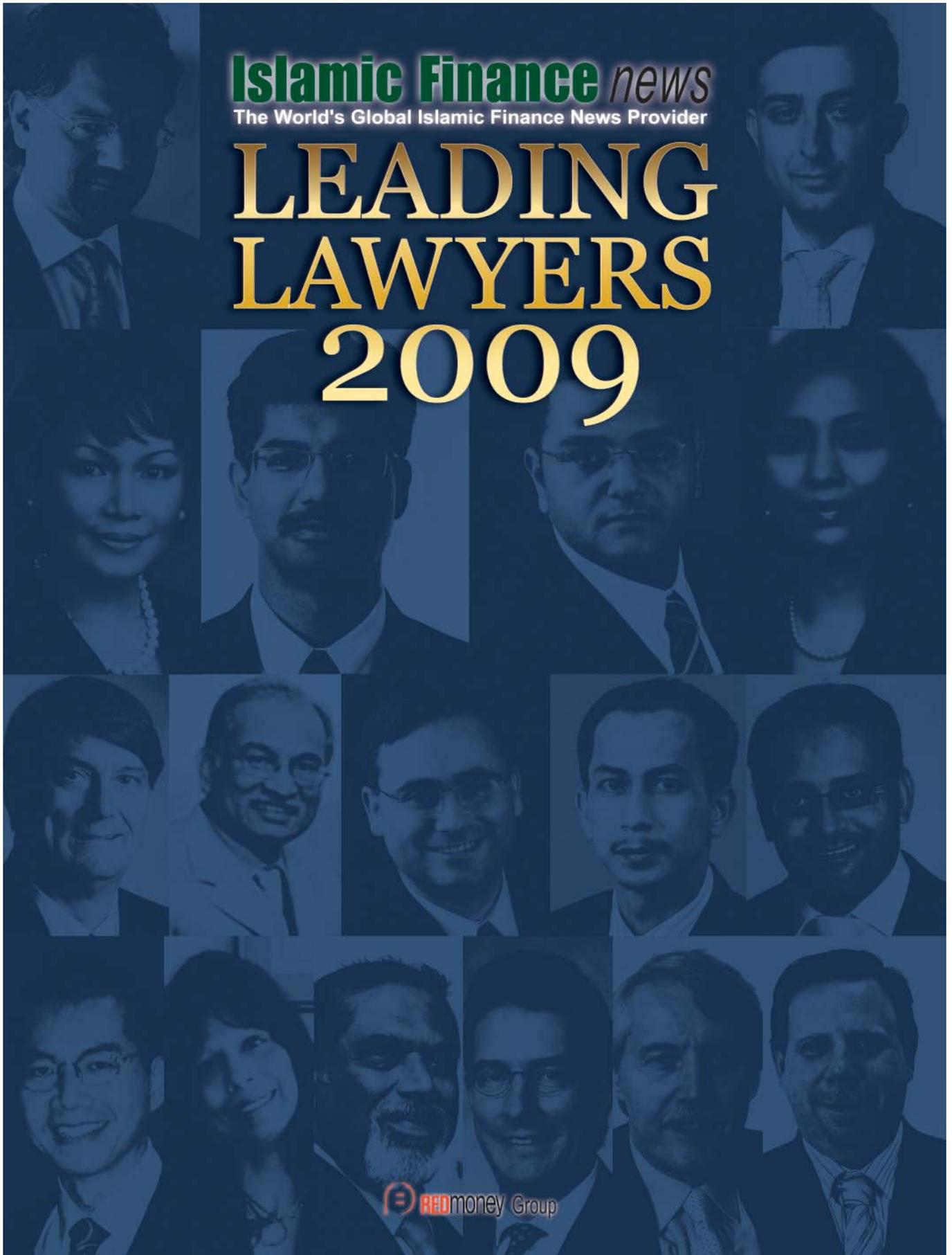
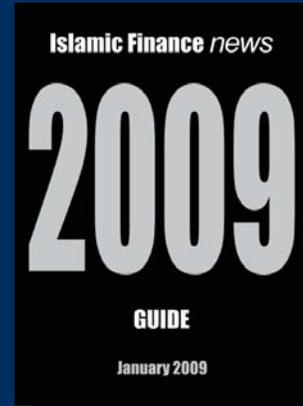
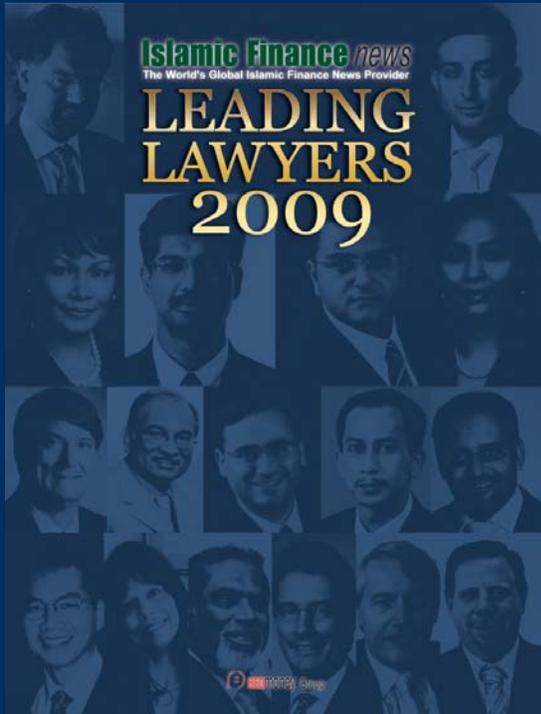


**Islamic Finance** *news*  
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# LEADING LAWYERS 2009





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**Islamic Finance** news

## Spotlight on the Leading Lights

This report, the latest *Islamic Finance news* supplement, is based on a survey which recognizes the individuals and law firms that are regarded as the best in their respective fields within the Islamic finance space.

Senior management of Islamic finance issuers, investors, financial institutions and government bodies from around the world were invited to participate. Survey participants were requested to take into account only those individuals they had, at some stage over the past 12 months, been directly involved with. Each participant could only vote once in each category. Only those individuals with three or more votes have been selected as IFN Leading Lawyers in each of the categories.

A total of 1,873 votes were cast in the 13 keenly contested categories. Of these, 126 were rejected due to irregularities discovered during the due diligence process. Therefore, a total of 1,747 votes counted towards the final results.

In addition to highlighting the leading lawyers, this first-of-its-kind publication has also compiled a range of reports on various sectors of Islamic finance. These include real estate, dispute resolution, offshore activities, securitization, transportation finance and Shariah funds amongst others. In fact, many of the voted lawyers have chosen to include their professional profiles within these pages.

This report is of particular significance because it demonstrates the immense breadth and depth of the legal sphere within Islamic finance. Readers will readily grasp the comprehensiveness of the legal framework and services that reinforce the practice of Islamic finance, making this publication even more relevant, not only to those within the legal fraternity but also other practitioners in the Islamic finance sphere, as well as those on the outside wanting in.

May the reading pleasure also promote productivity and profitability.☺

Kind regards,



Sivaselvam  
Managing Editor

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## Global Legal Islamic Finance Industry: Present State and Prospects

By S Sivaselvam

When the US financial crisis went global and then permeated non-financial economic activities as well, there were certain sectors that found prospects for their business improving instead. The legal community is a case in point. Non-fulfillment of contracts, companies going belly up—such instances meant work for lawyers.

Hence, even when the Islamic finance industry began to feel the impact of the spillover from the economic crisis, lawyers in that sector continued to be kept busy. And it appears that this trend will continue for some years to come at least.

Why? Simply because the nascent industry has numerous legal issues to be sorted out. Some lawyers have even taken to questioning pronouncements by Shariah scholars, such as whether the sale of debt is, to certain extent, permissible in Muamalat.

There is, of course, an important aspect of Islamic finance in which the legal practitioners are taking the lead: how best to make it compatible with conventional financial practices without impairing Shariah principles and requirements. Islamic finance operates in the same tax, regulatory and legal environment, and experiences similar susceptibilities and challenges as the conventional sector.

The collapse of the real estate sector in the Gulf Cooperation Council in the wake of the credit crunch has stimulated the creative juices of those in the legal fraternity on other asset classes that Islamic financial institutions can diversify into. The drop in the values of investments and deposits has prompted clients to seek legal advice on not just recovery paths but also new growth strategies.

They are looking at areas such as Islamic private equity and venture capital activities. According to a re-

port, Islamic venture capital is a virtually unexplored region of Islamic investment banking and could be set for quick growth when the turnaround comes.

A major issue is evolving that is bound to set the agenda for the next few years: Can the religious aspects of Islam be kept apart from the practice of Islamic finance, other than adherence to the relevant aspects of Shariah law? Legal interpretations concerning this are bound to proliferate as those who are opposed to Islam as a religion, for one reason or another, also oppose the practice of Islamic finance, arguing that it is just another aspect of the religion and not a standalone financial system.

Hence, a closely-watched court case will be that in Michigan, over the US federal bailout of American International Group (AIG) because it has subsidiaries that sell Takaful. Federal judge Lawrence Zatkoff contends that the US government's majority ownership of AIG raises the question of whether the government is promoting religion, contrary to the First Amendment to the US Constitution. With AIG trying to offload all its insurance units, the case could become a non-starter. It has nonetheless set the scene for a long drawn out debate over the link between religion and financial system.

Another issue in similar vein: The British government is co-sponsoring the Islamic Finance and Trade Conference in October, but has distanced itself from one of the co-organizers, the Muslim Council of Britain, because one of its officials signed a statement supporting violent jihad in Israel. It is being propagated that the promotion of Shariah financial services in the UK is "part of an overall program to implement Shariah law on Muslims in Europe and to send the message that it is the duty of all Muslims to bank in such a way if they wish to be considered proper Muslims."

*continued....*

*Global Legal Islamic Finance Industry: Present State and Prospects (continued..)*

One report stated: "In the last few decades implementing Shariah law has become a point of focus and discussion in many parts of the world. Acknowledging the role of Shariah was addressed by both terror groups such as the Taliban and by civilized countries such as the UK, where the Archbishop of Canterbury backed the introduction of Shariah laws. In the US there is an ongoing war between groups and organizations that support Shariah compliant finance and those who are against it."

An uncomfortable situation is seen to be emerging that — if the propaganda is successful — could stymie the expansion of Islamic finance. Nevertheless, it is a fertile greenfield for Islamic finance legal practitioners on how to either evade or overcome these minefields.

On the other hand, governments of other developed countries are warmly welcoming the introduction of Islamic finance. Australian assistant treasurer Nick Sherry said: "Our minds should be open to the potential for Islamic finance to operate in Australia alongside what we have come to regard as more conventional financial products." He spoke of opportunities for innovative Australian financial sector companies, while acknowledging that Islamic banking and finance products have different structures from conventional products, which may cause some regulatory and taxation questions. To Sherry, a key question is whether existing principles or rules, perhaps appropriately refined, can address these issues without the need for specific rules for Islamic finance. The inference: more work opportunities for Islamic finance legal practitioners.

There are also fresh fields to conquer for Islamic finance practitioners — besides emerging markets, territories that were once battlegrounds are developing financial architectures as they attempt to make a go of becoming nations. For instance, there are now significant opportunities in the financial services sector in Iraq and the government is reportedly seeking to attract new investors to help develop the available services.

"A competitive, modern banking system is now considered to be essential for the development of the economy, and now that the country is more determined to establish a liberal, market economy, all kinds of financial services will be increasingly in demand," says a report. Corporate financial services at present are very limited.

Furthermore, very few Iraqis take out insurance or invest in private pension schemes. Sophisticated financial services for business, such as factoring and leasing, are still rare as Iraq reportedly experiences a surging demand for trade finance. In a couple of years or so, Afghanistan could be in a similar situation. And there are countries in Africa that can also become amenable to Islamic finance.

Even ongoing activities within established Islamic finance jurisdictions are offering a continuous stream of opportunities for legal practitioners. Among them are mergers and acquisitions, to consolidate smaller banks and of conventional institutions acquiring Islamic banks. The need for better corporate governance and improved financial performance indicators calls for legal documentation, as do sales of non-core assets of Islamic banks.

The creation of trust laws that are specifically tailored for Islamic finance is becoming a fad. Then, of course, there is the Herculean task of standardization of Islamic finance products, of creating a platform to enable various regulatory and similar Islamic finance authorities to hum in tune, and getting the rival Islamic finance hubs in the various regions to collaborate even as they compete with each other.

Malaysia has set the pace by offering incentives to major legal firms to use it as a base to conduct international Islamic finance activities. Prospects are there for large international firms specializing in Islamic finance to have large stakes in an expanding pie. With research activities becoming an integral component of these firms, the legal community has a real potential of spearheading the global growth of Islamic finance. (F)

## The Development of Islamic Banking and Finance

*By Mohamed Ismail Mohamed Shariff*

Malaysia is generally recognised as a country that has made great advances in Islamic banking and finance. The first step in the process was the enactment by Parliament of the "Islamic Banking Act 1983" (the Act). It allowed for the establishment of licensed Islamic banks and in the same year, the first Islamic bank — Bank Islam Malaysia — was set up.

Since an Islamic bank has to comply with Shariah in all its operations and financing procedures, the issue of the applicable Islamic law is an important aspect in the establishment and operational processes of Islamic banks.

However, there is no standard comprehensive text of Shariah jurisprudence, which can be used as a reference for the business of an Islamic bank.

This critical issue is, however, cleverly dealt with in the Act by a simple, yet effective, mechanism. First, the Act provides that an Islamic bank licensed under it can carry out "Islamic banking business (IBB)", which it defines as "banking business whose aims and operations do not involve any element which is not approved by the Religion of Islam".

It then stipulates that before a licence can be granted to a company to carry out Islamic banking business, it must establish a Shariah advisory body (SAB) "to advise the bank on the operations of its banking business in order to ensure that they do not involve any element which is not approved by the Religion of Islam". Apart from these, there is no other provision in the Act relating to Islamic law generally or to Islamic banking specifically.

By this device, the legislature has left it to each Islamic bank, through its SAB, to determine the nature of the IBB that it can carry out. It would be noted that the definition of IBB is broad and the sources of

Islamic law are not restricted to any particular school of Islamic jurisprudence. It is well known that there are differences of opinion among the various schools of jurisprudence and Islamic scholars on many aspects of Islamic law.

Hence, prescribing any particular school as the governing body of law would have been restrictive and potentially divisive. The broad definition therefore allows for the import and application of any applicable principle from any recognized source of Islamic law. This liberal approach enables the SAB to adopt any principle that is relevant to the needs of the business of the bank.

This approach would work well if there is only one Islamic bank in the country. However, if there is more than one bank (at present there are 17 licensed Islamic banks), situations could arise where practices among the various banks differ because each may be applying a different, but recognized, principle. This can ultimately lead to uncertainty in the law and confusion among bankers and the public.

To address this problem, a central Shariah Advisory Council (SAC) was established in 2003 under the aegis of the Central Bank of Malaysia. This body will advise the Central Bank on Shariah issues and the Central Bank, in turn, will issue directives to the other banks.

In this way, the possibility of conflicting principles being adopted and applied is reduced, if not totally eliminated, as an element of certainty is introduced in Shariah applied in Malaysia. Even so, it must be noted that not all the principles approved by the SAC and applied by the Malaysian banks are accepted as valid in all countries. For example, the Bai Bithaman Ajil and Bai al Inah contracts, that are

*continued....*

*The Development of Islamic Banking and Finance (continued..)*

used extensively in Malaysia, are not regarded as valid Shariah contracts in many jurisdictions.

**Court systems**

Malaysia practices a dual court system: the civil courts and the Shariah courts. The civil courts are founded on the common law courts system that is well established in the UK and the Commonwealth countries; this is the mainstream court system in Malaysia.

The Shariah courts, however, have limited jurisdiction and are mainly confined to Islamic personal law matters affecting Muslims. They have no jurisdiction to take cognisance of other matters, even if they involve Islamic law, for example Islamic banking and finance. Thus Malaysia has the unique system where Islamic banking and finance disputes are litigated in the civil courts.

**Law applicable to Islamic banking and finance**

Another peculiar but interesting feature of the Islamic banking and finance practice is the law applicable to it. The civil laws of the country, passed by the Federal Parliament, are laws of general application. For instance, the Contracts Act 1950 applies to all contracts, Islamic or otherwise, so these civil laws also apply to Islamic banking transactions.

The civil courts have long recognized Islamic law as part of the law of the land and this means Islamic law will apply to such transactions, in addition to the civil laws.

In such circumstances, there can arise situations where there is a conflict between these two laws in a given contract. Indeed, such situations have arisen and the courts have had to deal with them on a case-by-case basis.

As of now, there is no provision in the law which specifically states that if there is such a conflict, Islamic law will prevail. Legislative intervention is therefore necessary to introduce a law to that effect and to make other amendments to existing laws to

expressly provide for the application of Islamic law to those transactions.

*“Malaysia has the unique system where Islamic banking and finance disputes are litigated in the civil courts”*

**Islamic banking and conventional banks**

Only a bank licensed under the Act could carry out Islamic banking business. So, in an effort to get conventional banks involved in Islamic banking, Parliament amended the Banking and Financial Institutions Act 1989 (BAFIA), which governs conventional banks, in 1996 to allow them to conduct Islamic banking business.

A notable feature in the new section introduced is the definition of the Islamic banking business: it adopts the definition in the Act. This means that the scope of the Islamic banking business that can be carried out by a conventional bank is exactly the same as that for an Islamic bank.

The practical outcome of this is to turn conventional banks into two-in-one banks, that is, they are conventional banks as well as Islamic banks, in all but name. This novel experiment resulted in almost all conventional banks having “Islamic windows” through which they offered a full suite of Islamic banking products.

Overtime, conventional banks found Islamic banking to be profitable and embraced it enthusiastically. They were then encouraged by the authorities to establish Islamic banking subsidiaries licensed under the Act, which would take over and further expand their Islamic banking operations and function as independent legal entities.

