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## Lady Justice Cannot Hear Your Prayers

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## LADY JUSTICE CANNOT HEAR YOUR PRAYERS

Deborah Ogali\*

*The Islamic finance industry continues to grow quickly as the appetite for everything, from Sharia-compliant home mortgages and car loans to sophisticated financial products, increases. This growth has triggered an interest in sukuk, bond-like financial instruments. And while the international market for sukuk has long been dominated by foreign issuers and English law, the attraction of a niche market compatible with U.S. federal and international securities laws may propel increased participation by U.S. issuers and investors who wish to transact under U.S. federal and state laws.*

*As with all Islamic financial products, sukuk transactions inherently pose a Sharia compliance risk. Thus far, religious compliance has not posed a significant barrier to the international market given that most sukuk transactions are governed by secular laws that incorporate Sharia law or laws that are not averse to interpreting religious law. U.S. jurisprudence, however, has strongly avoided religious questions that would require courts to interpret religious doctrines. While the application of the religious-question doctrine helps maintain the separation of church and state, it can withhold secular judicial remedies from parties to a commercial agreement that incorporates religious tenets, such as a sukuk transaction.*

*Drawing upon the example of Dana Gas PJSC, a company that sued to have its own sukuk certificates declared invalid and related payment obligations declared unenforceable due to the transaction's alleged noncompliance with Sharia law, this Note explores the Establishment Clause obstacles to adjudication of a similar claim under New York law. Ultimately, this Note concludes that the Establishment Clause bars adjudication of the merits of such a dispute and proposes the adoption of legislation, at the state and federal level, that would permit secular courts to "certify" religious questions to party-selected religious tribunals. Pending passage of such litigation, commercial parties are encouraged to utilize alternative dispute resolution.*

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#### INTRODUCTION

Implicit in every contract is the availability of a judicial remedy.<sup>1</sup> The presumed authority of courts to intervene in a contract dispute gives teeth to the threat of consequences for a breach of contract. Otherwise, parties would only be incentivized to perform their contractual obligations by reputational and reputation-related economic considerations.<sup>2</sup> A world in which a harmed party cannot sue a breaching party to recover damages<sup>3</sup> runs counter to the history of common-law breach of contract, wherein a valid agreement demands performance or damages.<sup>4</sup> For parties whose contract dispute touches on religious matters, however, the possibility that a breach will not

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1. The concept of alternative dispute resolution (ADR), including arbitration or mediation, is premised on the notion that such disputes could otherwise be adjudicated in a court. See Michael A. Helfand, *Religious Arbitration and the New Multiculturalism: Negotiating Conflicting Legal Orders*, 86 N.Y.U. L. REV. 1231, 1243–44 (2011) (recognizing that an arbitration agreement “demonstrate[s] [the parties’] consent to exit the realm of standard legal adjudication”).

2. See Barry E. Adler, *Efficient Breach Theory Through the Looking Glass*, 83 N.Y.U. L. REV. 1679, 1685 & n.18 (2008) (noting that certain business communities rely on reputation, not damages, to enforce contracts).

3. This premise assumes the claim is not otherwise barred by statutes of limitations, ADR agreements, or for lack of standing.

4. See *United States v. Winstar Corp.*, 518 U.S. 839, 919–20 (1996) (Scalia, J., concurring) (“Virtually every contract operates, not as a guarantee of particular future conduct, but as an assumption of liability in the event of nonperformance . . .”).

be remedied is an ever-present reality.<sup>5</sup> As a matter of faith, the Bible may correctly claim that the “effective, fervent prayer of a righteous man avails much.”<sup>6</sup> As a matter of law, a plaintiff with a religious claim may only pray for divine justice because a court will likely not hear the case.

This legal conundrum is not the byproduct of anti-religion bias, but of courts’ strict adherence to the First Amendment’s Establishment Clause.<sup>7</sup> By denying courts the authority to adjudicate religious disputes, states seemingly abide by the Founding Fathers’ vision of a nation free of religious tyranny.<sup>8</sup> What is less clear, however, is how the Founding Fathers would have reacted to the fact that this free-religion paradise slams shut the doors of secular justice for those whose deeply held religious beliefs permeate every facet of their lives, including their contracts. When an agreement incorporates religious obligations, the parties risk that, no matter the breach or the wrong, the Establishment Clause will bar a court from deciding the merits of the dispute.<sup>9</sup>

When a dispute arises under a commercial agreement that was drafted to accord with religious beliefs, the judicial remedies available are limited.<sup>10</sup> Courts in general, and New York courts in particular, have an interest in both resolving commercial disputes<sup>11</sup> and promoting the free exercise of religion.<sup>12</sup> These interests conflict when a commercial dispute is also a religious dispute. Considering courts’ limited authority to resolve religious disputes, this Note examines the legal obstacles that parties face in adjudicating religious disputes arising from commercial agreements governed by secular law, specifically in the context of the quickly growing Islamic finance industry. This Note focuses on the adjudication of disputes in which a party to a commercial financial agreement governed by New York law seeks excuse from its obligations due to the agreement’s noncompliance

5. See Shai Silverman, *Before the Godly: Religious Arbitration and the U.S. Legal System*, 65 *DRAKE L. REV.* 719, 720, 722 (2017) (noting that U.S. courts cannot decide matters of religious law).

