbitrators consider to be the right of one of the two parties of the dispute. Such request shall not be made to a party who is an agent, unless he is delegated to do reconciliation. Preferably, the issuance of a reconciliation decision is to be based on a clear clause in the arbitration document indicating that arbitrators have the right to pursue reconciliation.

#### **Consensual Settlement**

It refers to the case when the two parties of the dispute agree, outside the arbitration task, on a settlement which they both accept, and request the arbitrators to issue a decision based on that settlement. The arbitrators in this case shall concur to the request of the two parties, unless the proposed settlement is impermissible, or contrary to public order.

#### **Arbitration Document**

It is a document signed by the two parties to pursue arbitration on a dispute which has arisen between them.

#### **Arbitration Agreement**

It is a prior condition or a contract stipulating resort to arbitration when dispute arises.

#### **Material Mistakes**

It refers to unintentional mistakes in names or numbers, when proofs or documents indicate the aspects which need correction.

#### **Institutional Arbitration**

It is the selection of an Institution that comprises competent arbitrators to resolve the dispute. In this case, there is no need for designating the arbitrator in name.