Today there are 12 such full-fledged Islamic banks (subsidiaries of conventional banks) operating in Ma-

*continued....*

*The Development of Islamic Banking and Finance (continued..)*

aysia. These, together with two originally dedicated Islamic banks — Bank Islam Malaysia and Bank Muamalat Malaysia — and three wholly foreign-owned Islamic banks — Kuwait Finance House (Malaysia), Al Rajhi Banking & Investment Corporation (Malaysia) and Asian Finance Bank — make a total of 17 Islamic banks licensed under the Act.

**Liberalization of the financial sector**

In April 2009, the Government announced a financial sector liberalization plan under which, among others, two new licences will be issued for two mega Islamic banks (each having a minimum paid-up capital of US\$1 billion) to be established in the country. The plan also announced an increase in foreign equity limits in local Islamic banks of up to 70%, and that such banks must maintain a paid-up capital of US\$1 billion.

**Islamic capital market**

The governing body for capital markets is the Securities Commission of Malaysia, which plays a major role in the development and proper regulation of Islamic capital market (ICM) activities. Among others, it has issued guidelines for Islamic debt securities and Real Estate Investment Trusts (REITS). The guidelines for Islamic REITS, issued in late 2005, were the first in the global Islamic finance sector and set a global benchmark for the development of Islamic REITS.

The Malaysian ICM is a robust and active market and the number of Sukuk issuances, for example, has increased phenomenally over the years. Malaysia is

the largest Sukuk issuer in the world, representing 60% of global Sukuk in 2008.

The listing of Islamic REITS has given the Islamic capital market another boost. The Al-Aqar KPJ Healthcare REIT (the main assets were seven hospitals) was listed on the Malaysian stock exchange in 2006, making it the first listed Islamic REIT. The Al-Hadharah Boustead REIT is the first Islamic plantation-based REIT, issued and listed in 2007.

**The future**

Although much has been done in the last quarter of a century to develop and promote Islamic banking and finance, its full potential remains to be tapped. There is tremendous scope for innovation in the type of Islamic products that can be offered.

The recent economic turmoil in the US and other countries offers a marvellous opportunity to promote Islamic banking and finance. This can help to bring about the dawn of a new global economic order and an alternative banking system, that in many respects, superior to the present conventional one. ☺

**SKRINE**

Mohamed Ismail Mohamed Shariff is a partner at Skrine in Kuala Lumpur, Malaysia. Refer to his profile on page 16.

Furthermore, Malaysia has achieved many world's firsts in Sukuk issuance:

Year	Issuer & Size	Description
2001	Kumpulan Guthrie – US\$150 million	First global corporate Sukuk
2002	Government of Malaysia – US\$600 million	First global sovereign Sukuk
2005	Cagamas MBS – US\$540 million	First Islamic residential mortgage- backed securities
2006	Khazanah Nasional (Rafflesia Capital) – US\$750 million	First exchangeable Sukuk
2007	Binariang GSM – US\$4.8 billion	Largest global Sukuk issuance as at the end of 2007



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### Individual Profile

Amjad is a co-founder and managing partner of Afridi & Angell.

He has been involved in several Shariah compliant transactions, Sukuk and treasury products.

He represents foreign and local private equity firms, banks, and leading multinationals in banking and financial transactions and corporate acquisitions in the UAE and other GCC states. He also represents Islamic banks and Shariah compliant borrowers/issuers in the UAE. He also regularly advises hotel owners on arrangements with international hotel management companies.

He has advised clients on management buy-outs and sale of businesses across the GCC states. He was recently involved in several project finance transactions and in the setting up of industrial projects in the UAE.

### AFRIDI & ANGELL

#### Areas of Expertise:

- Acquisitions & Divestitures
- Private Equity
- Banking & Financial Services
- Project Finance
- Islamic Banking
- Treasury Products
- Hotel Management

#### Bar Qualifications & Admissions:

- New York State Bar
- Punjab Bar Council
- International Bar Association (IBA)

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- Punjab University Law College, Lahore, Pakistan, 1979

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### Individual Profile

Edham is a corporate banking and finance lawyer with Abdul Rahman & Partners in Kuala Lumpur, a firm founded by his father in 1984. His areas of practice include Islamic banking and finance as well as corporate and commercial.

He has vast experience in advising onshore and offshore banking clients, setting up private equity/trust funds, preparing standard Islamic banking security documents for local and foreign incorporated banks and clients, and providing advisory work on Sukuk issuances, among others. He has also advised his clients on structuring Islamic facilities for project financing and syndicated-related and club deal works.

He has also worked with various corporations and institutions on essential debt and equity documentation such as mandatory general offer (MGO) acquisition financing and other related commercial practices.

Edham holds a Master's Degree of Law in Banking from the International Islamic University Malaysia. He graduated with an LLB (Hons) from the University of Sheffield, UK, and attended BPP Law School in London to complete his Bar Vocational Course. He was called to the English Bar as an utter barrister of Gray's Inn in July 2003 and subsequently returned to Malaysia to commence legal practice.

Being a young, enthusiastic and dynamic lawyer, Edham hopes to lead his firm to the forefront of Malaysia's efforts to be a center of excellence for Islamic banking and finance.



### Areas of Expertise:

- Asset Finance & Securitization
- Capital Market
- Corporate Recovery
- Islamic Banking & Finance
- Project Finance

### Islamic Finance Deals worked on:

- Advised a Qatari-owned bank in Malaysia on its first Tawarruq ship financing facility for newly built vessels
- Darul Takaful — First Murabahah sale-based financing for a prime property acquisition in Kuala Lumpur
- Advised and structured the legal documentation for a government-owned development bank on its first overseas Islamic project based on revolving Istisna
- Advised one of the promoters and fund managers of the Safeena Fund, a Labuan-based Islamic closed-end debt-equity fund
- Advised a government-linked company, in building its office in KL Sentral, on its Sukuk Ijarah issue

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### Individual Profile

Faresa is a Barrister-at-Law and joined Liaquat Merchant Associates (LMA) in 1984. Since then she has played a major role in developing corporate work at LMA. She currently heads the eight-member corporate department which advises extensively on all matters pertaining to banking, finance and corporate matters.

Since the introduction of Islamic banking in Pakistan in 2003, LMA has structured, designed and drafted Islamic banking documents in consultation with Shariah advisors and bankers, both within and outside Pakistan. The documents prepared by LMA are used by the corporate, commercial and consumer departments of banks and pertain to a wide variety of products. These documents are now used as standard base documents on a recurring basis, for transactions worth billions of Pakistani rupees. LMA has structured and advised on Islamic treasury documents, such as Mudarabah placement and Commodity Mudarabah finance. LMA has also drafted Islamic security documents covering a wide range of collateral.

Faresa has been instrumental in the development of the Islamic banking law practice at LMA due to her knowledge, insight and sound understanding of the issues involved when structuring Islamic banking transactions. She has worked closely with bank officers, as well as Shariah advisors, in coming up with the best course of action, keeping in mind that the civil and commercial laws of Pakistan are in the process of being adapted to Shariah principles applicable to banking.

The firm is headed by managing partner Liaquat H. Merchant who has been the driving force behind the practice. LMA enjoys an excellent working relationship with Kennedys, renowned insurance and banking lawyers in London, and also with Habib Al Mulla & Company, one of the most reputable law firms in Dubai headed by Dr Habib Al Mulla. With 15 Barristers-at-Law and Advocates, the firm also enjoys a relationship with Lane & Partners and during the past few years has developed a structured relationship with DLA Piper of the UK. This has resulted in the two firms working together on a number of projects in Pakistan.



### Areas of Expertise:

- Islamic Finance
- Microfinance
- Consumer Finance
- SME Finance
- Banking & Finance
- Litigation & Alternative Dispute Resolution
- Capital Markets & Derivatives
- Mergers & Acquisitions
- Clinical Negligence
- Power Projects
- Corporate / Commercial
- Privatization
- Real Estate & Construction
- Cross-Border Joint Ventures & Cross-Border Litigation
- Regulatory & Compliance
- Information Technology
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- Structured & Project Finance
- Takaful

### Other offices:

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\* denotes associate offices

### Clients:

Chase Manhattan Bank, American Express Bank, Deutsche Bank, Royal Bank of Scotland, Standard Chartered Bank, National Bank of Pakistan, Habib Bank, United Bank, Allied Bank, MCB Bank, Habib Metropolitan Bank, Emirates Bank, Bank Al Habib



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### Individual Profile

Helen obtained her Law Degree from the University of Indonesia in Jakarta in 1992, majoring in Law on Economic Activities. She is a founding partner of Marsinih Martoatmodjo Iskandar Kusdihardjo Law Office (MMIK), one of the leading law firms in Indonesia.

Helen is not only the principal legal counselor for all Sukuk issuances counseled by MMIK, but has also dealt with many complex legal issues in the capital market, corporate, loan restructuring, mergers and acquisitions, insurance and litigation.

Before co-founding MMIK, Helen was a legal consultant for more than 11 years at one of the most prominent law firms in Indonesia. She is licensed as an Advocate by the Indonesian Advocate Association (PERADI) and is also an Indonesian Capital Market Legal Consultant with the Capital Market Supervisory Board and Financial Institution (BAPEPAM-LK).

### Islamic Finance Deals worked on:

- IDR200 billion Syariah Ijarah PLN I Bond (2006)
- IDR300 billion Sukuk Ijarah PLN II Bond (2007)
- IDR760 billion Sukuk Ijarah PLN III Bond (2009)
- IDR160 billion Aneka Gas Industri Sukuk Ijarah (2008)
- IDR2.714 billion Domestic Sovereign Sukuk Series IFR-0001
- IDR1.985 billion Domestic Sovereign Sukuk Series IFR-0002
- IDR5.556 billion Domestic Sovereign Sukuk Series SR-001
- IDR1.5 billion Domestic Sovereign Sukuk for Dana Haji Indonesia Series SDHI 2010 A



### Areas of Expertise:

- Islamic Finance
- Capital Market
- Corporate
- Loan & Restructuring
- Mergers & Acquisition
- Insurance
- Litigation

### Achievements and Accolades:

*Islamic Finance news* for the Indonesian Deal of The Year 2008 – Indonesia Government Sukuk

*Islamic Finance Asia* for Groundbreakers 2008

Ministry of Finance of the Republic of Indonesia for the issuance of the Sukuk Retail Series SR-001 (the first retail Sukuk)



## Jal Othman

### Partner

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### Individual Profile

Jal heads the Islamic finance practice in Shook Lin & Bok, one of the oldest and largest law firms in Malaysia. He was instrumental in setting up the Islamic finance practice and continues to chart the course of this practice area. His task includes setting the policy direction for the development of a structured research and development unit to promote an effective continuing legal education scheme.

Leveraging on 16 years of experience as a banking and finance lawyer, Jal guides and leads his team of 20 lawyers advising on Islamic finance deals. He is also actively involved in the drive for innovation in the industry and advises Islamic banks, both in Malaysia and abroad, on various product developments. His experience in advising some major conventional cross-border mergers and acquisitions and real estate acquisitions have benefited him in his role as an Islamic finance lawyer.

Concurrent with managing his portfolio in the firm, Jal is also very much involved in the Islamic finance industry in general. He holds positions in INCEIF University, and has also been commissioned by the Securities Commission of Malaysia and the Rating Agency of Malaysia for product development and regulatory requirements. Jal is also involved in law reform through the Malaysian central bank committee for Islamic Finance Law Reform.

Consistent with the firm's policy of driving a global presence, Jal has participated in various international platforms as a speaker, moderator, panelist and commentator. These include conferences, workshops and forums in Australia, China, Hong Kong, Indonesia, Egypt and Singapore.

### Areas of Expertise:

- A wide range of Sukuk issuances for financing power plants in Malaysia and China
- Project financing for the automotive, textile and garment industries, as well as downstream and upstream activities in the palm oil industry
- Islamic structured products and Islamic syndicated financing

### Islamic Finance Deals worked on:

- Retail, mezzanine and tier-one financing deals, both for onshore and cross-border clients

### Education:

- Queen Mary & Westfield College of the University of London



## Jawad I Ali Partner

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### Individual Profile

Jawad is a partner at King & Spalding's Dubai and London offices and is the deputy leader of the firm's award-winning Middle East & Islamic finance practice group. His practice covers a broad range of Shariah-compliant and conventional finance and investment transactions. He is especially recognized for his knowledge of Shariah issues and his skill in developing innovative, Shariah compliant investment and financing structures. His practice has involved investment and financing transactions throughout the Middle East, across Europe, in the US and in Southeast Asia.

He received his Bachelors of Law (LLB) with honors from Liverpool University School of Law, England, in 1993 and his Masters of Law (LLM) in International Banking and Finance, cum laude, from Boston University School of Law in 1994. Jawad was admitted to practice in New York in 1995.

## KING & SPALDING

### Areas of Expertise:

- Islamic Finance & Investment
- Investment Funds
- Private Equity
- Project Finance
- Banking & Finance
- Infrastructure
- Restructuring

### Other Offices:

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## Matthew Sapte Partner

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### Individual Profile

Matthew is a partner in the firm's banking and finance department and specializes in debt capital markets and derivatives. He regularly advises bank and corporate clients on a wide range of Shariah compliant and conventional debt issuance including MTN Programmes and equity linked issuances and derivative transactions (whether OTC, exchange traded, credit, commodity or equity linked).

### Islamic Finance Deals worked on:

- US\$2.53 billion Aldar Properties Exchangeable Trust Certificates (Sukuk-al-Mudarabah)
- US\$3.52 billion Nakheel pre-IPO Equity linked Trust Certificates (Sukuk al-Ijarah)
- US\$225 million Sharjah Islamic Bank Trust Certificates (Sukuk Sharikat Melk)
- US\$460 million Aabar Sukuk - Exchangeable Trust Certificates (Sukuk al-Mudarabah)
- US\$3.5 billion PCFC Development FZCO Pre-IPO Convertible Trust Certificates (Sukuk al-Musharakah)
- Acapita of US\$210 million Trust Certificates (Sukuk al-Wakala Bel-Istithmar)
- US\$550 million Wings FZCO Trust Certificates (Sukuk al-Musharakah)
- US\$200 million Dubai Metals and Commodities Centre Trust Certificates (Sukuk al-Musharakah)
- US\$1 billion Dubai Department of Civil Aviation Trust Certificates (Sukuk al-Ijarah)

## DentonWildeSapte...

### Areas of Expertise:

- Sukuk
- Shariah Compliant Derivatives

### Other Offices:

#### Europe

- London
- Istanbul
- Milton Keynes
- Paris

#### Middle East and Africa

- Abu Dhabi
- Amman (associate office)
- Cairo
- Doha
- Dubai
- Kuwait (associate office)
- Muscat
- Riyadh (associate office)

#### CIS

- Almaty
- Moscow
- St Petersburg (associate firm)
- Tashkent
- Ashgabat (associate firm)

#### Southeast Asia

- Singapore (associate firm)



## Mohamed Ismail Mohamed Shariff

### Partner

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### Individual Profile

Ismail has played a significant role in his capacity as an advocate and solicitor in the development of Islamic banking and finance in Malaysia. In 1983, he drafted the first Islamic banking documents used by Bank Islam Malaysia, the only Islamic bank then. He has appeared as leading counsel in cases involving Islamic banking in the Superior Courts in Malaysia.

He is a Fellow of the Chartered Institute of Arbitrators (UK) and of the Malaysian Institute of Arbitrators and a Barrister-at-law of Lincoln's Inn. He is also a Notary Public. Ismail is a member of the Islamic Capital Market Working Group of the Securities Commission of Malaysia. He is also a director of Kuwait Finance House Malaysia. Prior to this, he was a director of Bank Muamalat Malaysia, as a nominee of Khazanah Nasional.

Not only is he an External Fellow of the Islamic Banking and Finance Institute Malaysia (IBFIM) but also an External Examiner in law at University Teknologi MARA. He is a Visiting Industry Expert at the International Centre for Education in Islamic Finance (INCEIF) and the Adjunct Faculty of Universiti Tunku Abdul Rahman.

Ismail was a member of the Working Committee on Islamic Law Review of Bank Negara Malaysia (the Central Bank) and Chairman of the Sub-Committee to review the law of contract (the Contracts Act 1950 of Malaysia) on its compatibility with Shariah. He was also a member of the Steering Committee on the International Islamic Money Market in Malaysia, which is now headquartered in Bahrain.

## SKRINE

### Areas of Expertise:

- Corporate Law
- Arbitration
- Islamic Banking

### Islamic Finance Deals worked on:

- Government of Malaysia's US\$600 million Sukuk (first global sovereign Sukuk)
- Kumpulan Guthrie's US\$150 million Sukuk (first global corporate Sukuk)
- Onshore and offshore Islamic financing transactions

### Education:

1969: LLB (Hons) degree from the University of Singapore

1970: Called to the Malayan Bar

1974: LLM from King's College, University of London

1992: Called to the Bar of the Supreme Court of the Republic of Singapore

2009: Admitted as a Practising Member of The Association of Chartered Islamic Financial Professionals Malaysia (ACIFP).



## Mohamed Ridza Abdullah

### Managing Partner

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### Individual Profile

Ridza graduated from the International Islamic University Malaysia with a Bachelor of Laws (First Class Honors) degree. He is also a graduate of the Institute of Chartered Secretaries and Administrators (London), a Fellow of the Institute of Chartered Secretaries and Administrators, and an Associate Member of the Chartered Institute of Arbitrators.

He set up his own firm, Mohamed Ridza & Co in 2005, specializing in Islamic banking and finance, corporate and commercial law, construction law and oil and gas, after leaving the partnership in Zaid Ibrahim & Co as head of his division.

Ridza is a trainer with the Securities Industry Development Corporation (training arm of the Securities Commission of Malaysia) and Financial Sector Talent Enrichment Program (training arm of Institut Bank-Bank Malaysia). He also sits on the *Islamic Finance news* Advisory Board. He has co-authored a book titled "Law and Practice of Islamic Banking and Finance" published by Sweet & Maxwell Asia. Ridza has also spoken extensively at seminars, locally and internationally, on corporate matters and Islamic banking and finance. Ridza was named as one of the world's leading Islamic finance lawyers as voted by his peers in the industry and sits as an independent director and member of the audit committee in several companies in Malaysia.