6. *James* 5:16 (New King James).

7. The First Amendment of the U.S. Constitution states, “Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof . . .” U.S. CONST. amend. I. The First Amendment has been incorporated against the states. *Sch. Dist. v. Schempp*, 374 U.S. 203, 215 (1963).

8. Steven K. Green, *A “Spacious Conception”: Separationism as an Idea*, 85 *OR. L. REV.* 443, 473 (2006) (noting that the Founders were concerned with avoiding religious tyranny when enacting the First Amendment).

9. See *infra* Part II.A.

10. Generally, a court will either find a religious dispute nonjusticiable or it will minimize the religious nature of the dispute to permit adjudication. See *infra* Part II for a discussion of the Establishment Clause and neutral principles of law, and see also Michael A. Helfand, *Fighting for the Debtor’s Soul: Regulating Religious Commercial Conduct*, 19 *GEO. MASON L. REV.* 157, 159–60 (2011), which outlines the choices courts face when adjudicating religious disputes.

11. See Jack M. Graves, *Party Autonomy in Choice of Commercial Law: The Failure of Revised U.C.C. § 1-301 and a Proposal for Broader Reform*, 36 *SETON HALL L. REV.* 59, 117–18 (2005); see also *infra* notes 112–15 and accompanying text.

12. See *Catholic Charities of the Diocese of Albany v. Serio*, 859 *N.E.2d* 459, 465–66 (N.Y. 2006).

with religious requirements. Although this Note presents resolutions currently available under New York law, it ultimately proposes a legislative remedy that would permit a court to “certify” religious questions to a religious tribunal and retain jurisdiction over the secular aspects of a commercial dispute.<sup>13</sup>

Part I introduces investment financing, Sharia law, and Islamic finance. It continues with an overview of *Dana Gas PJSC v. Dana Gas Sukuk Ltd.*,<sup>14</sup> which involved related cases in the United Kingdom, British Virgin Islands, and United Arab Emirates<sup>15</sup> and presents significant questions for U.S. entities involved in the Islamic finance industry. This litigation forms the basis for the hypothetical litigation this Note addresses. Part II examines the implications of the Establishment Clause in secular adjudication of religious disputes, including likely outcomes for parties seeking judicial recourse for religious commercial disputes. Specifically, this Part analyzes likely outcomes under New York law for a party seeking equitable rescission based on mutual mistake of fact and concludes that the Establishment Clause definitively bars the resolution of disputes in which a party seeks rescission due to an agreement’s noncompliance with religious obligations that were intended to form the basis of the agreement. Part III presents alternatives currently available under New York law that skirt the Establishment Clause and provide a forum for parties to resolve their disputes. Ultimately, this Note contends that alternative dispute resolution (ADR), while satisfactory, is not an ideal solution for parties whose disputes are both religious and commercial. Instead, it proposes a legislative remedy that would permit secular courts to certify religious questions to a religious tribunal of the parties’ choosing. In so doing, a secular court would retain authority to hear the dispute while avoiding excessive religious entanglement that would violate the Establishment Clause.<sup>16</sup> Nevertheless, in acknowledging potential barriers to timely enactments of legislation permitting religious certification,<sup>17</sup> this Note concludes that parties who choose to incorporate religious beliefs into commercial agreements should also include ADR provisions in those agreements. ADR provisions help ensure that religious parties can contract according to their beliefs while maintaining an avenue for legal recourse and resolution of the merits of their dispute—an outcome presently unavailable in secular judicial courts.<sup>18</sup>

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13. See *infra* Part III.

14. [2017] EWHC (Comm) 2928.

15. *Id.* at [25]–[27].

16. See *infra* Part II.A for a discussion of excessive entanglement under the Establishment Clause.

17. See *infra* note 184 and accompanying text.

18. Although ADR provisions are generally upheld, a court may find an ADR provision unenforceable. See Judith Resnick, *Diffusing Disputes: The Public in the Private of Arbitration, the Private in Courts, and the Erasure of Rights*, 124 *YALE L.J.* 2804, 2839 n.165, 2886 & n.397 (2015) (noting that the U.S. Supreme Court has not held that an arbitration provision was inadequate, inaccessible, or ineffective, but state courts occasionally strike arbitration provisions on grounds of unconscionability or inadequate vindication). For parties

## I. AN INTRODUCTION TO INVESTMENT BANKING

It is important to understand the terminology and elementary investment principles that appear throughout this Note. Part I.A begins with a basic introduction to Western<sup>19</sup> securities, bond offerings, and investment financing. Part I.B introduces general principles of Sharia law pertaining to Islamic contracts. Part I.C explains the Islamic finance industry, including its development and standards, with a focus on tradeable Islamic financial instruments. Part I.D briefly reviews the Dana Gas dispute, and Part I.E highlights the implications of the Dana Gas dispute for American issuers and investors.

