

Implications of the Kuwait TID V. Blom Judgment on Wakala Contracts

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Introduction

Wakala contracts are agency agreements that are widely used in Shari'ah compliant Islamic finance transactions. A wakala contract is formed when a principal, the muwakkil, appoints an agent, the wakeel, to undertake certain transactions on the principal's behalf. An important characteristic of wakala contracts is that the muwakkil and the wakeel share in the profit and risk of loss of the transaction. Nonetheless, some wakala contracts contain provisions that guarantee a specified rate of return or certain profits despite the results of the transaction(s). Such provisions arguably contravene Shari'ah principles as guaranteed returns or profits are not Shari'ah compliant in that they do not enable risk sharing between the wakeel and the muwakkil.

Recent court decisions regarding disputes involving such wakala contracts have created some concerns among the Islamic finance sector. One such dispute involving Blom Developments Bank, S.A.L. ("Blom"), a Lebanese bank, and the Investment Dar ("TID"), a Shari'ah-compliant finance house based in Kuwait, was litigated in England in late 2009. In addition, a case with a similar fact pattern has been litigated in Kuwaiti courts and its implications on the current Islamic finance sector within Kuwait will be analyzed below.

Blom v. TID

The aforementioned dispute surrounds Blom's English law governed master wakala contract with TID (the "Contract"). Under the Contract Blom appointed TID as its agent to make certain investments in Shari'ah-compliant instruments on behalf of Blom's 11.5 million US Dollar investment with TID. TID also had an obligation to pay Blom a specific rate of return regardless of the results of the investments. TID's investments were unsuccessful and as a result TID was unable to make payments to Blom under the Contract. Consequently, Blom filed a claim for summary judgment requesting that the court order TID to repay to Blom the amounts it had invested with TID, in addition to the repay the specified rate of return on the investments owed to Blom. The English High Court granted summary judgment to Blom and ordered that TID pay Blom the original principal amount but not the profit element.

During appeal, TID argued that its constitutional documents prohibit it from entering into non-Shari'ah compliant agreements and that the Contract was non-Shari'ah compliant, and therefore nullifying the Contract. The appellate court held that TID raised an arguable case which required consideration at a full trial.

National Sukuk Company v. Al-Madina Finance and Investment Company

With respect to the recent decision held by the courts of Kuwait, two companies had entered into a wakala agreement (the "Agreement") whereby National Sukuk Company (the "Principal") provided facility amount of AED 120 Million (KD 9,261,045) to Al-Madina Finance and Investment Company

(the "Investment Agent"). In the Agreement, the two parties agreed that upon a defined maturity date, the Investment Agent would repay to the Principal the original facility amount plus a prescribed profit amount. Upon the maturity date, the Investment Agent failed to repay said amounts, and entered into a settlement agreement with the Principal to pay a lesser amount on a subsequent maturity date. Upon this subsequent maturity date, the Investment Agent failed to pay the agreed upon amount, and thus the Principal filed a civil claim against the Investment Agent.

The Kuwait Court of First Instance rendered a judgment in favour of the Principal ordering the Investment Agent to pay settlement amount to the Principal. It based its opinion on a report submitted by an expert. Upon appeal by the Investment Agent, the appellate court slightly reduced the award to the Principal. The Investment Agent filed a second appeal basing the same on the following: (i) the judgment is in violation of the law; (ii) the court erred in its application of the law by failing to provide an adequate explanation as to the fault of the Investment Agent; and (iii) that its judgment was based on the expert's opinion which failed to apply the principals of a Shari'ah compliant wakala agreement.

The Investment Agent's argument against the expert's opinion was that the expert failed to accept that the Agreement was based on the Shari'ah principles of a wakala arrangement by concluding that the parties intended for the facility amount to be repaid with a fixed profit. In other words, the relationship between the Investment Agent and the Principal was built upon the premise that profit is expected and probable and not fixed. Further, the Investment Agent argued that the expert should have interpreted the Agreement whereby the Investment Agent was not guaranteeing the facility amount but rather that the two parties shared the risk of loss, unless in circumstances of intentional error or gross negligence by the Investment Agent.

The appellate court agreed with the Investment Agent that if these defences raised by the Investment Agent were substantiated and if the expert did not apply an acceptable rationale for its opinion, then there would be reason to overturn the lower court's opinion. Therefore, the appellate court remanded the case to a panel of three experts from the Kuwait Department of Experts at the Ministry of Justice to determine the following issues of law: (i) whether the facts of the case merit an interpretation that the Agreement is a Shari'ah compliant wakala arrangement; (ii) whether either party had breached its obligations; and (iii) what is the proper amount of the award, if any.

Analysis

An ultimate decision has yet to be held in either case; however, from a Kuwaiti law and court perspective, it seems as though the outcome of the National Sukuk case may provide an affirmative defence for Islamic financial institutions like Al-Madina Finance and Investment Company that because the executed transaction was later viewed as non-Shari'ah compliant despite having knowingly agreed and accepted terms and conditions of the so-called wakala arrangement, its obligations to repay become nullified.

Such a decision will likely raise a red flag to any creditor who has entered into similar arrangements under Kuwaiti law with Kuwaiti court jurisdiction. Furthermore, the credibility of these institutions may be negatively impacted if such an affirmative defence would allow nullification of these arrangements. Ultimately, any creditor who seeks to enter into a similar arrangement shall consider inserting protective provisions such as a waiver by the investment agent to any defence it may have in connection with the arrangement being Shari'ah compliant and furthermore to require a Shar'iah pronouncement by the investment agent's Shar'iah board confirming the terms and conditions of the arrangement.