## MOHAMED RIDZA & Co

### Areas of Expertise:

- Islamic Banking & Finance
- Corporate & Commercial Law
- Construction Law
- Oil & Gas

### Islamic Finance Deals worked on:

- AirAsia
- Asian Finance Bank-QIB Financing
- Baitak
- Brunei LNG
- Citigroup-Telekom Islamic ABS
- Dentalmatics, Canada
- DRB Hicom Sukuk
- HSBC Dubai
- Iskandar Malaysia
- Kuwait Finance House (Kuwait)
- Metro Ikram (Turkey)
- Nanhai China
- Olam-Islamic Bank Asia Singapore
- Pavilion Malaysia
- Pertamina Indonesia
- PT IAT Indonesia
- Safeena Marine
- United Engineering Malaysia Sukuk
- South Quay Musharakah
- Baitak Asian Real Estate Fund I (Labuan Limited)
- Menara ABS Sukuk Ijarah



## Mohd Shuhaimi Ismail

Partner, Islamic Banking and Finance

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### Individual Profile

Mohd Shuhaimi heads the Islamic banking and finance department at Hisham, Sobri & Kadir. He has extensive experience in drafting various types of Islamic finance documents on Islamic capital markets, syndicated financing, project financing, as well as corporate and consumer financing.

He has been involved in the drawing up of Islamic banking documents for a number of banks in Malaysia which have been adopted as the bank's standard or template documents. He also plays an active role in advising clients on the formulation, structuring and development of new Islamic finance products and instruments.

Mohd Shuhaimi is frequently invited to present conference papers, deliver talks and conduct training in the area of Islamic banking and finance. Mohd Shuhaimi holds a law degree from the International Islamic University Malaysia. He graduated in 1994 and was admitted to the Malaysian Bar in May 1995.

Hisham, Sobri & Kadir is one of the pioneer law firms in the area of Islamic banking and finance. It has distinguished itself as an active player in the development of structural frameworks for new Islamic financial products.

HISHAM  
SOBRI &  
KADIR

### Areas of Expertise:

- Islamic Finance
- Banking
- Capital Markets

### Islamic Finance Deals worked on:

- Involved in numerous issuances of Sukuk and Islamic debt securities based on Ijarah, Musharakah and other approved Shariah principles — Sarawak Power, Sejangkat Power, Gas Malaysia, DRB-Hicom, IJN Capital and Syarikat Prasarana Negara
- Advised on the formulation and documentation of the first Islamic credit card issued in Malaysia

### Achievements:

- Member of the Law Review Committee established by Bank Negara Malaysia to undertake studies and make recommendations on legal issues that affect the operation of Islamic finance in Malaysia
- Member of the Law Review Sub-Committee on Tax and Stamp Duty instrumental for the tax neutrality treatment between conventional and Islamic finance instruments



## Richard de Belder Partner

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### Individual Profile

Richard recently returned to the UK after being the managing partner of the Abu Dhabi office. He has been involved in the Middle East since 1979 and has spent 20 years living and working in the UAE and Oman. Richard heads up the co-ordination of the firm's Islamic finance practice.

He has extensive experience advising banks (including Islamic financial institutions) and borrowers in a wide range of banking and financial transactions in the UAE, the Middle East, the UK and the US and has also been involved in various capital market transactions in the Middle East.

Richard has had many years experience in dealing with leading Shariah scholars and has been actively involved in the structuring and documentation of many leading Shariah compliant transactions.

### Islamic Finance Deals worked on:

- US\$210 million Tamweel Sukuk
- Ijarah based aircraft facility for a leading Middle Eastern airline
- Qatari Diar Real Estate Investment Company on a multi-million reverse share Murabahah financing
- US\$200 million Amlak Finance Sukuk Musharakah
- Amlak Finance's First Real Estate Fund
- Abu Dhabi Islamic Bank's multi-million Dirhams unsecured facility extended to a Dubai corporate using an Ijarah structure
- Abu Dhabi Islamic Bank Nujoom Islands Fund and Al Shorouq Fund
- Abu Dhabi Islamic Bank: A complex Shariah compliant financing for a major Dubai real estate project which involved both equity investment and Shariah compliant shareholder loans
- US\$1.25 billion Shuweihat Ijarah Financing

DentonWildeSapte...

### Areas of Expertise:

- Islamic Finance
- Sukuk

### Other Offices:

#### Europe

- London
- Istanbul
- Milton Keynes
- Paris

#### Middle East and Africa

- Abu Dhabi
- Amman (associate office)
- Cairo
- Doha
- Dubai
- Kuwait (associate office)
- Muscat
- Riyadh (associate office)

#### CIS

- Almaty
- Moscow
- St Petersburg (associate firm)
- Tashkent
- Ashgabat (associate firm)

#### Southeast Asia

- Singapore (associate firm)

All Nominated Lawyers in the Category of Islamic Banking & Finance


  
**Abradat Kamalpour**  
 Ashurst  
 Also Nominated in Islamic Securitization & Structured Finance  
 See Full Profile on Page 66


**Ahmad Fikri Assegaf**  
 Assegaf, Hamzah & Partners


**Ahmad Lutfi Abdull Mutalib**  
 Azmi & Associates


**Amer Mahar**  
 Allen & Overy


  
**Amjad Ali Khan**  
 Afridi & Angell  
 See Full Profile on Page 9


**Amjad Hussein**  
 Eversheds


**Anzal Mohammed**  
 Allen & Overy


**Chris Sioufi**  
 Dewey LeBoeuf


  
**Christopher Aylward**  
 DentonWildeSapte...  
 Also Nominated in Islamic Real Estate Finance, Islamic Securitization & Structured Finance  
 See Full Profile on Page 56

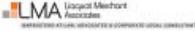

**Abdul Raman Saad**  
 Abdul Raman Saad & Associates


**Davide Barzilai**  
 Norton Rose


**Debashis Dey**  
 Clifford Chance


  
**Dian S. Kusdihardjo**  
 MMIK Law  
 Also Nominated in Islamic Corporate Finance  
 See Full Profile on Page 25


  
**Edham Reza Shah**  
 Abdul Rahman & Partners  
 See Full Profile on Page 10


  
**Fareesa Ahsan**  
 Liaquat Merchant Associates  
 See Full Profile on Page 11


**Giovanni Mofsol Muhammad**  
 Hanafiah Ponggawa & Partners


**Hamid Yunis**  
 Taylor Wessing


  
**Helen Joni Marsinih**  
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**Husam Hourani**  
 Al Tamimi & Company


**Ian Siddell**  
 Baker & McKenzie


**Indri Pramitaswari Guritno**  
 Hadiputrano, Hadinoto & Partners


**Irfan Tayebaly**  
 Mohsin Tayebaly & Co


  
**Jal Othman**  
 Shook Lin & Bok  
 See Full Profile on Page 13


  
**Jawad Ali**  
 King & Spalding  
 Also Nominated in Islamic Energy Finance and Shariah Investment Funds  
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**Jeffrey Smith**  
 Norton Rose


**Kazi Rahman**  
 Wragge & Co LLP


**Loh Mei Mei**  
 Zul Rafique & Partners


**Luma Saqqaf**  
 Linklaters

continued....

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Megat Hizaini Hassan  
Zaid Ibrahim & Co

Mike Duncan  
Allen & Overy

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See Full Profile on Page 16

Mohamed Ridza Mohamed Abdullah  
Mohamed Ridza & Co  
MOHAMED RIDZA & Co  
See Full Profile on Page 17

Mohammed Al-Jadaan  
Al-Jadaan Law Firm

Mohd Shuhaimi Ismail  
Hisham Sobri & Kadir  
See Full Profile on Page 18

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Richard de Belder  
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## Convertible Sukuk in Kuwait: A Legal Framework

By Hossam Abdullah

Given the current turmoil of the international financial sector, convertible Sukuk becomes one of the most attractive corporate finance instruments to both issuers and investors. Convertible Sukuk grants the Sukuk holders the option to convert the Sukuk for a pre-agreed number of listed and traded shares in the issuing entity or the obligor.

As such, convertible Sukuk are considered hybrid instruments with both beneficial ownership of the Sukuk assets that have underlying Shariah compliant transactions such as Ijarah, Musharakah or Mudarabah that generate a profit return and equity features. A common misunderstanding is that Sukuk are bonds or debts but from a Shariah standpoint, Sukuk should represent ownership of underlying assets or transaction which determine whether or not they can be traded in the secondary market.

Companies would typically consider the factors stated below before proceeding to issue Sukuk:

- conversion price — the nominal price per share at which conversion would take place
- conversion ratio — the number of shares each convertible Sukuk converts into which may be expressed on a number of Sukuk or as a percentage
- conversion value — the result of multiplying the conversion price by the conversion ratio
- conversion premium — the divergence of the market value of the Sukuk compared to that of the conversion value

Issuers may also prefer to have an early redemption call feature to induce investors to exercise the conversion option at the right timing.

The main benefit for a corporate entity to issue convertible Sukuk is to reduce the cash profit payment it makes to Sukuk holders as compared

to a standard Sukuk. In exchange for this benefit, the value of shareholders' equity is reduced due to the equity dilution if the Sukuk holders convert the convertible Sukuk into new shares. From investors' prospective, despite the low profit rate of return, convertible Sukuk carry an additional value through the option to participate in the company's equity as they benefit from the potential rise in the price of the underlying stock. If the stock does not perform well there would be no conversion and Sukuk holders would hold on to the Sukuk until maturity with a lower return as compared to the return of non-convertible Sukuk.

The shares or the equity to be delivered against the redemption of the convertible Sukuk do not need to exist at the time of issue of the convertibles. Often, such shares or equity are issued in the future by the issuer or the obligor upon exercise of the conversion option by the Sukuk holders.

In addition to cost, timing, Shariah and tax issues applicable to Sukuk generally, among the most important issues lawyers will need due diligence before recommending issuance of convertible Sukuk, are the level of support the legal framework can afford for a smooth issue and conversion of Sukuk.

These include the recognition of Sukuk issue in the target jurisdiction, structure of the Sukuk to be a bankruptcy remote from the issuer and the obligor, whether the company which will issue the equity part upon conversion is allowed to have authorized capital to ease the conversion process, and any restriction on the maximum face value of Sukuk a company can issue.

Kuwaiti convertibles — issues

Unlike some of the GCC jurisdictions, there has been no specific provision in Kuwait for the issuance of

*continued...*

*Convertible Sukuk in Kuwait: A Legal Framework (continued..)*

convertible securities. Stimulus Decree Law passed recently by the Amiri Decree No 2 of 2009 and its executive regulation issued by the Council of Ministers' Resolution No 285 of 2009 (the "Stimulus Laws") only allows issuance of convertibles bonds and Sukuk by banks and investment companies that are in financial distress if they fail to secure equity finance through rights offerings.

As such, other than Kuwaiti banks and investment companies that are regulated by the Central Bank of Kuwait, there is still a lack of regulatory coverage for the vast majority of Kuwaiti companies that would like to issue convertibles. In addition, Kuwaiti law does not allow for classes of shares other than under the Stimulus Laws which are only applicable to Kuwaiti banks and investment companies.

The Kuwaiti Commercial Companies Law No 15 of 1960, as amended, does not provide for the availability of authorized capital which entail that every time a Kuwaiti company would like to issue shares it must seek the approval of its extraordinary shareholders assembly.

Ministerial Order 388 of 2007 amended Executive Regulation No 113 of 1992, (executive bylaw of the Decree Law 31 of 1990 for the Regulation of Securities and Foundation of Investment Funds as amended) are the first rules promulgated in Kuwait with respect to the issuance of Sukuk but did not set the legal platform for the conversion of Sukuk into equity or the possibility of having SPV issuers.

In addition, under the current Kuwaiti legal framework, a Kuwaiti issuer cannot issue Sukuk in excess of its paid-up capital which will relegate the local market to small and medium-sized Sukuk issuances. This may explain the reason for the lack of Sukuk issued directly by Kuwaiti issuers as opposed to Sukuk issued by orphan SPVs that are established outside Kuwait and guaranteed by Kuwaiti obligors — the only one convertible Sukuk issued by a Kuwaiti obligor was the IIG Sukuk in 2007 using offshore structure.

As such, Kuwaiti companies have the option to issue Sukuk through an SPV to be incorporated in a foreign tax heaven jurisdiction, or to be issued directly by the Kuwaiti company. In both cases, the conversion of the Sukuk will be made into shares of the Kuwaiti company, but through an option to the Sukuk holders to convert the Sukuk for a certain number of shares in the Kuwaiti company ("physical settlement") or to pay to the Sukuk holders in cash the market price of the shares which were supposed to be delivered ("cash settlement").

***"A Kuwaiti issuer cannot issue Sukuk in excess of its paid-up capital which will relegate the local market to small and medium-sized Sukuk issuances"***

In the case of physical settlement, the Sukuk will be redeemed against delivery of either treasury shares or issuance of new shares by the Kuwaiti company. The Kuwaiti legal system so far does not recognize or allow companies to have authorized capital where the board of directors receive upfront shareholders approval and then issue new shares in the future.

As such, if the company would need to issue new shares, the approval of the extraordinary shareholders assembly is required to increase the capital and waive the pre-emption rights offering of the shareholders in favor of the Sukuk holders. The pre and post regulatory approvals to issue new shares should not take more than a couple of months to complete. If the Kuwaiti company was established through a public offering process, the issuance of new shares would require the approval of H H the Amir which can take a relatively longer time.

The time impact makes it difficult for major companies in Kuwait that were established through  
*continued....*

*Convertible Sukuk in Kuwait: A Legal Framework (continued..)*

public offering to issue convertibles and would entail using exchangeable Sukuk structure as opposed to a convertible Sukuk structure. With the support of the government, it is expected that the capital increase process would be reduced in the near future.

In addition to the timing issue, in case the company would like to satisfy its obligation to convert the Sukuk into capital through physical settlement by delivering treasury shares, all physical delivery of Kuwaiti shares need to be traded through the Kuwait Stock Exchange (KSE) and each Sukuk holder would need to have a trading account with the KSE to receive the shares.

This creates a difficulty for convertibles as the shares to be delivered upon conversion would need to be traded at a discount to the market price, such as the conversion price and the rules of the KSE only allow certain margin deviation from the market price.

**Solutions**

To overcome this difficulty, there are three potential choices for the company. The first choice is for the company to offer the shares at market price and pay the Sukuk holders sufficient cash to cover the difference between the market price and the conversion price.

This is a cumbersome process and creates the risk that the company is obligated to deliver a large amount of cash to cover the amount of the convertible Sukuk and does not entirely eliminate the possibility of an interloper acquiring the shares.

The second choice is to arrange for a secondary listing of the shares on a second stock exchange that allows the delivery of the shares to the Sukuk holders to be made through OTC (over the counter) procedures. This is potentially a lengthy and time-consuming process.

The third choice would be to change the structure of the Sukuk to exchangeable and not convertible. This would entail transferring the title of the shares to the

SPV issuer of the Sukuk against the cash proceeds arising from the offering of the Sukuk to investors or transferring the shares to an omnibus portfolio account for the benefit of the Sukuk holders.

However, tax issues may arise if selections are not made carefully as to the jurisdiction of the SPV or the type of investors to participate in the offering. Again, delivery of the shares should be made through the second listing outlined above.

In the case of a cash settlement, the Sukuk will be redeemed against payment of the market price of the promised shares in cash. This could be burdensome on the company. In order to protect directors making such a decision, the shareholders should approve the issuance of convertible notes in advance.☺



Hossam Abdullah is a corporate, banking and finance partner of ASAR (Al-Sarraf & Al-Ruwayeh), a leading legal services firm in Kuwait. Refer to his profile on page 26.

## IN THE CATEGORY OF

Islamic Corporate Finance, Islamic Banking & Finance

**L** Islamic Finance *news*  
LEADING LAWYERS  
2009



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#### Areas of Expertise:

- Finance & Securities
- Islamic Finance
- Mergers & Acquisition
- Oil & Gas Transaction
- Capital Market
- Project Financing

#### Individual Profile

Dian attained her Law Degree from the University of Indonesia in 1994 and an Economics Degree from Trisakti University, Jakarta, in 1995. She is a founding partner of Marsinih Martoatmodjo Iskandar Kusdihardjo Law Office (MMIK), one of the leading law firms in Indonesia. MMIK deals extensively with corporate and loan restructuring, project financing, general corporate and investments, mergers and acquisitions, and the capital market.

Other than being the principal legal counselor for many Sukuk issuances, she has also been dealing with legal matters in finance and securities, mergers and acquisition, oil and gas transaction, project financing and capital market.

Before co-founding MMIK, Dian was a legal consultant for more than 11 years at one of the most prominent law firms in Indonesia. She is licensed as an Advocate by the Indonesian Advocate Association (PERADI) and is also an Indonesian Capital Market Legal Consultant with the Capital Market Supervisory Board and Financial Institution (BAPEPAM-LK).

#### Achievements and Accolades:

Islamic Finance *news* for the  
Indonesian Deal of The Year 2008  
– Indonesia Government Sukuk

Islamic Finance Asia for  
Groundbreakers 2008

Ministry of Finance of the  
Republic of Indonesia for the  
issuance of the Sukuk Retail Series  
SR-001 (the first retail Sukuk)

#### Islamic Finance Deals worked on:

- IDR200 billion Syariah Ijarah PLN I Bond (2006)
- IDR300 billion Sukuk Ijarah PLN II Bond (2007)
- IDR760 billion Sukuk Ijarah PLN III Bond (2009)
- IDR2.714 billion Domestic Sovereign Sukuk Series IFR-0001
- IDR1.985 billion Domestic Sovereign Sukuk Series IFR-0002
- IDR5.556 billion Domestic Sovereign Sukuk Series SR-001
- IDR1.5 billion Domestic Sovereign Sukuk for Dana Haji Indonesia Series SDHI 2010 A



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### Areas of Expertise:

- Islamic Transactions including Sukuk, Islamic Finance & Structured Products
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- Mergers & Acquisitions
- International Commercial Transactions
- Taxation, Arbitration & Litigation

### Individual Profile

Hossam received his LLB (1992) and Diploma in International Trade Law and Investment (1993) from Cairo University, Egypt; Diploma in Private Law (1996) from IARS-ALESCO; and LLM, International Business Law (1998) from Manchester University, UK. He was admitted to the Egyptian Bar Association in 1993.