*A. Western Investment Financing*

Western investments often involve the sale and purchase of securities.<sup>20</sup> A “security” is generally defined as a tradeable financial instrument with monetary value, but the term can also refer to any contract or arrangement that involves a monetary investment in a common enterprise that is expected to yield profits solely from a third party’s efforts.<sup>21</sup> Issuers offer securities to raise capital<sup>22</sup> and generally characterize the security as equity or debt.<sup>23</sup> The most common equity and debt instruments are stocks and bonds, respectively. As an equity instrument, a share of stock represents an ownership interest in an issuer’s company,<sup>24</sup> whereas a bond represents a debt obligation payable by the issuer to the bondholder.<sup>25</sup> Moreover, a security can be traded on a public exchange or sold to a restricted group of private investors.<sup>26</sup>

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to a religious dispute, striking an ADR provision would leave the parties without an enforceable avenue of resolution.

19. “Western” will refer to American and English systems, as distinguished from their Islamic counterparts.

20. This Note does not address alternative investments, which generally refer to investments that fall outside stocks and bonds. H. Kent Baker & Greg Filbeck, *Alternative Investments: An Overview*, in ALTERNATIVE INVESTMENTS: INSTRUMENTS, PERFORMANCE, BENCHMARKS, AND STRATEGIES 3, 3 (H. Kent Baker & Greg Filbeck eds., 2013).

21. See SEC v. W. J. Howey Co., 328 U.S. 293, 298–99, 301 (1946); ALAN N. RECHTSCHAFFEN, CAPITAL MARKETS, DERIVATIVES AND THE LAW 246, 248 n.28 (2d ed. 2014). A security can include, but is not limited to, a note, stock, treasury stock, security future, security-based swap, bond, or debenture. 15 U.S.C. § 78c(a)(10) (2012); *W. J. Howey*, 328 U.S. at 297 n.3.

22. See RECHTSCHAFFEN, *supra* note 21, at 46–47. The issuer is the entity that creates the security. *Id.*

23. *Id.* Securities may also include hybrid financial instruments, with equity, debt, or derivative instrument features, but a detailed overview of financial instruments is beyond the scope of this Note. For more, see generally JASON A. PEDERSEN, THE WALL STREET PRIMER: THE PLAYERS, DEALS, AND MECHANICS OF THE U.S. SECURITIES MARKET (2009), and RECHTSCHAFFEN, *supra* note 21.

24. RECHTSCHAFFEN, *supra* note 21, at 49. In addition to an ownership interest in the asset, the stockholder may receive dividend payments from the profits generated by the asset. *Id.*

25. *Id.* at 128.

26. *Id.* at 144–45.

While a stock issuer can only be a company, a bond issuer may be a company or a sovereign governmental entity.<sup>27</sup> In addition to widening access to capital-raising opportunities, a bond offering allows an issuer to borrow capital in a manner that is generally less restrictive and less expensive than a bank loan.<sup>28</sup> Issuers of bonds have greater flexibility to operate as they choose because they are not subject to the restrictive covenants that usually accompany bank loans.<sup>29</sup> Bond offerings do not dilute company ownership or give bondholders voting rights that enable them to control the issuer.<sup>30</sup> Bondholders are creditors of the issuer, and in the event that the issuer becomes insolvent or bankrupt, the bondholders may have a priority claim on the issuer's assets.<sup>31</sup>

Although investors can enter the financial market individually, many seek collective investments that provide access to a broader range of opportunities, better management expertise, and lower costs. For example, many investors will use a pooled investment vehicle, such as an investment fund.<sup>32</sup> In an investment fund, investors do not make the day-to-day investment decisions, but they entrust those decisions to an investment manager.<sup>33</sup> Investors select a fund based on targeted returns, risk, management expertise, and management fees.<sup>34</sup> A private equity fund is often structured as a limited partnership (LP), in which the investors are the limited partners.<sup>35</sup> To join an LP, an investor must execute a subscription

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27. *Id.* at 46.

28. William W. Bratton, *Bond and Loan Covenants, Theory and Practice*, 11 CAP. MARKETS L.J. 461, 478–80 (2016). A bond's cost depends on factors such as coupon rate, maturity date, and redemption options. RECHTSCHAFFEN, *supra* note 21, at 128. A coupon rate is the contractual interest rate on the bond. *Coupon*, A DICTIONARY OF FINANCE AND BANKING (6th ed. 2018). The coupon rate may be fixed or variable. A fixed rate is a set interest rate that does not change regardless of interest rate fluctuations in the market. *Fixed Rate*, A DICTIONARY OF FINANCE AND BANKING (6th ed. 2018). A variable rate, also known as a floating rate, is based on a market-index rate, such as the London Interbank Offered Rate (LIBOR). *Floating Interest Rate*, A DICTIONARY OF FINANCE AND BANKING (6th ed. 2018). LIBOR is the interest rate at which banks lend money to each other for short-term loans in the London intermarket. *London Inter Bank Offered Rate (LIBOR)*, A DICTIONARY OF FINANCE AND BANKING (6th ed. 2018). The maturity date is the date on which the principal and interest must be repaid in full to the bondholder. RECHTSCHAFFEN, *supra* note 21, at 128. Redemption options may allow an issuer to repay the principal before the maturity date or allow a bondholder to redeem the principal before the maturity date. *Id.* at 128–29. An issuer's credit rating is determined by independent agencies, including Moody's, Standard & Poor's, and Fitch, based on the issuer's financial position. *Id.* at 129.

29. Bratton, *supra* note 28, at 478–80.

30. RECHTSCHAFFEN, *supra* note 21, at 128.

31. *Id.* at 128.

32. See Harry Cendrowski & Adam A. Wadecki, *Introduction to Private Equity*, in PRIVATE EQUITY: HISTORY, GOVERNANCE, AND OPERATIONS 3, 5 (Harry Cendrowski et al. eds., 2d ed. 2012). Although there are several types of investment funds, this Note focuses on the private equity fund structure. Private equity investments are considered a type of alternative investment, as contrasted with traditional investments such as stocks and bonds, and generally are not traded on a public exchange. *Id.* at 4.

33. *Id.* at 6.

34. *Id.* at 23.

35. *Id.* at 5.

agreement that specifies the investor's contribution to the fund.<sup>36</sup> The LP, in turn, executes an investment management agreement with an entity with investing expertise.<sup>37</sup> The investment manager controls the fund's investments, subject to any restrictions specified in the governing documents, including assets acquired, duration of holdings, and disposition of holdings.<sup>38</sup> The fund generally has a limited lifecycle,<sup>39</sup> during which the investment manager invests the fund's capital for a defined period of time to generate the targeted financial returns for the fund and its investors.<sup>40</sup> At the end of the fund's lifecycle, the investment manager disposes of the fund's assets, returns the investors' investment, and provides the investors with fees, profit splits, and guaranteed returns, if any.<sup>41</sup>

### B. *Sharia Law Limitations on Contract Formation*

Sharia<sup>42</sup> is the divine law of Islam and covers topics ranging from religious practices to contracts. Islamic law is derived from four sources: the Qur'an, Sunna, *ijma'*, and qiyas.<sup>43</sup> The Qur'an and Sunna are revered as sources of divine revelation, while *ijma'* reflects community consensus, and qiyas reflects logical reasoning, most commonly in the form of reasoning by analogy.<sup>44</sup> A fatwa is a formal Islamic legal opinion and is generally issued when a novel legal question arises.<sup>45</sup> Fatwas are routinely issued by Sharia

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36. See TIMOTHY SPANGLER, *THE LAW OF PRIVATE INVESTMENT FUNDS* 89 (3d ed. 2018).

37. *Id.*

38. See Cendrowski & Wadecki, *supra* note 32, at 12. Private equity funds may invest in private companies or buy out public companies. See *id.* at 4. The fund may hold and improve an asset with the goal of selling the asset later at a significant profit, such as a low-performing company whose business operations are optimized before being sold at a profit. *Id.* at 21–22.

39. *Id.* at 12. The fund's lifecycle is usually defined in the fund's limited partnership agreement. *Id.*

40. See *id.* at 8, 12.

41. *Id.* at 10.

42. There are two distinct branches within Islam—Sunni and Shi'a—which differ, largely, on the line of succession after the Prophet Muhammad. To the extent there are any doctrinal or practical differences, this Note will enunciate the Sunni perspective because the Sunni branch dominates the Islamic finance industry. David M. Eisenberg, *Sources and Principles of Islamic Law*, in *ISLAMIC FINANCE: LAW AND PRACTICE* 15, 30–31 (Craig R. Nethercott & David M. Eisenberg eds., 2012). Islamic jurisprudence comprises human interpretations of the divine law and includes substantive principles. The sources used to elaborate on the substantive principles are known as *fiqh*. Cynthia Shawamreh, *The Legal Framework of Islamic Finance*, in *CONTEMPORARY ISLAMIC FINANCE: INNOVATIONS, APPLICATIONS, AND BEST PRACTICES* 39, 39 (Karen Hunt-Ahmed ed., 2013). Sharia is considered unlimited and, therefore, unknowable. *Id.*

43. Eisenberg, *supra* note 42, at 17–18.

44. *Id.*; Shawamreh, *supra* note 42, at 40–41. The Qur'an, which Muslims believe was revealed to the Prophet Muhammad by Allah directly, was standardized during the third Sunni caliph and is generally accepted in its current standardized form. Shawamreh, *supra* note 42, at 40. The Sunna, compiled during the ninth century, is a collection of the recounted actions and sayings of the Prophet Muhammad, known collectively as hadith. Eisenberg, *supra* note 42, at 22–23. Islamic scholars agree on the text of the Qur'an and Sunna. Shawamreh, *supra* note 42, at 41.