Hossam has over 16 years extensive legal experience in corporate, banking and finance sectors, with emphasis on structuring and handling Islamic finance transactions, debt and equity, capital markets, investment funds, and mergers and acquisitions. He also has an in-depth knowledge of Shariah principles and has worked on leading Islamic and conventional transactions not only in Kuwait but also the Gulf Cooperation Council region, and the US.

Hossam was recently named as a leading lawyer in Kuwait and Asia by a number of institutions, including Best Lawyers International (US) covering corporate, capital markets, banking & finance in Kuwait, IFLR as a World Leaders' Islamic finance lawyer; and AsiaLaw Leading Lawyers on June 2009 as one of the leading lawyers in Asia.

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### Individual Profile

Rob received his education at the University of Saskatchewan in Canada. He was admitted to both the Law Society of Upper Canada (Ontario) and the Law Society of Saskatchewan in 1993.

Prior to joining Al-Sarraf & Al-Ruwayeh, Rob practiced law in Canada, where he also lectured at the Bar Admission Course and published papers on various aspects of commercial law. Rob specializes in general corporate commercial, capital markets, project work and financial transactions, and also regularly advises banks and other financial institutions on both conventional and Islamic finance.

Rob has a strong, diversified and practical background in relation to a variety of commercial, corporate and financial matters and projects, and working on large commercial and investment projects. He has over 19 years of legal experience out of which 12 years have been spent working in Kuwait.

Rob was recently named as a leading lawyer in Kuwait by a number of publications including Chambers & Partners, Legal 500, IFLR and Best Lawyers for his corporate, commercial, banking and finance work.



### Areas of Expertise:

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- Sukuk, Bonds & Structured Debentures
- Banking & Finance
- Corporate & Commercial Matters
- Mergers & Acquisitions
- International Commercial Transactions

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Arfat Selvam Alliance

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See Full Profile on Page 25



Gregory Man  
Clifford Chance

Helen Joni Marsinih  
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See Full Profile on Page 12



Hossam Abdullah  
Al-Sarraf & Al-Ruwayeh  
See Full Profile on Page 26



Imtiaz Shah  
Lovells

Indri Pramaswari Guritno  
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Rob Little  
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See Full Profile on Page 27



Simon Briscoe  
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Murtha Cullina

Zubair Mir  
Herbert Smith

## Islamic Finance Dispute Resolution

*By Oliver Agha*

Islamic finance has come to a crossroads in its evolution. Shariah compliant financings have developed exponentially in many jurisdictions. However, there is a considerable variation in standards and wide divergence in industry practices.

The global downturn has resulted in increased levels of disputes, thus highlighting the need for an authoritative and specialist body that can adjudicate and provide reliable and specific decisions guided by Shariah in a modern commercial context.

There are many fora operating within national legal systems that deal with the adjudication of Islamic finance disputes. Such disputes can be handled by both state courts, as well as by alternative dispute resolution (ADR), as for example the Central Bank of Malaysia Shariah Advisory Board, the Kuala Lumpur Regional Center for Arbitration and the Islamic Center for Reconciliation and Arbitration in Dubai. However, existing fora face many issues on their way to becoming globally recognized centers for Islamic dispute resolution.

The first and foremost problem lies in a diversity of thought and practice of Shariah across all the Islamic countries. Besides the differences between Sunni and Shi'a Islam, there are four notable schools (madhab) within Sunni Islam itself: Maliki, Hanafi, Hanbali and Shafi'e. Although each individual is free to follow the school of his choice, certain populations in Islamic states have traditionally followed a certain Madhab.

Thus, to demonstrate the degree of fragmentation existing in the Islamic world of jurisprudence, the Hanafi school prevails in Turkey, Syria, Lebanon, Iraq, Jordan, Egypt and the Sudan; Maliki has governed the Muslim populations of North, West, and Central Africa; Shafi'e has prevailed in East Africa, Malaysia, and the southern part of the Arabian Peninsula and Hanbali is the basis for the codified law of the Kingdom of Saudi Arabia.

Such differences inevitably influence the approach to Islamic finance and related disputes. Malaysia, for example, takes a more liberal approach to the interpretation of Shariah, whilst the Gulf region's interpretation is considered more purist.

A vast amount of Islamic finance cases are adjudicated by the state courts of various countries, thus falling under the purview of national law. There are countries where Shariah is: (i) a supreme source of law, as for example, in Saudi Arabia, Iran, Sudan and Pakistan, (ii) one of the sources of law as in Malaysia, Kuwait and UAE, (iii) not part of the legal system. Naturally, the issues arising in relation to Islamic dispute resolution vary depending on the category to which the country belongs.

Of course, the majority of legal systems are not based first and foremost on Shariah and, as a result, courts will apply Shariah law in the context of its interplay with the national laws. This raises issues both in relation to the status of Shariah law within the contract, court adjudication process and also in relation to the enforcement of overseas judgments.

In the Middle East, a vast amount of Islamic finance transactions name the courts of England and Wales as the applicable forum and the law of England and Wales as the governing law. Naturally, the English courts have addressed the extent of applicability of Shariah law to certain contracts. For example, in the case of Shamil Bank of Bahrain (EC) versus Beximco Pharmaceuticals Ltd, the court considered the status of a purportedly dual Shariah and English governing law clause.

Contracts between the parties stated that they were "subject to the principles of the glorious Shariah" and would be governed by and construed in accordance with the laws of England and Wales. Beximco claimed that the dual reference to Shariah and English law meant that the contract had to be

*continued....*

*Islamic Finance Dispute Resolution (continued..)*

recognized as binding by both systems of law (and that the contract was not Shariah compliant). The Court of Appeal ruled that because Shariah law was not the law of any individual country and there was too much uncertainty as to its terms for it to be a binding system of law, English law was the sole governing law.

This case has caused controversy, given the popularity of English governing law clauses in the Islamic finance industry. Parties are now advised to make sure that any Shariah compliant arrangements and mechanisms included within their agreements also comport with the chosen national law. However, there may be circumstances where this simply is not possible and Shariah principles may be sacrificed. Whilst the Shamil case is limited to England and Wales, it is possible that other common law legal systems may apply similar reasoning.

In cases where parties are considering choosing a specific national law, the legal system of which includes Shariah law, they must ensure that there is a reciprocal enforcement treaty in place between both countries.

However, in certain circumstances, even when such arrangements are in place, a successful enforcement may be impossible. For example, if the decision of a foreign court involves payment of interest, such a decision will not be enforced in Saudi Arabia since it contravenes the basic precepts of Shariah.

Thus, submitting an Islamic finance matter to a state court of any jurisdiction may evince various issues, which include enforcement, adjudication in accordance with Shariah law, lack of competent training of judges, and conflict of laws issues, among others.

Therefore, the market has reached a point where an authoritative and specialist Islamic finance ADR institution is needed. Such a forum must draw on both Islamic academia, as well as robust commercial expertise.

ADR fora for Islamic finance matters exist in many countries in a variety of forms (arbitration, expert determination, among others). However, such fora face certain issues that impede their growth. Notwithstanding the issue with the diversity of schools of Islam, the ADR fora must be able to pass a final and binding decision. However, frequently, this is not the case.

*“Whilst the Shamil case is limited to England and Wales, it is possible that other common law legal systems may apply similar reasoning”*

Until this month, under the Central Bank of Malaysia Act 1965, for instance, the court had a discretion to refer a question concerning a Shariah matter in Islamic finance to the Shariah Advisory Council.

However, the Shariah Advisory Council could only make recommendation that were not ultimately binding. That Bank Negara Malaysia Act 2009 has reformed the situation, making the Shariah Advisory Council's decisions binding is an indicator of the increasing maturity of Islamic finance ADR in Malaysia. However, the situation is not uniform.

In the Middle East, the leading regulatory body for Islamic finance is the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). It develops and publishes standards that regulate the industry. One of the standards to be issued by AAOIFI concerns arbitration and the publishing of such should assist in the development of Islamic ADR fora.

Another question confronting Islamic ADR institutions is the optimal scope of their mandate. In Malaysia, for instance, the role of a Shariah arbitrator has often been limited to that of an expert, who renders

*continued....*

*Islamic Finance Dispute Resolution (continued..)*

a judgment in terms of a discrete aspect of a case, and then refers it back to the main ADR forum.

To the extent an Islamic ADR institution attempts to undertake a scope that is all-encompassing, and therefore akin to its conventional commercial arbitration equivalent, raises the issue of competence and qualifications of the arbitrators. In a conventional context, many commercial arbitration fora are qualified to issue a ruling on all of the aspects of the issues between the parties.

*“Another issue concerns the identity of arbitrators, that is, can non-Muslims issue binding decisions that affect Islamic parties”*

One has to query whether a sufficient number of Shariah scholars are qualified to deal with the dynamics of complex commercial arbitration and/or whether commercial arbitrators can be sufficiently expert in the intricacies of Shariah law. Another issue concerns the identity of arbitrators, that is, can non-Muslims issue binding decisions that affect Islamic parties.

In relation to enforcement of arbitral awards, Islamic ADR fora may face the same issues as the state courts. In circumstances where a party needs to enforce an arbitration decision overseas, they may find it difficult to do so under another nation’s law. The parties need to ensure that there is a reciprocal enforcement treaty in place between both countries.

The New York Convention of 1958 on the enforcement of foreign arbitration awards has gone a long way to deal with cross-border enforcement of arbitral awards and most countries, under which the arbitration of Islamic finance disputes are carried out, are signatories. The convention requires that signa-

tory states recognize and enforce arbitral awards made under the governing law of other nations.

However, there are exceptions, in particular the public policy defense, that allows a party to avoid enforcement of an award on the ground of “public policy”. It could potentially be used by national courts to prevent the enforcement of Shariah compliant arbitration awards where judges consider that the arbitration award runs counter to public policy, as for example by trumping explicit national laws or jurisdictions.

In summary, the credit crunch has exposed certain practical issues vis-à-vis the workings of dispute resolution in Islamic finance. But it has also revealed an opportunity to set the policy and agenda for the development of Islamic finance. The establishment of a recognized Islamic Finance ADR forum is needed to adjudicate disputes with recognized capability and standing.

The Middle East is a strong candidate for the role owing to its rigorous approach to Shariah law and its growing Islamic finance sector.<sup>(2)</sup>

*agha shamsi*  
A SHARIAH COMPLIANT PRACTICE

Oliver Agha is managing partner of Agha & Shamsi, the first Shariah compliant firm, based in the UAE. Refer to his profile on page 33.



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- Finance & Banking
- Dispute Resolution
- Mergers & Acquisitions

#### Individual Profile

Noor is an International Partner at Blake Dawson Asia Business Services Ltd. and currently a Senior Foreign Legal consultant with Soebagjo, Jatim, Djarot (in association with Blake Dawson). She has worked in Singapore, New Zealand, Sweden and Indonesia.

Noor has advised major domestic and international clients, among others, in general commercial law, cross-border investment and negotiations, finance and banking (including Islamic funding), and the Indonesian process towards dispute resolution. She is well known for her expertise in mergers and acquisitions (M&A).

Noor has been recognized as an AsiaLaw Leading Lawyer from 2004 to 2008 for professional services in M&A and for Islamic finance from 2005 to 2008.

A Singaporean, Noor has been called to the Singapore Bar and has an LLM from the University of London. She is active in Indonesian business and industry circles, and international legal organizations. Noor is also a Council Member of the Inter-Pacific Bar Association (IPBA); Chairman of the IPBA Scholarship Committee and sits on the governing board of the Singapore Chamber of Commerce in Indonesia.

## IN THE CATEGORY OF

Takaful, Securitization & Structured Finance, Dispute Resolution, Real Estate Finance, Transportation Finance, Project Finance, Banking & Finance



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#### Areas of Expertise:

Devising innovative, yet compliant and commercially viable, Islamic finance structures in Ijarah, Murabahah, Mudarabah, Takaful, Musharakah, Istisna, Wakalah and Sukuk constructs.

#### Individual Profile

Oliver is one of the two founding partners of Agha & Shamsi, a Shariah compliant law firm. The firm has been established, pursuant to Oliver's vision, to develop the cause of "genuine" Islamic finance by:

- conducting its affairs in compliance with Shariah
- enabling its lawyers to pursue and develop Islamic scholarship
- providing authentic and considered Islamic law advice for application in today's modern day complex transactions.

Prior to establishing Agha & Shamsi, Oliver was the global head of Islamic finance at DLA Piper and prior to that was the head of projects and co-head of Islamic finance at Clifford Chance's Saudi affiliate. Oliver is a New York lawyer and prior to the Middle East was with Fulbright & Jaworski.

He is recognized as a leading Islamic finance authority; he is on the board of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and is recognized as a top Islamic finance lawyer by numerous publications including Chambers Global 2009, Islamic Finance news: Leading Lawyers 2009 survey, Legal 500, Who's Who Legal, Expert Guides: Best of the Best Islamic Finance Lawyers 2008, 2009 and as one of the top 20 lawyers that helped the Gulf's economic boom by Brief Magazine in 2008.

Oliver brings a deep knowledge of Shariah, acquired after years of study, coupled with hands-on experience in structuring, documenting and negotiating landmark deals in the region with a business-savvy, client-friendly and responsive approach. He has served as a lead lawyer in some of the landmark and novel Islamic project financings in the region, with an aggregate deal value in excess of US\$30 billion.

#### Islamic Finance Deals worked on:

- US\$8.5 billion refinery and petrochemical project at Rabigh
- US\$800 million Saudi Basic Industries Corporation (SABIC) Sukuk
- US\$847 million Yansab (SABIC) Islamic financing
- US\$526 million Al-Waha Project in Saudi Arabia
- Conversion of a US\$1 billion real estate fund into a Shariah compliant fund
- US\$1.5 billion Murabahah variant financing of an infrastructure project
- US\$500 million Ijarah financing of a shopping centre
- US\$10 billion Saudi petrochemical project
- US\$1.4 billion financing of an integrated acetyls complex
- US\$115 million Syndicated Ijarah facility

amongst others...

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Abdulaziz AlGasim Law Firm

■ **Husam Hourani**  
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■ **Mehmood Y Mandviwalla**  
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■ **Mohamed Ismail Mohamed Shariff**  
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See Full Profile on Page 16

■ **Noor Meurling**   
Soebagjo Jatim Djarot  
See Full Profile on Page 32

■ **Oliver Agha**   
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See Full Profile on Page 33

■ **Osama Hassan**  
Ashurst

■ **Rahmat Bastian**  
BT Partnership

## Structuring Shariah Compliant Funds

*By Nabil A Issa and James Stull*

While 2009 has presented challenges for the funds industry amidst the global economic downturn, a large number of investors in the Middle East still see the value of pooling money into a fund to acquire companies and properties globally that are undervalued and available. Many investors in the Gulf Cooperation Council (GCC) countries prefer to make investments in a Shariah compliant fund rather than a conventional fund for religious reasons.

As the Sukuk market has slowed and the amount of available financing has receded, real estate and private equity firms are increasingly turning towards Shariah compliant funds to secure the capital from these investors needed to acquire a stake in these new investment opportunities.

However, while being Shariah compliant does impose certain restrictions, in our experience, a Shariah compliant fund is more marketable than a conventional fund in the GCC. In particular, investors in Kuwait and Saudi Arabia have a strong preference for investing only in a Shariah compliant manner.

In general, nothing prevents a non-Muslim investor from investing in a Shariah compliant fund. Therefore, forming and offering a Shariah compliant fund opens the fund to a wider pool of potential investors. In fact, many potential non-Muslim investors appreciate that such investments are being made ethically and will not involve high-risk financial products.

A Shariah compliant fund operates like a conventional fund, but several key differences exist:

- inability to make investments in companies in sectors that are not Shariah compliant (haram),
- certain requirements that investors be treated equally,
- inability to utilize conventional financing or invest in companies highly leveraged with conventional debt and
- requirement for oversight of fund activities and investments by a Shariah board.

### Restricted investments

Whether an investment fund is Shariah compliant or not makes a significant difference as to how and where the fund may invest its capital. A Shariah compliant fund cannot invest in companies or assets that are themselves not Shariah compliant.

Careful consideration must be paid to target investment companies that could derive partial income from unlawful or haram activities, such as supermarkets, airlines, hotels and restaurants that may sell pork or alcohol.

It is generally accepted that any haram income of a non-compliant target company that does not exceed 5% of overall gross income is considered marginal or incidental. The target company would then be considered acceptable, provided sufficient cleansing or income purification occurs in accordance with the guidelines set forth by the Shariah board.

Restricted investments should not be a foreign concept to most investors as most private equity and real estate funds require diversification and entirely restrict investments in certain arenas (or at least restrict them to a percentage of commitments to such fund).

### Equal rights for investors

One of the key tenets of Shariah involves risk sharing between the fund manager and investors and amongst the investors themselves. One of the fundamental principles of Shariah is that any loss by the fund be borne by the investors proportionally to their invested capital regardless whether the investors hold different classes of shares in the fund. However, it is possible to have a Shariah compliant fund in which profits are not shared proportionally to invested capital.

### Shariah compliant financing

Avoiding interest (riba) and conventional debt is  
*continued....*

### *Structuring Shariah Compliant Funds (continued..)*

critical to a Shariah compliant fund when leveraging an acquisition or investment. Shariah compliant financing is readily available in the GCC, but in other parts of the world a fund manager may struggle to find a bank that is willing and capable of providing financing on a Shariah compliant basis. This makes such financing more difficult to obtain and more expensive to structure in a Shariah compliant manner, but banks outside the GCC are often more willing to provide limited recourse financing at more competitive rates.