45. Eisenberg, *supra* note 42, at 29.



supervisory boards of Islamic financial institutions regarding general practices or the Sharia compliance of specific products or transactions.<sup>46</sup>

Islam highly values the concept of personal ownership of property.<sup>47</sup> As such, Islamic contracting principles aim to reduce or eliminate exploitative or risky behaviors that would unduly deprive one of property.<sup>48</sup> When entering an Islamic contract, there are a few general governing principles. One of the most important principles is the prohibition of *riba*, unjustified increase.<sup>49</sup> While the full boundaries of *riba* are still disputed in Islamic scholarship,<sup>50</sup> there is general consensus that it prohibits any payment or receipt of interest.<sup>51</sup> Since Islam does not recognize the time value of money, money alone cannot increase or decrease in value without being linked to an asset.<sup>52</sup> Next, Islamic law prohibits transactions involving excessive *gharar*, or uncertainty.<sup>53</sup> *Gharar* is implicated in any transaction where the value of the subject matter cannot be determined at the time the agreement is executed, such as in a purchase agreement for grain from a specific field that has not yet been harvested.<sup>54</sup> Most transactions involve a degree of *gharar*,<sup>55</sup> but excessive *gharar* voids a contract.<sup>56</sup> Lastly, the subject matter of Islamic contracts cannot involve haram, or forbidden, activities.<sup>57</sup>

### C. Primer on Islamic Finance

In keeping with Islamic contracting concerns about exploitation and excessive *gharar*, Islamic finance is based on a risk-sharing model.<sup>58</sup> This model directly contradicts the Western interest rate-based system that guarantees a return for the lender.<sup>59</sup> Because the traditional model demands repayment even if the borrower is unable to pay, Islam views interest rate-based systems as unjust and exploitative.<sup>60</sup> Instead, Islamic finance uses a

46. *Id.* at 30.

47. See SIRAJ SAIT & HILARY LIM, LAND, LAW AND ISLAM: PROPERTY AND HUMAN RIGHTS IN THE MUSLIM WORLD 11–13 (2006).

48. *See id.* at 11.

49. Shawamreh, *supra* note 42, at 47.

50. This Note does not focus on the intricacies of the scholarly debates regarding *riba* and does not delve into the distinctions in types of *riba* or competing interpretations.

51. Eisenberg, *supra* note 42, at 41; Atif Hanif & Julian Johansen, *Sukuk*, in ISLAMIC FINANCE: LAW AND PRACTICE, *supra* note 42, at 254, 259. This principle prohibits the use of credit cards with interest rates or penalty rates for late payments of debt. ACCOUNTING AND AUDITING ORGANIZATION FOR ISLAMIC FINANCIAL INSTITUTIONS, SHARI'AH STANDARDS 80, 95 (2015) [hereinafter AAOIFI].

52. *See* SAIT & LIM, *supra* note 47, at 12.

53. Eisenberg, *supra* note 42, at 45.

54. Shawamreh, *supra* note 42, at 50. Advance sales of crops are permissible where the quantity and quality are predetermined. *Id.*

55. Eisenberg, *supra* note 42, at 45.

56. *Id.* at 47–48.

57. *See* AAOIFI, *supra* note 51, at 642 (noting that Sharia-impermissible activities include those relating to alcohol, drugs, gambling, pork, prostitution, nightclubs, and statues); *see also* Shawamreh, *supra* note 42, at 45.

58. Shawamreh, *supra* note 42, at 45.

59. *Id.*

60. *Id.*

system of profit and loss sharing, in which parties are less likely to be exploited by one another because the risk of nonpayment is spread among all parties.<sup>61</sup> As with individual contracts, any financed business activity must also comport with Islamic standards.<sup>62</sup>

Just as stocks and bonds may be the most recognizable Western financial instruments, the most well-known Islamic financial instrument is the *sakk*.<sup>63</sup> In 1988, the Islamic Fiqh Academy of the Organization of the Islamic Conference held that “any combinations of assets . . . can be represented in the form of written financial instruments” and thus opened the door for the modern *sukuk* market.<sup>64</sup> Presently, the Sharia Board of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) defines *sukuk* as “certificates of equal value representing undivided shares in ownership of tangible assets.”<sup>65</sup> AAOIFI, formed in 1991, promulgates Sharia standards for Islamic financial transactions.<sup>66</sup> In its relatively short history, AAOIFI has established itself as an authority on standards of Sharia compliance for financial transactions.<sup>67</sup>

In 2007, the chairman of AAOIFI’s Sharia Board, Sheikh Muhammad Taqi Usmani, published a paper criticizing *sukuk* structures that he believed created impermissible debt obligations despite facial compliance with Islamic principles.<sup>68</sup> Usmani’s paper led to the issuance of revised AAOIFI Sharia standards in 2008 and an industry-wide shakeup in the structuring of Islamic financial transactions.<sup>69</sup>

Although *sukuk* are commonly referred to as Islamic bonds, they provide the owner with an equity interest.<sup>70</sup> Like an issuer offering bonds, an originator raising capital forms an incorporated special-purpose vehicle (SPV) that issues the *sukuk* certificates.<sup>71</sup> As in a private equity fund, investors subscribe and purchase the *sukuk* certificates.<sup>72</sup> The cash from the subscription is used by the SPV to purchase the target assets or finance the business activity.<sup>73</sup> As equity instruments, the certificates represent an ownership interest in the underlying assets.<sup>74</sup> Like a bond’s coupon payments, *sukuk* generate periodic payments to investors, which constitute

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61. *Id.*

62. *Id.* Therefore, Islamic financial transactions cannot relate to trade in forbidden products, such as pork, alcohol, drugs, or pornography.

63. *Sakk* is an Arabic word that translates to “deed” or “instrument.” Hanif & Johansen, *supra* note 51, at 255. The plural form of *sakk* is *sukuk*. *Id.* Historically, *sakk* referred to any document that represented a financial liability. *Id.* at 255.

64. *Id.* at 256.

65. AAOIFI, *supra* note 51, at 468.

66. *Id.* at 10.

67. *Id.* at 11.

68. Hanif & Johansen, *supra* note 51, at 257.

69. *Id.* at 256; *see infra* notes 88–91 and accompanying text.

70. Hanif & Johansen, *supra* note 51, at 259.

71. *Id.*

72. *Id.*

73. *Id.*

74. Hanif & Johansen, *supra* note 51, at 258–59; Shawamreh, *supra* note 42, at 53.

either rent or installment sale payments,<sup>75</sup> and return the investors' capital with a profit when available.<sup>76</sup> While the periodic payments are calculated using a profit rate rather than an interest rate, like a bond's coupon rate, the profit rate is often benchmarked against a market index, such as LIBOR.<sup>77</sup> Unlike a bond, investors are not guaranteed recovery of their capital, much less a profit.<sup>78</sup> If the asset underperforms and generates a loss, all parties, including the investors, bear the loss.<sup>79</sup> This important feature satisfies the risk-sharing model of Islamic finance.

The Islamic finance industry generally employs eight common *sukuk* structures based on investment goals.<sup>80</sup> Of these, *sukuk al-wakala* and *al-mudaraba* resemble the traditional investment fund arrangement, in which the fund manager manages assets or a portfolio of assets.<sup>81</sup> *Sukuk al-mudaraba* best replicates a limited partnership agreement.<sup>82</sup> The *rabb al-mal*, the financier, contributes capital but does not participate in the business activities of the venture, while the *mudarib*, the sponsor, manages the business activities but does not contribute capital.<sup>83</sup> Thus, the *rabb al-mal* and *mudarib* mirror the roles of limited partners and investment managers.<sup>84</sup> In the event of asset underperformance, the *rabb al-mal* bears the financial loss, while the *mudarib* loses the value of his labor.<sup>85</sup> *Sukuk al-musharaka* resembles a joint venture in which all parties contribute funds and may actively participate in the business.<sup>86</sup> Profits and losses are distributed according to a predetermined ratio,<sup>87</sup> similar to pro rata distributions in Western investment funds.

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75. The source of the funding of the periodic payments—whether rent or installment sale payments—will depend on the structure of the *sukuk*.

76. Shawamreh, *supra* note 42, at 53.

77. Hanif & Johansen, *supra* note 51, at 256. See *supra* notes 27–31 and accompanying text for a discussion of traditional bond offerings.

78. See AAOIFI, *supra* note 51, at 477.

79. See *id.*

80. See Hanif & Johansen, *supra* note 51, at 258. See generally ISLAMIC FINANCE: LAW AND PRACTICE, *supra* note 42, for detailed discussions of the eight common *sukuk* structures: (1) *al-ijara*, (2) *al-musharaka*, (3) *al-istithmar*, (4) *al-manafa'a*, (5) *al-istisna'*, (6) *al-wakala*, (7) *al-mudaraba*, *al-manafa'a*, and (8) *al-murabaha*.

81. See *supra* notes 33–41 and accompanying text for a discussion of traditional investment funds. A *mudaraba* agreement is akin to an investment management agreement. Contrast this with *sukuk al-murabaha*, which most resemble conventional loan financing and are generally nontradeable on the secondary market because they are considered debt receivables. Shawamreh, *supra* note 42, at 52. *Sukuk al-murabaha* structures are generally disfavored in the Islamic market, as some consider the use of *al-murabaha* to be a facial workaround of the principles of Islamic finance. *Id.*; see also Craig R. Nethercott, *Murabaha and Tawarruq*, in ISLAMIC FINANCE: LAW AND PRACTICE, *supra* note 42, at 192, 200–01.

82. Julian Johansen & Atif Hanif, *Musharaka and Mudaraba*, in ISLAMIC FINANCE: LAW AND PRACTICE, *supra* note 42, at 174, 184–85; Shawamreh, *supra* note 42, at 52.