#### Shariah board

The Shariah board for a Shariah compliant fund can take different forms. The fund may have its own advisor or use the advisor of its fund manager, general partner or sponsor. Additionally, we have seen the Shariah board range from a single scholar to a group as large as five scholars, who collectively decide matters.

The Shariah board's role varies from fund to fund and can range from simple oversight to involvement in management and operations. However, fundamentally, the role of the Shariah board is to be an independent regulator to ensure the fund is conducting its activities in a Shariah compliant manner.

Shariah boards tend to recognize that many target companies are not completely "interest free" and that if one is a minority investor, the ability to demand that such conventional debt be refinanced on a Shariah compliant basis is limited. If a Shariah compliant fund acquires a portfolio company with conventional debt, the Shariah board may require this debt to be extinguished or refinanced in a Shariah compliant manner within an agreed period of time.

Further, if it is determined that a percentage of a portfolio company's income is acquired from non-Shariah compliant sources, this revenue must be removed from the profits of the Shariah compliant fund and the Shariah board will likely require that such a percentage of the income be donated to a

charity, under the supervision of the Shariah board, through a process known as "income purification".

In our experience, potential investors in a Shariah compliant fund will want to know the names and background of the members of the Shariah board. They will also want to see a fatwa from the Shariah board certifying that the offering documents, as well as any acquisitions and financings, are Shariah compliant.

#### Current trends

Traditionally, fund managers would only market Shariah compliant funds (often based in the Cayman Islands) in the Middle East to raise money, while deploying the fund's capital outside the Middle East. However, increasingly, we are seeing Shariah compliant funds, whether raised by international or GCC-based fund managers, targeting Middle East assets and acquisitions.

In particular, we have noticed a number of Shariah compliant funds recently increasing investments in portfolio companies and real estate in Saudi Arabia and Egypt. Also, we have seen a growing trend for funds, that will be deployed in the GCC, to also be based in the GCC rather than an offshore jurisdiction.

Since the second-half of 2008, we have also seen a dramatic decline in the "capital commitment" model by fund managers of Shariah compliant funds in the GCC, and a movement to require investors to contribute all capital upfront at a closing. While this tends to hurt a fund's internal rate of return, fund managers feel reassured knowing that they will be able to make investments. This has become of the utmost importance in an economic environment in which limited partners are increasingly refusing to meet capital calls.

In the past few years, there have been a number of new entrants into the Middle East attempting to raise capital through the offering of a fund. Many fund managers in the GCC are now raising and

*continued....*

### *Structuring Shariah Compliant Funds (continued..)*

managing their first fund (or at least their first Shariah compliant fund). This trend may, however, reverse and follow Western markets where the number of fund managers is decreasing as they merge with one another or leave the fund management sector altogether.

While investors prefer fund managers and general partners with proven track records, the number of new players has provided investors wishing to invest in a Shariah compliant manner with a plethora of options as Shariah compliant funds now invest in most asset classes.

Traditionally, real estate has been the major asset class for investors in the GCC, but there is a growing interest in diversifying portfolio assets outside of real estate.

In the past, investors in Shariah compliant funds have had limited rights and often fund managers would not even consider negotiating side letters. The refusal to negotiate side letters stems from:

- the tenet being marketed that all investors are treated equally
- fund managers previously having the dominant negotiating position
- investors wishing to invest on a Shariah compliant basis previously having few alternative options

Now, however, investors have more negotiating leverage as funds desperately need their capital, especially new entrants into the market who cannot fall back on their proven track record to provide comfort to the investors.

Additionally, with the increased number of new players, investors have a number of alternatives if a fund manager refuses to acquiesce to its demands. Also, it is becoming increasingly common for investors to demand in side letters that the fund manager waive or reduce certain fees.

While negotiations between the investors and fund managers are still less common compared to Western

conventional funds, investors are increasingly taking advantage of their improved bargaining positions.

#### Conclusion

While the popularity of Shariah compliant funds has grown in recent years in many parts of the world, they are still viewed as a niche practice for raising capital.

However, given the success of many of these funds and the struggles of fund managers to raise money in the West or Asia, fund managers are increasingly exploring creating Shariah compliant funds to improve their chances of accessing liquidity in the GCC.

Fund managers wishing to form a Shariah compliant fund need to consider all aspects of forming a Shariah compliant fund, including:

- the process of appointing the Shariah board
- local law restrictions and tax consequences depending on the domicile and ownership of the fund
- considering acquisition structures that contemplate how a Shariah compliant financing will be structured in the jurisdiction of the potential target companies or real estate

While some fund managers view legal services as an afterthought to be utilized once the fund is formed, an experienced law firm can play an active role by recommending experienced and respected members for the Shariah board.

Also, it can develop a structure for the fund and future acquisitions and financings that are tax efficient and take advantage of the relevant laws in the jurisdiction for future investments of the Shariah compliant fund. (3)

#### **KING & SPALDING**

Nabil A Issa is a partner and James Stull is an associate at King and Spalding. Refer to Nabil's profile on page 38.



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He received his JD from the University of Pennsylvania Law School and a Graduate Certificate in Islamic & Middle Eastern Law from the University of Pennsylvania. He received his undergraduate degree, magna cum laude, from the University of California at San Diego, where he was elected to Phi Beta Kappa.

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## Shariah Litigation & Arbitration in Malaysia

*By Mohamed Ismail Mohamed Shariff*

Malaysia has a dual court system. One is the common law system that is practised in England and other Commonwealth countries. This system is familiar to most readers. The other is the Shariah court system. In Malaysia the Shariah courts deal only with Islamic personal law issues as applicable to Muslims; they have no jurisdiction over other matters even where they involve Islamic law, such as Islamic banking and finance transactions. A significant development was the establishment in 2003 of a dedicated Muamalat division within the High Court solely to hear Islamic banking and Takaful cases.

Another notable feature of the Malaysian legal framework is that Malaysian law comprises both civil law (statute law and common law and equity as applied in Malaysia) and Islamic law. This unique situation provides diversity and richness to Malaysian law while creating certain potential areas of conflict.

As in other jurisdictions, in tandem with the court system, there is a well-developed arbitration system with a center, the Kuala Lumpur Regional Center for Arbitration, which facilitates the proper conduct of arbitration. In 2007, the Center set up the machinery for the arbitration of Islamic financial business disputes and published the Rules for Islamic Banking and Financial Services Arbitration 2007. Thus, the legal infrastructure for the resolution of disputes is in place.

There is thus a comprehensive system for dispute resolution in place in Malaysia. The writer is not aware of any other jurisdiction where a situation such as that in Malaysia obtains.

Islamic banking cases in the courts

Soon after the introduction of Islamic banking and finance in Malaysia in 1983 and Takaful in 1984, cases were filed in the courts. These were mainly of a domestic nature, the vast majority of these arising from defaults in home and business financing

transactions. Before the establishment of the Muamalat division these cases were heard in the commercial division of the High Court.

While most cases were heard and disposed of in the usual course, there were instances when the documentation employed were challenged as being null and void, either on the ground that they did not comply with Islamic law or were contrary to existing civil laws. The first ground of challenge was mounted mainly, with respect, on a lack of proper understanding of Islamic banking principles by the lawyers handling those cases while the second was based on perceived conflicts with civil law.

Many of the civil laws still in force were enacted before Islamic banking was introduced and these legislation, obviously, did not take account of Islamic principles. In some instances the Islamic banking concepts and principles employed in the transactions were seen to be in conflict with the enacted laws which the courts had to apply as being the law of the land. This situation arose because when the Islamic Banking Act 1983 was enacted, suitable transitional provisions were not included to deal with such conflicts. While amending each of the existing enacted laws would have required considerable legislative time, some form of omnibus provision could have been introduced to cater for such situations.

A saving feature in the Malaysian system is that the Islamic law applicable to the transactions was determined by a Shariah advisory body established in each Islamic bank. Later a Shariah Advisory Council (SAC) was established under the aegis of the Central Bank of Malaysia (CBM) which issued rulings on these matters.

The SAC was subsequently revamped and its scope widened and has now become the authority for the determination of Islamic law for these purposes. By

*continued....*

*Shariah Litigation & Arbitration in Malaysia (continued..)*

a recent amendment to the law, the determinations of the SAC and rulings issued by the CBM based on them are binding on all parties, including the courts. In this manner, a degree of certainty has been introduced into the law.

**Differences of opinion**

There are four schools of jurisprudence (madhab) in the Sunni branch of Islam. While they all agree on the fundamentals of Islam, they differ in certain other areas. Though these schools form a substantial body of Islamic law, they are regarded as secondary sources, the primary sources being the Qu'ran and Sunnah (the teachings and examples of the Prophet of Islam). There are also many other secondary sources of Islamic law, such as Ijma (consensus of opinion of early Islamic scholars), Qiyas (analogical deductions) and Ijtihad (individual reasoning). It is therefore not surprising that there are differences of opinion regarding Muamalat issues.

These differences have often been used to challenge the validity of the principles used in many transactions in Malaysia. A case in point is the Islamic contract of Bai Bithaman Ajil (BBA) (deferred payment sale) and the related Bai al Inah (sell and buy back contract).

The BBA contract (which involves a purchase of an asset by the financier from a client on cash basis and the sale of the same asset back to the client by the bank on credit terms at a price which includes the bank's profit for the deferred term), has been used in Malaysia since 1983 although it is not accepted as valid in many other jurisdictions, such as the Middle East and Pakistan.

**Recent case involving BBA contract**

In a series of BBA cases in 2008, the Muamalat court held that the BBA contract was not a valid Islamic contract but, in fact, a loan agreement. The judge ruled that the profit arising in the sale transaction was in reality interest and, since interest is prohibited in Islam the bank could not recover the profit but only the purchase price (the conventional equivalent being the principal sum).

The effect of this decision was far-reaching as well as devastating, as banks in Malaysia had provided billions of Malaysian ringgit in financing to thousands of customers and all those contracts were in jeopardy. This contract (and the Bai al Inah contract) has also been extensively used in capital market transactions. The judgement caused great shock and consternation in the Islamic financial sector. If allowed to stand, the judgment could have caused the closure of some of the smaller Islamic banks and delivered a terrible blow to Islamic banking generally in Malaysia.

The judge's finding was largely based on a comparison of the BBA contract with conventional loan agreements, where he found that the BBA contract was more onerous to a customer than a conventional loan and therefore could not be Islamic.

The banks appealed to the Court of Appeal (in which the writer was the lead counsel for the banks) and the court, in an unanimous decision, overturned the judgment of the High Court. It held, among other points, that the BBA was a valid contract in Malaysia.

The CA also found that whatever perceived unfairness there was in a BBA contract was illusory and there was sufficient mechanisms already in place within the banks and the system to address these concerns. In fact, these had been instituted since the early days of Islamic banking in Malaysia. The position of the BBA contract was restored to where it was before the High Court decision.

**Arbitration in Islamic banking disputes**

To the writer's knowledge there has been no major dispute that has been referred to arbitration in Malaysia. Arbitration, and latterly mediation, are not only alternative dispute resolution procedures that have become popular among the business community, but are also methods that are encouraged in Islam. It would not be surprising if these modes gain popularity for resolving Islamic

*continued....*

*Shariah Litigation & Arbitration in Malaysia (continued..)*

banking disputes and they may even become the preferred methods.

**Other jurisdictions**

It would not be possible to discuss the dispute resolution process in other jurisdictions, but the position in England may be taken as an example. It has long been the practice of the business community to specify English law as the choice of law to govern the contract and English courts as the courts of jurisdiction over the disputes, especially in cross-border transactions. This practice is now being adopted for Islamic financing contracts. While the suitability of English law and the integrity of English courts cannot be questioned in these matters, yet for contracts governed by Islamic law there is a danger.

Now, where the transaction is an Islamic banking transaction the parties to the contract would naturally want it to be governed by Islamic law. Even so, an English court will not apply Islamic law to the contract. This was the decision in the *Shamil Bank of Bahrain versus Beximco Pharmaceuticals and others*, [2004] All E R 1072 (CA). One of the issues in that case was the governing law of the contract. The governing law of the agreements in that case was stated to be: "Subject to the principles of glorious Shariah, this agreement shall be governed by and construed in accordance with the laws of England".

In the High Court the judge said that the reference to Shariah was no more than a reference to the fact that the bank purported to conduct its affairs according to the principles of Shariah. But that did not mean, he continued, that Shariah law was applicable to the contract in an English court.

On appeal the CA said that the statement as to the governing law was "intended simply to reflect the Islamic religious principles according to which the bank holds itself out as doing business rather than a system of law intended to 'trump' the application of English law as the law to be applied in ascertaining the liability of the parties under the terms of the agreement...".

There was another reason why Shariah law could not be applied in an English court. The trial judge in dealing with the question of the applicable law referred to the Rome Convention on the Law Applicable to Contractual Obligations 1980 (to which England was a party). He said it only made provision for the choice of the law of a country but did not provide for the choice of law of a non-national system of law, such as Shariah law.

It has been suggested that one way to overcome the problem is to set out in extenso the principles of Shariah that will govern the contract in the contract itself. If that is done, the courts will apply those principles as terms of the contract agreed by the parties. While this may appear to provide some comfort it cannot be a viable solution to the problem.

It would simply be not possible to set out all the terms that will govern a contract within the contract itself since there is a vast body of statute and common law and equity that will apply to contracts whether they are expressed in the contract or not.

The message is clear. Parties that wish to apply Shariah law to their contracts have to choose a jurisdiction that will apply such law, otherwise their intentions will not be carried out. Malaysia is one such jurisdiction. ☹

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## A New Dawn For Islamic Project Financing

By John Dewar

The US\$1.6 billion Hub River Power Project in Pakistan was the first large-scale project to include tranches of financing structured on a Shariah compliant basis. Initially, the project accessed Islamic bank finance from Al Rajhi Banking and Investment Corporation and IICG for bridge facilities prior to full financial close.

These facilities were structured as Istisna and Murabahah financings and were of a relatively short tenor. In addition, the project company entered into a longer term Islamic facility with a number of Pakistani banks. At the time, Islamic project finance was heralded as a new source of funding for projects in the emerging markets.

However, after the closing of Hub River in 1994, there was little, if any, activity in the Islamic project finance market. This was partly due to the fact that tenors were stretched as conventional banks found project financing more attractive (particularly projects with creditworthy long-term off-take contracts which became prevalent in the power and water sectors). Islamic banks found it difficult to match the tenors offered by conventional banks mainly because their deposit bases were significantly smaller than the major conventional banks doing business in the project financing sector.

In the last few years though, there has been a significant change in the capital bases of Islamic banks, particularly among Saudi Arabian and certain Far Eastern institutions.

However, the growth of Islamic financing has been driven not only by a growing depositor base, but also by demand for Shariah compliant financing from corporations in the Middle East and in Far Eastern countries such as Malaysia. This has led a number of leading conventional banks to set up so-called "Islamic windows" which specialize in attracting deposits from Islamic investors and making finance available on a Shariah compliant basis.

In the Middle East, the growth of Islamic finance has been particularly noticeable in Saudi Arabia where a number of large-scale project financings have included a significant Islamic finance component.

A case in point is the US\$3.5 billion Marafiq independent water and power project (IWPP) in Jubail, which is scheduled to reach completion in the next few months and is the largest individual power and water project in the world.

*"Finance documentation in the Middle East project financings is governed by English law"*

The financing combines funding from Islamic finance institutions, international and local commercial banks and an export credit agency. This project represents a perfect example of how Islamic finance techniques have been successfully utilized in the context of multi-sourced financings, while remaining consistent with the principles of the Shariah.

Customarily, Islamic financings in the kingdom have been governed by the law of Saudi Arabia and the provisions of Shariah law. Generally, finance documentation in the Middle East project financings is governed by English law (except in New York preferring Qatar).

The Islamic facilities in Marafiq followed the model first developed on the Shuaibah IWPP and is based on a Wakalah-Ijarah Mawsufah Fi Al Dhimmah structure, a hybrid structure utilizing the existing and recognizable Ijarah Islamic finance technique under which a financial institution leases an asset to the customer. In the context of a project financing however, the asset needs to be built and this is where the structure must be redefined so that it remains fit for purpose while conforming to the Shariah.

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*A New Dawn For Islamic Project Financing (continued..)*

The cornerstone of the Wakalah-Ijarah Mawsufah Fi Al Dhimmah structure, is the employment by the Islamic finance institutions of the project company as their agent or 'Wakil' under an agency agreement, entitled the Wakalah Agreement, to procure the construction and delivery of certain assets required by the project and identified in the Wakalah Agreement (the 'Assets').

The provision of the Assets is facilitated by the project company's entry into the EPC contract with the EPC contractor. A key Shariah principle is that the financial institution must share the commercial risks with project company, and thus it is expressed to be responsible for effecting the insurance and major maintenance of the asset.

In order to offset the financial institutions' risks in this regard, the project company agrees separately in the service agency agreement to insure and maintain the assets on behalf of the Islamic facility agent. This structure can be characterized by the on-going risk with respect to the assets which the Islamic finance institutions are agreeing to take.

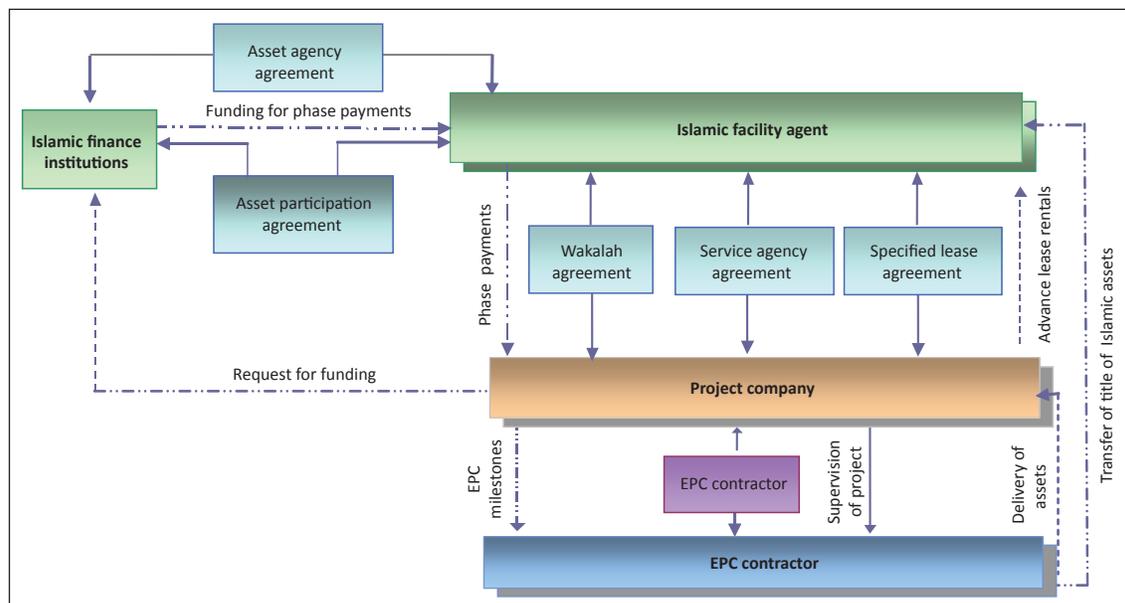
Pursuant to the agency agreement, the Islamic finance institutions appoint the Islamic facility agent to be their agent in respect of the financing and, under the asset participation agreement, agree to participate in financing the construction and ownership of the assets procured from the EPC contractor by the project company.

Title to the assets passes directly from the EPC contractor to the Islamic facility agent and the Islamic facility agent undertakes (on behalf of the Islamic finance institutions) to lease the assets (to be constructed).

The lease will be effective from a specified date as set out in the specified lease agreement. In certain jurisdictions this may lead to concerns over the relevant tax treatment and thus appropriate structuring should be considered.

During the construction period, upon receipt of funds from the Islamic finance institutions, the Islamic facility agent makes phase payments to the project

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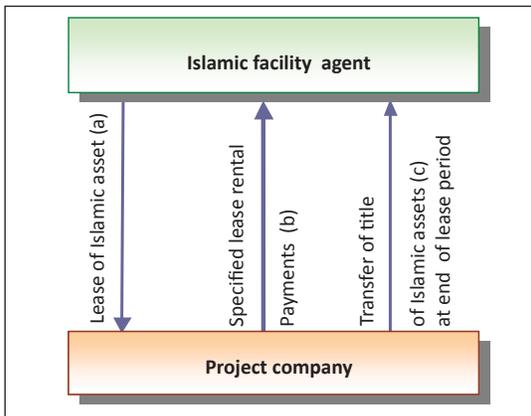
*A New Dawn For Islamic Project Financing (continued..)*

company in accordance with an agreed payment schedule for on-payment to the EPC contractor under the EPC contract.

All responsibilities relating to the procurement of the project's execution, completion and supervision rest with the project company. During this period, the project company is required to pay to the Islamic facility agent advance lease rentals set out in a pre-determined advance lease rental schedule. Contracts which have an uncertain price may be treated as void under the Shariah principles.

From the commencement date specified in the specified lease agreement, the Islamic facility agent (on behalf of the Islamic finance institutions) leases the assets to the project company. During the specified lease period, the project company pays specified lease rentals, semi-annually. The specified lease rental is comprised of two elements:

- a fixed element for each payment date which represents the principal repayment; and
- a variable amount representing the Islamic finance institutions' profit.



While Shariah prohibits the payment of interest, Islamic principles do not prohibit the making of profit provided that there is a level of risk sharing between the parties. The specified lease rental

represents the financial institutions' return based on the profits generated on the sale of the asset to the project company.

Project financing by its very nature means that the financial institutions are assuming certain risks in the project and this is consistent with Shariah principles. At the end of the lease period, provided that all lease rentals have been paid, legal title to the leased assets will be transferred to the project company.

Many of the recent projects financed in Saudi Arabia have included Islamic financings structured on this basis and with the imminent signing of an independent power plant at Rabigh, the future of Islamic project financing has never looked brighter.

Meanwhile, across the Causeway in Bahrain, the US\$1.9 billion Al Dur IWPP is also about to reach financial close with two tranches of Islamic financing, the first tranche using the Wakalah-Ijarah structure described above and the second comprising an Istisna-Ijarah financing. Having witnessed the false dawn marked by the closing of the Hub River project during the 1990s, there is little doubt in my mind that the significant recent application of Shariah compliant structures marks a new dawn for Islamic project financing. ☺

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John Dewar is a partner at Milbank, Tweed, Hadley & McCloy in London. Refer to his profile on page 48.



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Isam is a senior partner at King & Spalding's New York and Dubai offices and is the leader of the firm's award-winning Middle East & Islamic finance practice group. His practice covers a broad range of international and domestic finance and investment matters, with particular emphasis for the past 15 years, on the structuring of Shariah compliant finance and investment transactions.

King & Spalding's Islamic finance practice group was the first of its kind to be established (in 1995) by any US or UK law firm. It was the first firm to be recognized as the leading firm in Islamic finance and, with 30 dedicated professionals based in the Middle East, London and New York, provides credible coverage on Islamic finance matters in Europe, the Middle East and the US.

A graduate of Case Western Reserve University, Isam received his law degree from Cleveland State University, where he served as editor-in-chief of the Cleveland State Law Review. He received his LLM from Georgetown University, where he held a fellowship at the University's International Law Center.

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John has been at the forefront of structuring Islamic compliant project and acquisition financing transactions and is credited with structuring the Wakalah/Ijarah structure which has been used to finance a number of projects across the Middle East. He is recommended as a leading practitioner in the field of Islamic finance by the independent directories Chambers Global, 2009 and Chambers UK, 2009.

### Islamic Finance Deals worked on:

- Advised Islamic banks on the US\$2.2 billion Shuaibah-3 power and water desalination project in Saudi Arabia, which included a US\$210 million Islamic tranche. The documentation developed and structured in the Wakalah Ijarah Mawsufah Fi Al Dhimmah financing has been adopted in the subsequent expansion financing for Shuqaiq, Marafiq and Shuaibah.
- Advised finance parties, including Islamic finance institutions, on the US\$3.5 billion, 2400MW, 79 million gallons-a-day Marafiq IWPP in Saudi Arabia. This is the largest independent water and power producer in the world and at US\$600 million, has one of the largest Islamic financings in the sector to date. This deal was named by Project Finance International as the "EMEA Power Deal of the Year" and by Project Finance magazine as the "Middle East IWPP Deal of the Year".
- Advised finance parties on the structuring and documentation of a Shariah compliant acquisition financing in the US — incorporating senior, mezzanine and revolving financing facilities — which was rated by the Credit Rating Agencies.

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## Developments in Islamic Energy Finance — The Middle East

*By Craig Nethercott and Mohammed Al Sheikh*

In 2004, the Qatargas II LNG project achieved financial close on about US\$500 million Istisna/Ijarah financing for part of the US\$6.5 billion Qatargas II LNG facilities. Islamic financing did not feature in the subsequent Qatari oil and gas financings.

The Qatargas Islamic structure, which was itself based on developments in the UAE ADWEA power deals, was later followed in Oman — the Sohar aluminium smelter, in Saudi Arabia — the Saudi Aramco/Sumitomo Chemical joint venture PetroRabigh in the amount of US\$600 million and later in the SABIC Kayan project for a significant US\$1.6 billion.

In large part, these financings did not provide the all-important “additionality” to funding sources. Commercial banks split their participation between commercial and Islamic windows. The additional dollars from the dedicated Islamic finance institutions were not perceived as justifying the time and cost for development of the Islamic finance participation.

These path finding Islamic project financings arguably had more to do with the political desire for the involvement of Islamic financings in projects than the fundamental need to establish a fully-funded financing plan. While the Islamic financing market has achieved greater involvement in non-energy-related project financings in the Middle East since 2004, the large energy projects have been financed primarily in the non-Islamic banking market.

Fast forward five years and the project financing market looks very different from the heady days of 2004-2007. Crude oil pricing is at nearly half the levels achieved in 2007. Project finance loan volumes are at 2005 levels based upon some statistics. Many of the major non-Islamic banking participants have withdrawn from the market or are participating at much lower levels of commitment. The recent

distressed restructurings in the Middle East have also weighed upon regional and international bank appetite.

The one silver lining in an otherwise gloomy assessment is that pricing, one of the main deterrents to Islamic bank participation in low margin energy financings prior to the credit crunch, has improved “marginally”.

The reduction in the availability of non-Islamic bank financing and the slump in crude oil pricing means that the monster-sized energy projects under development will have to look more closely at Islamic financing participation in financing plans. Financing a multi-billion dollar project in today’s markets will require more creativity than in the 2004 to 2007 period.

The Istisna/Ijarah structures used in the earlier Qatargas/Rabigh/Kayan string of financings will still form an important part of the financing plans for the new energy projects coming on stream in the Middle East.

Formerly the Istisna/Ijarah Islamic bank participations in energy project involved many of the international bank participants splitting the exposure between non-Islamic bank participation and Islamic participation through their Islamic banking windows. The involvement of the non-Islamic banks through their Islamic windows can be expected to decline. The emergence of new Islamic banks and the entrance of the more established institutions in the project finance market will offset the disappearance of the Islamic window participants to some degree.

Although there is significantly more Islamic bank capacity to participate in transactions than five years

*continued....*

*Developments in Islamic Energy Finance — The Middle East (continued..)*

ago, the capacity is still limited in comparison to the financing needs of the mega-projects. Help will not arrive from across the relative borders. Cross-border Islamic bank lending has not increased to a great degree and has perhaps taken a step backwards due to the lending constraints and domestic demands faced by many of institutions in the Middle East and elsewhere.

One potential solution offered to sponsors seeking increased Islamic financing funding is the emergence of the Sukuk option. The most interesting development over the last five years has been the emergence of significant Sukuk markets in countries beyond the traditional issuers, Dubai and Bahrain.

SABIC (the Saudi petrochemical giant) has tapped into this market at the corporate level. The credit crunch impacted the market severely with volumes down 50% year-on-year as of the second half of 2008 and effectively closed thereafter. However, in July this year the market came back to life with SEC (Saudi Electricity Company) successfully completing a SAR7 billion (US\$2 billion) issuance. But, again, this was a corporate level financing and we have not seen any Sukuk issuance forming the basis of energy project financings in the Middle East.

However with the development of the Sukuk market in the Middle East and the need to locate alternative funding sources, it is likely that the mega-financings currently under development in the region will see the Sukuk market as attractive funding sources.

The development of the Istisna/Ijarah structures already banked by Islamic financiers in the Qatar gas/Petro Rabigh/Kayan transactions will form a good base for any project financing Sukuk issuance. A Sukuk issuance for a project should open up a deeper seam of funding than that delivered by the Islamic banking market based upon the Istisna/Ijarah structures.

Beyond the regional Sukuk markets, interesting shoots of growth have been seen in the more established US 144A bond markets. Non-Islamic

bond financings have not been a common feature of energy financings in the region. With the exception of some of the Qatari financings, the bond market has not been seen as attractive compared to the (previously) readily available and cheap commercial project finance market.

To date, three Sukuk offerings have been completed under the 144A structure, the most recent being the debut US\$650 million Sukuk offering by Indonesia. It is early days for the 144A Sukuk market, but large projects have looked at the 144A market prior to the credit crunch. With the 144A investors becoming more comfortable with the Sukuk structure and issuers becoming more comfortable with the 144A process, the 144A market could emerge as a further credible funding source beyond the domestic Gulf Sukuk markets.

The Islamic finance market will step into the gap left by the withdrawal of some of the conventional banks from the energy project finance market. How much of that gap will be met by Islamic financing remains to be seen. In the current regional power projects under financing the Islamic finance institutions have been vital to the funding plan. But the capacity requirements of these projects are not significant compared to some of the larger energy projects in the Middle East.

In the search for scarce funding, sponsors will be driven to the Islamic finance market and, in particular, the Sukuk market. If these efforts are successful we may see a steep change in the significance of the participation of Islamic finance products in the energy sector in the region. ☺

Craig Nethercott is a partner at White & Case while Mohammed Al Sheikh is the executive partner of the Law Office of Mohammed Al Sheikh in association with White & Case in Saudi Arabia.

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## Opportunities in Islamic Real Estate

*By Nichola West and Alex Thomas*

Real estate bears a low correlation to other asset classes and in the interests of spreading investment risk is an important diversifier. When to invest is the ultimate open-ended question. Since the peak of the market in mid-2007, property values have fallen significantly on a global basis.

Some perceive the summer of 2009, for example, as a good time to invest, resulting in sealed bids for UK investment opportunities, with buyers keen to take advantage of the 30% to 40% reduction in values since the market high.

The fluctuations in currency exchange rates and oil prices also have an impact. However, it is really a tale of two halves in that other investors are still cautious, believing capital values will be further adjusted to take into account falls in rent and tenant defaults. There is also a feeling that the market has yet to see truly distressed, as opposed to stressed, sellers.

### Advantages and disadvantages

A real estate investment, if well selected, has the potential to realize good income and capital growth. The use of leverage and sound tax planning can also enhance the returns for the benefit of investors. Increasingly, lot size is a factor. For example, some investors would like to invest in a large trophy asset but cannot take the risk alone.

Equally, other investors like the ability to invest in smaller lot sizes but it would not be cost efficient to do so unless a portfolio of similar assets is created. An advantage of real estate investments is that they can be structured so as to be flexible enough to allow for different investors' preferences, including their own geographical/sector focus.

On the other hand, real estate assets are perceived to be illiquid. However with good planning and structuring this perceived difficulty can be overcome if units/shares in the fund vehicle, as opposed to the asset level, can be traded.

### Investing in real estate

To invest in real estate, good strategic and legal advice is required. This is at the global level in terms of choosing the relevant investment jurisdiction and the specific sector to invest in. Likewise, such advice will also be required at a local level, to ensure a sound investment and that transaction/tax charges do not erode investment returns.

There are four key ingredients to a successful real estate investment: market knowledge, structuring and tax planning to maximize benefits, and the use of gearing.

Sound market knowledge is essential to ensure the suitability of each asset acquired. For example, the UK investment market is popular with overseas investors as it is well developed, resulting in quality investment research and analysis, leading to a high degree of transparency. This, combined with the UK lease model, providing for an upwards only income yield for lease terms of between 10 and 15 years, is particularly attractive to overseas investors.

The parties will also need to consider carefully the fund structure. Will it be more in the nature of a joint venture or a larger fund? Decisions on key issues must be taken and set out clearly in the documentation to provide clear rules for the fund managers and investors. For example, how should the investment vehicle be structured? What is the investment term and restrictions on sale of property and the investors' direct interests? How should major decisions be taken?

Once the characteristics of the fund have been determined, tax planning will play an important part as it is essential tax leakage is minimized. For example, the UK property market is a particularly attractive investment for overseas investors. This is because with proper tax planning capital taxes will not be payable on a sale of an investment property

*continued....*

*Opportunities in Islamic Real Estate (continued..)*

held by an overseas investor. Tax on rental profit can also be reduced through appropriate use of gearing.

Finally, the fund will generally be geared to enhance investment returns. Depending on investors' preferences, this can be conventional finance or structured in a Shariah compliant manner. For the purposes of this article, we shall assume Islamic finance will be the chosen gearing model and comment upon the key principles involved below.

Generally speaking, the fund's structure, its investment strategy (and therefore underlying investments) and contracts with service providers, especially the fund manager, must comply with Shariah principles. The fund's Shariah board will interpret those principles.

**Shariah compliant real estate structuring**

The structuring of Shariah compliant real estate funds are generally managed on the basis of either a Mudarabah or a Wakalah contract.

A Mudarabah structure contemplates one or more investors (the rabb al maal) investing in a fund that is to be managed by another person (the mudarib). The mudarib will contribute its knowledge and entrepreneurial expertise to the fund. In a Mudarabah, the investors cannot be involved in the day-to-day management of the fund. They can, however, set general limits on the mudarib's activity.

Under Shariah, the mudarib is entitled to share in the profits of the fund. Only the investors, however, are responsible for any losses (unless the mudarib's negligence or default caused them). If the fund makes a loss, the mudarib gets nothing. A Mudarabah bears some likeness to a partnership and for this reason a limited partnership (a common fund vehicle) can be used for the property fund.

A Wakalah is a contract whereby someone (the rabb al maal) appoints another (the wakil) to act as their agent or to pursue some matter on their behalf. Where a fund is structured using, for example, an

offshore company, the company will be the wakil (agent) of the rabb al maal (investors).

The wakil can charge a fee for its services but, unlike a mudarib, cannot share in the profits of the fund. The profit and loss will be passed on by the wakil to the investors after deducting any fees charged by the fund.

The International Fiqh Academy of the Organization of Islamic Conferences has held that owning shares in a company conducting Shariah compliant business activities is permissible. Therefore, funds aimed at Islamic investors can be set up as limited companies. AAOIFI has also issued Standard No 21 dealing with this issue.

**Tax considerations**

Once the characteristics of the fund have been determined, tax planning will play an important part. One of the overarching principles in structuring a property fund (or any other type of fund for that matter) is to ensure that investors are not in a worse tax position by investing in the fund rather than investing directly in the underlying assets. This principle is the same for Islamic funds as it is for conventional funds. Any tax leakage will reduce the investors' return on their investment.

The UK property market can be a particularly attractive investment for overseas investors. With proper tax planning the fund can be structured to ensure that no UK tax is payable on the sale of an investment property held by an overseas investor or a property fund.

The UK also provides generous reliefs for interest payments. In calculating the profits of a UK property business, certain expenses such as interest are allowable as a deduction where they are incurred "wholly and exclusively" for the purposes of the property business and are not of a "capital" nature. For this reason, it is common for property funds to be highly geared to enhance investment returns.