83. Shawamreh, *supra* note 42, at 52.

84. See *supra* notes 33–41 for a description of a typical private equity investment fund structure.

85. Johansen & Hanif, *supra* note 82, at 185.

86. Shawamreh, *supra* note 42, at 52.

87. *Id.*

Sheikh Usmani's 2007 fatwa challenged the Sharia compliance of 80 percent of the then-issued *sukuk* and particularly implicated *al-mudaraba* and *al-musharaka* structures.<sup>88</sup> Usmani stated that the structures impermissibly guaranteed repayment on maturity and, instead, should behave as equity instruments for appropriate profit and loss sharing.<sup>89</sup> Like bond issuers, *sukuk* originators or sponsors tend to be Islamic financial institutions but can include individual companies or sovereign governmental entities.<sup>90</sup> While *sukuk* issuances have been slow to gain popularity in the United States, there have been several issuances by American entities engaged in international markets.<sup>91</sup>

To have a *sukuk* issuance declared Sharia compliant, the parties must first obtain a fatwa from a board of Islamic scholars, who confirm the instruments are Sharia compliant.<sup>92</sup> These scholars base their decision on Islamic jurisprudence and consensus with one another.<sup>93</sup> There are no regulations or authoritative canonical laws that set forth exact parameters for compliance.<sup>94</sup> The originator may retain these scholars in its normal course of business or for the specific purpose of evaluating the transaction.<sup>95</sup> Beyond the lack of standardized contemporary Islamic financial practices, different schools of Islamic scholarship dominate in different geographic areas, which means that compliance determinations are often regional.<sup>96</sup>

#### D. Case Study: Dana Gas

In 2017, Dana Gas PJSC, an Emirati natural gas company,<sup>97</sup> became embroiled in litigation that threatened to rock the Islamic finance industry.

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88. Rahail Ali, *Islamic Finance and Documentation*, in ISLAMIC FINANCE: A PRACTICAL GUIDE 91, 106 (Rahail Ali ed., 2d ed. 2014); Hanif & Johansen, *supra* note 51, at 256; Matthew Martin et al., *Dana Gas Is Said to Miss Payment on \$700 Million Sukuk Today*, BLOOMBERG (Oct. 31, 2017, 7:29 AM), <https://www.bloomberg.com/news/articles/2017-10-30/dana-gas-is-said-to-miss-payment-on-700-million-sukuk-tomorrow> [<https://perma.cc/WK5U-Q5TG>].

89. See Martin et al., *supra* note 88.

90. Hanif & Johansen, *supra* note 51, at 256–57 (noting that a Malaysian plantation company issued the first international *sukuk*, followed by sovereign issuances by Malaysia, Bahrain, Qatar, Pakistan, and Dubai).

91. *Id.* at 267 (noting *sukuk* issuance and default by East Cameron Partners, an American oil and gas company); *UPDATE 1—Goldman Sachs Gets Strong Demand for Landmark Sukuk Issue*, REUTERS (Sept. 16, 2014, 1:01 PM), <https://www.reuters.com/article/goldman-sukuk-launch/update-1-goldman-sachs-gets-strong-demand-for-landmark-sukuk-issue-idUSL6N0RH2RH20140916> [<https://perma.cc/BJ6R-BUGF>] (announcing *sukuk* issuance by Goldman Sachs, an American bank); *UPDATE 1—US' GE Capital Raises \$500 Mln in Debut Islamic Bond*, REUTERS (Nov. 19, 2009, 9:23 AM), <http://www.reuters.com/article/gecapital-bonds/update-1-us-ge-capital-raises-500-mln-in-debut-islamic-bond-idUSLJ41775120091119> [<https://perma.cc/ZAP8-2NCD>] (announcing General Electric's *sukuk* issuance as the first *sukuk* issuance by a large U.S. conglomerate).

92. Ali, *supra* note 88, at 26.

93. *Id.*

94. *Id.* at 26–27.

95. *Id.* at 26.

96. *Id.* at 27 (noting that the *Sha'afi* school dominates in Malaysia but the *Hanbali* school dominates in Saudi Arabia and several Gulf Cooperation Council countries).

97. *Overview*, DANA GAS, <http://www.danagas.com/en-us/about/overview> [<https://perma.cc/PMZ2-R7WF>] (last visited Nov. 15, 2018).

Dana Gas issued 1 billion U.S. dollars' worth of *sukuk* certificates, structured as an *al-mudaraba* arrangement.<sup>98</sup> The certificates originally bore an October 2012 maturity date<sup>99</sup> but were restructured to extend the maturity date to October 31, 2017.<sup>100</sup> In early 2017, the company faced liquidity problems due to decreased global gas prices and delayed payments from its debtors and subsequently announced it wanted to restructure the certificates again.<sup>101</sup> At the time, approximately \$700 million of the *sukuk* certificates were outstanding.<sup>102</sup>

In June 2017, the company shocked the industry by announcing that its religious advisors concluded that the outstanding *sukuk* certificates were not compliant with Sharia law.<sup>103</sup> To bring the certificates into compliance, Dana Gas proposed an exchange of the outstanding certificates for Sharia-compliant certificates that further extended the maturity date and reduced the profit rate payable.<sup>104</sup> Additionally, Dana Gas announced that it would not pay the remaining periodic distributions due under the purchase undertaking agreement because of the purported noncompliance with religious law.<sup>105</sup> Doubling down on its assertion, Dana Gas sought and obtained injunctions in Emirati, British Virgin Islander, and U.K. courts to prevent any action from being taken against the certificates, including the triggering of default events when Dana Gas failed to make its periodic payments.<sup>106</sup> On October 31, 2017, Dana Gas did not redeem its matured *sukuk* certificates, but the injunctions prevented investors from declaring a default event.<sup>107</sup> The Dana Gas purchase undertaking agreement, which contains the payment obligation provisions, was governed by English law, while the assets backing the transaction and the underlying *mudaraba* agreement were subject to Emirati law, which wholly incorporates Sharia law.<sup>108</sup> The thrust of Dana Gas's legal

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98. Dana Gas PJSC v. Dana Gas Sukuk Ltd. [2017] EWHC (Comm) 2928 [5], [10]; *see supra* notes 82–85 and accompanying text.