*continued....*

*Opportunities in Islamic Real Estate (continued..)*

Under Shariah, however, interest is forbidden. On the face of it, this puts a Shariah compliant property fund at a disadvantage from a property fund which is leveraged with debt. Although the fund could use Shariah compliant financing such as a Tawarruq, the payments made under some of these forms of financing may be of a capital nature and therefore there is some uncertainty as to whether these payments would be deductible from the fund's property income.

The UK Government, however, has introduced the "alternative finance regime" in the UK's tax legislation with the aim of ensuring that Shariah compliant financial products are taxed in a way that is neither more nor less advantageous than equivalent banking products.

***"The alternative finance regime currently caters for Murabahah, Mudarabah, Wakalah and Musharakah"***

The broad effect of the alternative finance regime is to treat arrangements which meet a prescribed fact pattern as a loan for direct tax purposes, that is income tax and corporation tax. Payments made under such forms of financing (referred to as the "alternative finance return" or "profit share return" in the legislation) can be treated as an expense of the fund's property business. This, therefore, removes any uncertainty as to whether or not the fund can deduct its "financing costs" from its property income and puts it on a level footing with a "conventional" property fund.

The alternative finance regime currently caters for Murabahah, Mudarabah, Wakalah and Musharakah. If these forms of Shariah compliant financing are used, care needs to be taken to ensure that they are structured so that there are no additional tax costs such as stamp duty land tax, stamp duty or VAT, as the alternative finance regime only applies to direct

taxes. However, relief from stamp duty land tax is generally available.

**Investment strategy and Shariah principles**  
The Shariah supervisory board will examine the structure and documentation of the fund and will, if satisfied, issue a fatwa approving the structure and the fund documentation. The Shariah supervisory board will also approve the investment guidelines to be used by an investment manager and any changes that the investment manager wants to make in the future.

It is important to understand that any real estate investment must be used in a Shariah compliant manner. This means there can be problems in buying a property where the occupants are undertaking business activities that would not be in accordance with Shariah. Problems can arise, for example, when the property is let to a non-Islamic bank or if alcohol is sold on the premises.

However, there are various screening rules that can be used to analyze what proportion of income from a property is non-Shariah compliant, but which is still acceptable, so that the underlying property investment will not be regarded as "tainted". Clearly, it can be seen there are many considerations to take into account if investing in real estate, generally, and more specifically, in an Islamic finance context. ☺

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- Islamic Finance
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- Trade Finance
- Islamic Investment Funds
- Project Finance

#### Individual Profile

Christopher is a partner in the banking department of the Dubai and Riyadh offices. He has extensive experience in transactions involving the telecommunications, power, petrochemicals and industrial sectors. He has worked on numerous syndicated loan transactions, Islamic financing transactions and debt restructurings. Christopher also has significant securities and banking regulatory experience, particularly in Saudi Arabia and the GCC.

#### Islamic Finance Deals worked on:

- €28.5 million bridge financing for an African cement plant
- US\$20 million Murabahah financing with credit and political risk insurance for an African obligor
- US\$2.35 billion Islamic financing (and subsequently the US\$1.95 billion Islamic bridge financing) (Murabahah) for the acquisition of licenses and roll-out of the second Saudi Arabian mobile phone network
- US\$500 million Ijarah financing of a shopping complex in Mecca, Saudi Arabia
- US\$5 billion acquisition of licenses and roll-out of the third mobile phone network in Saudi Arabia including Shariah compliant financing (Murabahah)
- SAR2.975 billion Islamic (Murabahah and Ijarah) and conventional financing of the expansion of the Prophet's Mosque in Madinah, Saudi Arabia
- SAR1.5 billion financing of the construction of the Jamarat Bridge in Mecca and the Islamic financing of the SAR400 million extension
- US\$1 billion reverse Murabahah for a Saudi corporation

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Murtha Cullina

## Transportation Finance

*By Paul Jarvis*

Shariah prohibits a financier from making a return based solely on the time value of money, regardless of how that return is described. The fundamental principle is that money should be used for a proper economic purpose and that it is not acceptable for money to be treated as a commodity on which a return (interest) can be generated just by reference to a passage of time.

However, if financing is an integral part of a transaction involving trade of an asset, such as a sale, lease, construction or other trading-based activity, then the time value of money can be realized. Accordingly, Islamic financiers provide funds by financing the purchase of an asset or financing a business rather than lending money at interest to enable its customers to buy the asset or finance the business.

With this in mind, the transportation industry is a perfect fit for Islamic finance because it is an asset-based industry. This article focuses on aviation and shipping; however, the techniques described are equally applicable to other asset classes.

In order to meet Shariah rules, the Islamic financier is required to have true ownership interest in the assets it is financing. A genuine compliance with this carries additional risks and costs which a conventional financier does not face. As such, an Islamic financier is put at a competitive disadvantage compared to a conventional financier. For instance, in a lease-to-own contract (Ijarah) many of the risks associated with the ownership of an asset cannot be passed on by the Islamic financier to the customer. It is the requirement of true ownership rights, coupled with ongoing ownership risks, that is the most striking difference between conventional and Islamic finance as practiced today.

These additional ownership risks become more acute when the transaction involves complex capital assets such as aircraft and ships, as the potential

exposure faced by the Islamic financier can be very significant. This is especially true when the financing involves assets that carry potentially harmful cargo, — for instance oil tankers

Consumers, whether Islamic or others, always care about the cost of goods and services they acquire and the businesses they engage in and many are not amenable to the argument that, as the Islamic financier is taking on more risks, it should receive a greater reward. Accordingly, transactions tend to be structured so that the overall risk/reward matrix is, to a large extent, the same as conventional financing.

Finance leasing is a well-understood concept in the world of aviation and shipping. However, Shariah scholars only recognize an operating lease and treat the financier (lessor) and not the customer (lessee) as the true owner of the leased asset for legal and accounting purposes.

As such, the Shariah lease-to-own contract (Ijarah Muntahiya Bi Tamleek), is split into two separate contracts; an operating lease and a contract (gift or sale) transferring the title to the customer (lessee) upon making the final rental payment.

Given that the Islamic lease (Ijarah) forms a central part of many Islamic finance structures, it is no surprise that most Shariah compliant aviation and shipping deals tend to use an Ijarah. Conceptually, therefore, in many ways an Ijarah finance structure (viewed in its entirety) is not that different to a conventional lease. This makes the transition from conventional finance to Islamic finance relatively painless for ship owners and airlines.

Understandably, Islamic financiers are often concerned about the risks associated with owning an asset directly. To ring-fence the Islamic financier from some of these risks, it is not uncommon for a bankruptcy remote special purpose company (SPC)

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*Transportation Finance (continued..)*

to be set up to own the asset. As with a conventional structure, the SPC requires funds to acquire the asset. However, unlike a conventional structure, the SPC is not able to enter into a loan agreement with the Islamic financier as an interest-bearing loan is not Shariah compliant.

However, the Islamic financier may enter into a Mudarabah agreement with the SPC. In general terms, the Mudarabah agreement involves investors (being the Islamic financiers) providing funds to the mudarib. The mudarib holds itself out as having skill and expertise in a particular area.

The Islamic financier will advance funds to the mudarib so that the mudarib can employ those funds in a Shariah compliant manner to generate a profit for the Islamic financier. In a standard asset finance transaction, the mudarib agrees in the Mudarabah agreement to use the funds to acquire a specific ship/aircraft. The customer leases the asset through an Ijarah.

In return, the mudarib receives a small percentage of the profits. The mudarib is not responsible for any losses, unless such losses are caused by its wilful misconduct or gross negligence. It is important to note that the mudarib does not guarantee that it will generate a profit, as this is not Shariah compliant. In addition, its obligations are limited recourse; limited to proceeds it receives from the customer pursuant to the Ijarah.

Whilst there are many similarities between conventional finance lease and Islamic operating lease financing, there are also some key differences. The main difference is that the legal owner of the asset must bear certain risks associated with owning such asset. In a conventional structure, many of these ownership-related risks are passed through to the customer under the conventional finance lease.

Accordingly, a conventional lessor retains minimal ownership obligations. However, under an Ijarah, it is not permissible for ownership-related obligations,

and the financial consequences arising thereunder, to be transferred to the customer. In summary, these obligations are:

- obligations relating to ownership/ proprietorship taxes;
- obligations relating to major maintenance activities (for example, major maintenance checks); and
- obligations relating to insuring the asset.

The costs and risks associated with these obligations can be very significant. To address this, arrangements have been developed whereby these obligations are performed by the customer acting as the servicing agent of the owner. The parties achieve this by entering into a servicing agency agreement. Accordingly, the customer (as servicing agent) is responsible for performing the relevant obligations.

The servicing agency agreement will state that the servicing agent will indemnify the owner for any default in the performance of these obligations. There will also be a provision in the Ijarah stating that a breach of the service agency agreement by the servicing agent will trigger an event of default under the Ijarah. This then allows the owner to terminate the leasing of the asset.

Under general Islamic principles, a servicing agent must be compensated for any costs properly incurred by it on behalf of the owner. This means that the owner must reimburse the servicing agent for those expenses that it incurs in relation to the provision of such services.

However, so that the risk/reward matrix is the same as a conventional structure, the amount to be paid by the owner to the customer (as servicing agent) is paid by the customer (as lessee) to the owner (as lessor) as additional rent under the Ijarah. The documentation will provide that such payments will be made on the same date and will be netted off.

*continued....*

*Transportation Finance (continued..)*

Most Shariah boards accept this as being Shariah compliant because the owner remains primarily liable for the relevant obligations, even though the actual performance is undertaken on its behalf by a servicing agent.

In addition, it is acceptable to have rent calculated by reference to whatever lawful benchmark the parties agree. Consequently, there is no problem in having additional rent calculated by reference to the amount that the owner must reimburse its servicing agent.

Subject to the view of the relevant Shariah board, it is also possible to pass other costs on to the customer using the additional rent formula (increased costs and market disruption costs, for example). Through the netting off mechanism, the financial risk is transferred away from the owner in a manner that does not contravene Islamic principles.

Another significant difference between conventional asset financing and Islamic lease finance relates to total loss. This is particularly important in the context of aviation and shipping.

Generally speaking, if a total loss occurs, the leasing arrangements must immediately end. While the definition of total loss is often subject to negotiation and is also affected by the insurance policy provisions, in the context of analyzing total loss in relation to Shariah principles, total loss means an event which results in the customer no longer being able to use the asset for its intended purpose.

Once a total loss has occurred, it is not permitted for the rental obligation to continue, even if the total loss arose due to the default of the customer. If the customer caused the total loss, however, the owner is allowed to claim compensation from the customer.

In addition, it will not be possible to classify a total loss as an event of mandatory prepayment. This is because there will be no asset available for the Islamic financier

to transfer to the customer against payment of a pre-agreed price. In any event, absent the insurance proceeds being paid in cash, there is not likely to be the financial resources to pay such amount, even if a particular Shariah board permitted it.

The above is mitigated to a certain extent in asset finance deals by placing an obligation on the servicing agent to ensure that the total loss proceeds are paid by a certain date, regardless of whether such insurance proceeds are ever paid by the insurer. This is not unreasonable on the basis that the servicing agent is responsible for ensuring that the asset is insured. If the total loss proceeds are not paid by such date, the servicing agent is in breach of its obligations.

As a result of this breach, the servicing agent is obliged to pay liquidated damages. These liquidated damages will be an amount equal to the total loss proceeds that should have been received from the insurer. However, the concept of liquidated damages is not universally accepted by all Shariah boards.

The aviation and shipping industries have huge amounts of assets that need to be financed over the next three years. It is unlikely that conventional financiers will be in a position to fulfil all of these requirements and the Islamic finance industry seems well suited to be a viable alternative financing source. ☺

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### Individual Profile

Paul is a partner in the banking and finance department. He specializes in asset finance and in particular aircraft finance. Through his long association with the Middle East, he has also significant experience and understanding of Islamic finance and was for some time head of Islamic finance within the firm.

Paul has extensive experience in a considerable range of Islamic finance transactions acting principally for banks in a variety of sectors, including general corporate finance, project finance, international trade finance, asset finance and aircraft finance. He has written and published several articles and has delivered numerous lectures on the subject of Islamic finance.

### Islamic Finance Deals worked on:

- Aviation Lease and Finance Company: Advising a member of the Kuwait Finance House group over the last six years on various Shariah compliant aircraft finance and leasing transactions
- The Bank of London and the Middle East: Advising on numerous transactions
- Gatehouse Bank: Advising on Tawarruq facilities
- Faysal Islamic Bank of Bahrain: Advising on an Istisna real estate project
- Arcapita: Advising on European real estate investments
- Novus: Advising on an Islamically structured financing of two Boeing 767s to Condor

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## Securitization and Shariah Law

By John H Vogel

Following the dramatic growth of securitized financings during the past 15 years, the global economic collapse of 2008-2009 brought an abrupt end to these types of transactions, both in the Middle East and North Africa (MENA) region and the West. For the first time, there are defaults in the Islamic Sukuk market — most notably East Cameron Bay Partners and Investment Dar Company.

As recovery is seen in the economies of the Middle East, as well as those of the West, there is likely to be a substantial increase in governmental regulation of the financial sector, including a greater level of standardization, harmonization and transparency.

Moreover, liquidity is much reduced throughout the MENA region as a result of the worldwide economic crisis, as well as a “freeze” by central banking authorities in the Middle East on banking accounts of some developers. As a result, it is likely that there will be a renewed effort to encourage securitization in the MENA region of qualifying assets. Saudi Arabia has said it will institute a “Fannie Mae”-like structure for housing, and the UAE is likely to do the same.

In addition, MENA countries are increasingly permitting the foreign ownership of real estate, a condition for successful securitization. For MENA countries, asset securitization would help in the creation of new markets, reduce financial institutions’ capital adequacy requirements and sector concentration risk, and expand corporations’ access to new sources of finance on favorable terms.

The challenge, looking forward, is the harmonization and standardization of Shariah-compliant financial products, allowing their transformation into marketable financial instruments.

Many MENA countries are undertaking large-scale infrastructure projects requiring long-term finance, including roads, bridges, power and water facilities, oil and gas facilities and telecommunications. These

### Securitization 101

To refresh the reader’s memory, a securitization is a transaction whereby an asset (including payment streams from assets) is separated from the owner or originator of such an asset and independently financed, based upon its characteristics. To accomplish this, a single purpose entity (SPE) is created that purchases the asset from the owner/originator. The SPE obtains the funds for the purchase by issuing securities that represent, depending on the overall kind of transaction and legal regime, either ownership or some other obligation encumbering the asset at issue.

The sale and the securities issuance are consummated concurrently, so that the main risks the purchasers of the securities face are risks related to the asset itself and not the credit risk of the owner/originator. The SPE has restrictions on its ability to incur debt, make other financial arrangements, declare bankruptcy or insolvency and operate the asset.

For a securitization structure to comply with Shariah, the assets being securitized must be consistent with the principles of Shariah (the securitization of pools of interest-bearing loans would not be appropriate, for example) and should be a tangible asset.

The relationship between the underlying obligor and the originator should also fall within one of the accepted Islamic finance schemes. Because the main principle underlying any Islamic finance operation requires that the operation be asset-backed in the context of a Shariah compliant securitization structure, it must then translate into some degree of ownership. Another major principle is equitable risk-sharing as to the underlying assets by the parties to the transaction.

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*Securitization and Shariah Law (continued..)*

can be financed through securitizing the underlying assets, project receivables, or through the issuance of securities backed by the project's cash flow from user fees.

For a securitization market to grow and develop in the MENA region, a comprehensive and modern securitization framework satisfactorily addressing the legal, regulatory, accounting and tax issues must be implemented.

On the legal side, a modern insolvency and bankruptcy law must be implemented in order to assure that the assets being securitized are the subject of a "true sale" and are available to the originator's creditors, since one of the primary objectives of securitization transactions is to separate the underlying collateral from the credit risk of the originator and vest it in the SPE. Shariah law does not recognize the separation of legal and equitable title, and, therefore, "true sales" in Shariah jurisdictions must be structured as a sale of the legal interest in the collateral to the SPE in a way that satisfies all applicable Shariah requirements (such as notification of the transfer to all debtors and receipt of their confirmation, if applicable).

A modern insolvency law would also permit legal counsel to confirm in its non-consolidation opinion that creditors of the parent company will not be able to force it and the SPE to be deemed one economic unit, thereby permitting those creditors to reach the assets of the SPE through a consolidated bankruptcy or insolvency process.

Similarly, a modern insolvency and bankruptcy law must confirm the bankruptcy-remoteness of the issuing SPE, whose purpose must be limited to the securitization transactions and certain logically-related activities.

Additionally, relevant law must enforce the necessary structural requirements as to how the SPE must operate and its inability to initiate bankruptcy or insolvency proceedings.

At the same time, a modern securitization law is required to clarify investors' first priority security interest in the collateral, subject only to creditors who are mandatorily preferred by law, whose security interest must be perfected in accordance with applicable law.

Without such a law, Shariah does not recognize the concept of a security interest in a manner consistent with the understanding in western jurisdictions, and it is therefore difficult to obtain clear legal opinions confirming the nature of the security interest created under the transaction documents and any perfection requirements, such as registration or other recordation.

*"A modern securitization law would permit more meaningful enforceability opinions critical to successful securitizations"*

Similarly, a modern securitization law would permit more meaningful enforceability opinions critical to successful securitizations.

Shariah law, by its nature, often takes the form of "general principles", which often leaves the courts of the relevant MENA jurisdiction with considerable discretion as to the interpretation of a particular Shariah law and the manner in which it should be applied in a particular transaction.

It is not uncommon for differing views to exist on particular issues within each school of Shariah jurisprudence. Moreover, decisions of courts are not often reported and, even if reported, are generally not considered to establish binding precedent for subsequent decisions.

A modern securitization statute would permit confirmation in legal opinions that remedies are exercisable under transaction documents upon the

*continued....*

*Securitization and Shariah Law (continued..)*

occurrence of default, other than payment defaults, in compliance with Shariah precepts.

From a regulatory perspective, banking and capital market regulations should be enacted which permit financial institutions to reduce capital adequacy requirements and improve credit risk management (thereby reducing the cost of compliance with Basel Accord II requirements), and to reduce balance sheet exposure to different sectors (such as housing) or geographical areas.

*“It is necessary that tax laws should be modernized to clarify the tax classification and tax obligations of an SPE in a securitized financing”*

Additionally, many of the MENA countries lack a harmonized and standardized accounting and tax framework consistent with the international financial reporting standards and their treatment of securitization.

Finally, as the use of SPEs for financing securitization transactions in a Shariah compliant context is relatively new, it is necessary for tax laws to be modernized to clarify the tax classification and tax obligations of an SPE in a securitized financing.

All of the foregoing changes in law and regulation are required in order that transactions may obtain a rating, which is an essential ingredient in any successful securitized transaction.

There are many reasons why securitization has been slow to develop in MENA jurisdictions, quite separate and distinct from the global financial collapse we have recently witnessed.

The lack of legal and regulatory framework discussed above, a lack of familiarity, the lack of robust capital

markets and an abundance of liquidity have also slowed the growth of securitization. Nevertheless, with the diminution of liquidity and the strengthening of the legal and regulatory climates in MENA countries, we may begin to see more securitized financings.

Securitization can play an important role in promoting economic growth, developing financial and capital markets, contributing to poverty reduction and increasing market economy participation through unlocking the value of unutilized qualifying assets.

In addition, securitization can lower the cost of capital, permit the spreading of risk across regions and economic sectors and improve risk-based capital and other regulatory ratios. It will be interesting to see to what extent, largely as a result of the recent global crisis, increased government regulation encourages securitization and promotes greater certainty, stability and transparency in these transactions. (2)

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Abradat has been at the forefront of structuring Islamic compliant capital markets and securitization transactions, transforming structures into instruments acceptable to Islamic investors. He is included in The Lawyer's Hot 100, 2008 (the 100 legal professionals to watch) and is recommended in the field of Islamic finance by the independent directories Chambers Global, 2008 and Legal 500, 2008.

Abradat was a key member of the team that won the Euromoney award for Best Global Islamic Finance Legal Advisor 2006-2007.

### Islamic Finance Deals worked on:

- Gatehouse Bank as arranger and dealer on the establishment of the US\$1 billion Milestone Capital PCC Sukuk program and the inaugural issue
- Dresdner Kleinwort and HSBC as joint arrangers on the US\$1 billion Gulf Finance House Sukuk Program
- Merrill Lynch International as arranger and dealer on the establishment of the US\$25 billion Falak Islamic Certificate Program

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John helps clients navigate complex financing and securities transactions, focusing on conventional and Islamic financing, and on public and private offerings of equity and debt securities in the US and abroad.

John has extensive experience in the negotiation and drafting of contracts for the operation of businesses and investment properties in the US and foreign countries. He has participated in private and public placements of securitized and project debt securities issued by private issuers, as well as governmental agencies and instrumentalities of foreign governments.

John negotiates and documents privatization and project and equipment financing around the world. He has assisted clients in negotiations with US and foreign private and public financial institutions to structure conventional and/or Islamic financing for private and public sector investment, real estate and infrastructure projects located in the US and throughout the world.

### Professional Affiliations:

- District of Columbia Bar Association
- Maryland State Bar Association
- American Society of Foreign Affairs
- Washington Institute of Foreign Affairs
- Inter-American Bar Association
- International Bar Association
- Union Internationale des Avocats
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- Construction of six-star luxury hotel in Doha, Qatar
- Single investor aircraft lease

### Achievements and Accolades:

- Bond Buyers' Guide (Redbook)
- Who's Who in American Law
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## International Islamic Finance Vehicles

By Sameer K Tegally

With sound legal, fiscal and regulatory environments, international financial centers such as Mauritius, Bermuda, Cayman Islands and BVI beckon as jurisdictions of choice for structuring cross-border Islamic finance transactions.

The use of vehicles such as limited life companies, trusts, and special purpose companies is outlined in this article within the global Islamic finance context.

### Musharakah

Cross-border Musharakah — which involves the pooling of financial resources (shirkat-ul-amwaal) by two or more international partners (shariks) to carry out specific Shariah compliant projects or enterprises — may be efficiently engineered through a limited life company incorporated in an international financial center.

The limited life company is basically a partnership wrapped up in a corporate cloak; it has two shareholders (partners) who, under a Musharakah, will be the Islamic financial institution and the client. The constitution of the limited life company specifies its lifespan.

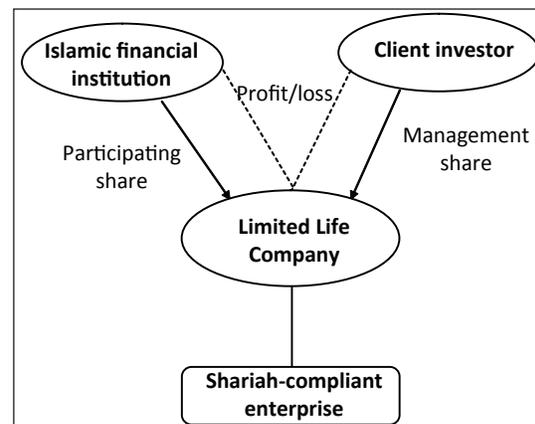
*“Mauritius, Bermuda, Cayman Islands and BVI beckon as jurisdictions of choice for structuring cross-border Islamic finance transactions”*

A share in the limited life company confers distinctive interests/rights in its profits, capital or management. The Islamic financial institution will be issued with a share having only a right to the profits and capital of the limited life company, whereas the share issued to the client carries — in addition to the right to profits and capital — a right to manage the limited life company.

This is a common feature of a Musharakah where the Islamic financial institution is the “silent” partner, having little or no say in the day-to-day management of the enterprise.

The shareholders of the limited life company may engraft into the constitution a clause to the effect that the board of directors may manage the affairs in the best interests of a shareholder or shareholders even though it may not be in the best interests of the company. Such a clause may prove to be convenient in the event the board finds itself in a delicate position where the best interests of the shareholders conflict with those of the limited life company.

Structure 1: Musharakah



The constitution of the limited life company may provide that the Islamic financial institution shall cease to be a shareholder upon the happening of a specific event, for example, after a set period of time (say after the infancy of the project or enterprise) or in the event that the client dies or becomes insolvent.

The Islamic financial institution would then be entitled to receive such value for its shares as may be determined in the limited life company’s constitution. However, if the limited life company is running at a

*continued....*

*International Islamic Finance Vehicles (continued..)*

loss at the time of exit, such loss remains to be borne by the Islamic financial institution in the ratio of its capital contribution.

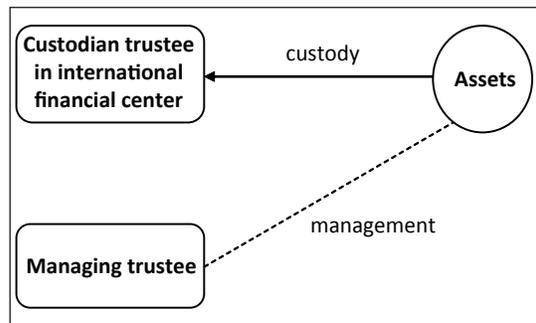
In essence, the constitution of the limited life company lays down the parameters of the joint venture between the Islamic financial institution and the client investor with the proviso that such parameters do not breach the tenets of Shariah.

**Mudarabah**

Trusts laws in some international financial centers allow the setting up of trusts with a managing trustee on the one hand and a custodian trustee on the other. The former will manage the trust, whereas the latter is vested with the trust assets. Such a trust is convenient for Islamic financing known as Mudarabah.

Under the Mudarabah structure, the mudarib (manager) is appointed as managing trustee and the trustee (in the international financial center) as the custodian trustee. The mudarib can be a company whose board of directors includes a Shariah advisor.

Structure 2: Mudarabah



Where one or more of the beneficiaries (who may be located anywhere in the world) wish to have some form of control over the trust, the trust deed may provide for the appointment of a protector (usually a friend or professional advisor) who oversees the conduct of the mudarib in the exercise of its trusts and powers under the trust deed. Interestingly, the

beneficiaries or the settlor may be appointed as protector.

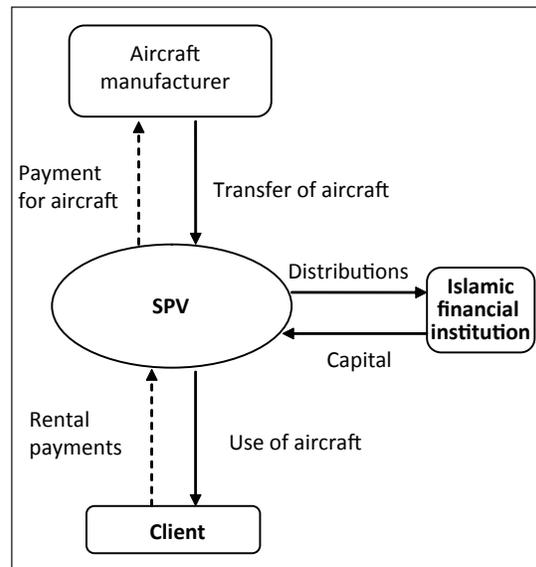
A Shariah compliant trust deed typically contains a clause that the trustee shall manage the trust fund/property in accordance with the principles of Shariah and that the managing trustee shall have the power to consult, or to appoint, an expert in Shariah (where the managing trustee does not have a Shariah conversant professional on its board).

The trust deed is not a public document and hence confidentiality of the beneficiaries (and the rab-ul-maal/settlor) is ensured.

**Ijarah & Sukuk al Ijarah**

Special purpose vehicles (SPVs) are commonly used for Islamic leasing (Ijarah). The SPV acquires the asset, for example an aircraft, and leases it to the client. In the case of a finance lease (Ijarah wa Iqtina), a purchase undertaking may be exercised upon maturity.

Structure 3: Aircraft Ijarah

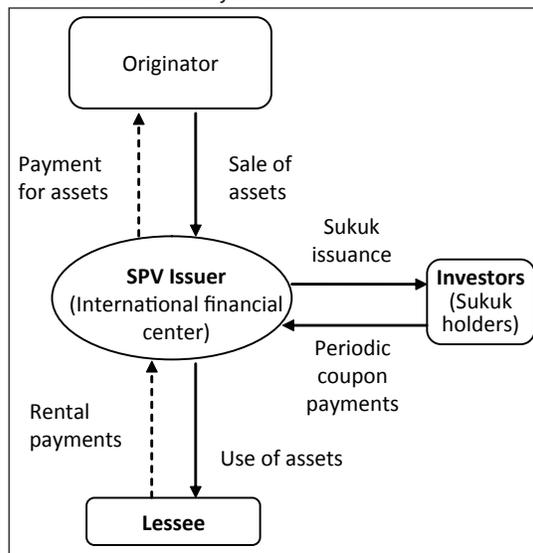


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*International Islamic Finance Vehicles (continued..)*

Moreover, an SPV is used in securitisation or shall we say "Sukukisation". Islamic certificates known as Sukuk are briefly defined as certificates of equal value representing undivided shares in the ownership of tangible assets, usufructs and services.

Structure 4: Sukuk al Ijarah



In the case of Sukuk al Ijarah, the originator sells the assets to the SPV which pays the purchase price through the issue of Sukuk to investors (Sukuk holders). The SPV then leases the assets back to

the originator or a third party lessee. It is crucial that the SPV be incorporated in a jurisdiction such as Mauritius, Bermuda, Cayman Islands or BVI in order to ensure tax efficiency of the Islamic finance structure.

**Conclusion**

International financial centers play an instrumental role on the global Islamic finance scene, offering carefully crafted solutions for this fast growing industry. Such centers have nil or reasonably low income tax and, in the case of Mauritius for instance, access to double taxation treaty benefits with India, China and African countries is possible.

There are generally no capital gains tax, registration duties and value added tax, nor are there withholding taxes on cross-border transactions arranged from international financial centers. Last, but not least, confidentiality is guaranteed for legitimate structures. ☺

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Sameer K Tegally is an associate with Conyers Dill & Pearman. Refer to his profile on page 72.

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Sameer is an associate at Conyers Dill & Pearman (Mauritius). He specializes in banking/finance (including Islamic finance) corporate commercial, investment funds, and trusts (including Shariah compliant funds and trusts).

Sameer advises major international banks, foreign government agencies and multinationals on corporate and financing/investment structures as well as collaterals involving Mauritius vehicles.

Prior to starting his legal practice, Sameer worked in the Legal Department of PricewaterhouseCoopers and at the Financial Services Commission, Mauritius.

Sameer graduated with a BA (Hons) Law with Economics from the University of East London in 1998 and completed the Bar Vocational Course (Council of Education, Mauritius) in 2000.

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## The Opportunities for Growth in Takaful and Current Challenges Faced

*By Susan Dingwall and Ffion Flockhart*

The Takaful industry has grown considerably over the past few years with gross Takaful contributions increasing from approximately US\$1.4 billion in 2004 to in excess of US\$3.4 billion in 2007. Industry commentators predict there is room for yet more growth with estimates that the size of the global Takaful market could be worth as much as US\$8 billion by the end of 2012.

If those current estimates turn out to be accurate, that will be an impressive achievement given the financial crisis that has gripped many of the world's financial institutions causing market capitalization to drop and moderating growth forecasts in almost every financial sector.

### Growth to date

Expansion has largely been achieved by targeting markets with significant Muslim populations but there remain largely untapped markets for the further development of Takaful (including Turkey, Iran, Pakistan, India and Egypt). In the Middle East, the largest market for growth has been Saudi Arabia and that growth is set to continue, particularly in view of the liberalization of the Saudi market.

The Gulf Cooperation Council (GCC) countries generally remain a strong contributor to growth particularly given the increasing amount of compulsory covers that are being introduced in the personal lines market together with the increasing trend in the commercial lines markets for Islamically funded projects to be insured Islamically. The number of Takaful operators now in existence means that it should no longer be necessary to insure projects in the conventional insurance markets.

Malaysia continues to be the largest and most established Takaful market in Southeast Asia with Family and Medical Takaful the largest and most

dynamic sector of business. Apart from savings and retirement plans, other products which are being sold include Hajj and Umra, marriage and education plans. Huge opportunities exist for Takaful operators in the GCC countries to realise the potential in Family takaful with its related savings and pensions products.

### Further opportunities for growth

There is no doubt that Europe (with approximately 15-20 million Muslims) presents a significant opportunity for the growth of Takaful.

There is already in Europe a strong consumer awareness of the benefits of insurance and so there would be a receptive audience to the unique selling points of Takaful even among the non-Muslim population, particularly the ethical investment policy and the potential distribution of surplus.

There is already a growing demand in Europe for ethical and so-called "green" insurance products, such as motor policies where a proportion of the premium goes towards carbon off-setting.

One idea to boost the Takaful industry in Europe would therefore be to offer green solutions as part of the Takaful products which would satisfy consumers' moral and ethical concerns while they guarantee each other against the risk of loss.

With London seeking to establish itself as the premier Islamic finance center in Europe and the Financial Services Authority being the first European regulator to authorize a Takaful operator, Takaful operators could seek authorization for their businesses in the UK and then use the "passporting" process to establish branches or sell cross-border to other EU countries.

*continued....*

*The Opportunities for Growth in Takaful and Current Challenges Faced (continued..)*

This would potentially provide a Takaful operator with access to the 27 EU countries and the EFTA countries (excluding Switzerland) all on the basis of a single regulatory authorization.

*“Takaful operators could seek authorization for their businesses in the UK and then use the ‘passporting’ process to establish branches to other EU countries”*

What are the challenges to the continued growth of Takaful?

A lack of understanding by consumers of the benefits of Takaful has, to date, been an impeding factor to growth in certain markets. It is generally recognized that more effort needs to be made to educate people about the value of Takaful and the protection it offers against risk. If social attitudes can be changed, then this will help growth considerably.

There is a lack of an over-arching Shariah judicial authority (and the uniform Shariah decisions which such an authority could provide). At present, there are a range of views from Shariah scholars on many issues, which can lead to uncertainty and a lack of clarity for the Takaful industry.

Strong regulatory support for Takaful and a comprehensive regulatory framework would also facilitate the development of Takaful. At the moment, however, the regulation of Takaful is at different stages of development throughout the world, which means that, in practice, there is currently no measure of international uniformity in the conduct of Takaful business and regulation.

Different jurisdictions have different regulations for Takaful and there is a lack of standardization. For example, some jurisdictions like Bahrain prescribe that a particular model must be used whereas

other jurisdictions like the Dubai International Financial Center, do not. The development of such international uniformity is key to facilitating the growth and global marketing of Takaful.

It is also true to say that further development of the Islamic capital and investment markets is critical to the corresponding development of Takaful. A broader range of Islamic unit-linked funds needs to be introduced. This will increase investment opportunities for Takaful operators, enabling them to maximize returns within the parameters of Shariah law.

One idea that might assist in enabling the Takaful industry to achieve its growth aims over the next few years would be to consolidate the industry and its practices under the umbrella of the Islamic Financial Services Board (IFSB) in collaboration with others such as the International Association of Insurance Supervisors and the Accounting and Auditing Organization for Islamic Financial Institutions.

This might do much to introduce the consistency in standards needed across the industry. Uniform codes of practice harmonising both Shariah and regulatory authorities under the auspices of the IFSB which are consistent with the Fatwas from the Saudi Arabian Fiqh Academy would also provide further consistency.

These continue to be exciting times for the Takaful industry, with considerable opportunities to develop Takaful in existing markets and introduce Takaful to new markets. To enable Takaful operators to make the most of those opportunities, cooperation and collaboration is needed among regulators, scholars and operators to avoid the potential of a fragmented industry using divergent models and practices.☺

Susan Dingwall is a partner and Ffion Flockhart is an associate at Norton Rose.

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