99. Anthony Dipaola, *Dana Gas to Start Restructuring Talks on Bond Due in October*, BLOOMBERG (May 3, 2017, 3:02 AM), <https://www.bloomberg.com/news/articles/2017-05-03/dana-gas-to-start-restructuring-talks-on-bond-due-in-october> [https://perma.cc/4GFS-KWRW].

100. *See* Davide Barbuscia, *UAE's Dana Gas Leaves Maturing Sukuk Unpaid but No Default Declared—Sources*, REUTERS (Oct. 31, 2017), <https://www.reuters.com/article/dana-gas-sukuk/uaes-dana-gas-leaves-maturing-sukuk-unpaid-but-no-default-declared-sources-idUSL8N1N60IT> [https://perma.cc/FF5B-7BM8].

101. Andy Critchlow, *Islamic Titanic*, REUTERS BREAKINGVIEWS (June 15, 2017), <https://www.breakingviews.com/considered-view/dana-gas-is-the-tip-of-islamic-bond-iceberg/> [https://perma.cc/MP9Q-3648]; Dipaola, *supra* note 99.

102. Dipaola, *supra* note 99.

103. Arif Sharif, *Why Everyone's Talking About Dana Gas's Sukuk*, BLOOMBERG (June 18, 2017, 4:12 AM), <https://www.bloomberg.com/news/articles/2017-06-15/dana-gas-s-move-to-void-sukuk-stuns-analysts-who-question-motive> [https://perma.cc/NJC9-5D6B].

104. *Id.*

105. *Id.*

106. *Id.*

107. Barbuscia, *supra* note 100. Under the governing documents, in the event of a default, Dana Gas was required to purchase the underlying assets at a predetermined “Exercise Price.” Dana Gas PJSC v. Dana Gas Sukuk Ltd. [2017] EWHC (Comm) 2928 [15].

108. Sharif, *supra* note 103.

argument was a mistaken-fact claim and an illegality defense: (1) the parties were mistaken about the certificates' compliance with Sharia law, and (2) because the certificates were not compliant with Sharia law, the then-existing obligations were illegal under Emirati law. Though Dana Gas did not believe its lawsuits would have a significant impact on the market, the legal questions posed by these suits may nevertheless impact the stability and growth of the Islamic finance industry.<sup>109</sup>

#### *E. Dana Gas's Implications for U.S. Capital Markets*

Although several American entities have issued *sukuk*,<sup>110</sup> the transaction agreements are generally governed by a foreign, secular law.<sup>111</sup> However, New York law has proven a highly desirable choice for domestic commercial transactions.<sup>112</sup> New York has a storied history as an important commercial center with a strong body of commercial law.<sup>113</sup> New York's substantive law is especially attractive for financial contracts.<sup>114</sup> The substantive law and New York's establishment of a commercial division of its court system increase New York's attractiveness as a choice of law and forum.<sup>115</sup> Thus, it is possible that a dispute concerning *sukuk* could arise under New York law, particularly for U.S. issuers. To date, only one *sukuk* issuance is governed by American law,<sup>116</sup> but as the market continues to expand, there

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109. Barbuscia, *supra* note 100. The English courts ultimately held that even if the agreements were not compliant with Sharia law, under English law, the risk of noncompliance had been allocated to Dana Gas. *Dana Gas*, [2017] EWHC (Comm) 2928 [75]–[77]. Further, even if the payments would be illegal in the United Arab Emirates, they were not illegal in the place of performance. *Id.* at [80]. Thus, Dana Gas could not avoid its payment obligations. Dana Gas eventually reached a restructuring deal with its *sukuk* holders. Andrew Torchia, *UPDATE 1—UAE's Dana Gas Agrees \$700 Mln Sukuk Restructuring Deal*, REUTERS (May 13, 2018, 7:01 AM), <https://www.reuters.com/article/dana-gas-sukuk/update-1-uaes-dana-gas-agrees-700-mln-sukuk-restructuring-deal-idUSL5N1SK090> [https://perma.cc/676X-S8PJ]; see also Press Release, Dana Gas, Dana Gas Shareholders Support US\$700 Million Consensual Sukuk Restructuring (June 21, 2018), <http://www.danagas.com/en-us/media-center/press-releases/press-release-details?ID=291> [https://perma.cc/NU46-ZWU].

110. See *supra* note 91.

111. While English law is the preferred choice of law for international *sukuk* transactions, Sharia-incorporating laws are often the preferred choice for domestic issuances. Hanif & Johansen, *supra* note 51, at 266.

112. See *supra* note 111; see also Theodore Eisenberg & Geoffrey P. Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held Companies' Contracts*, 30 CARDOZO L. REV. 1475, 1489 (2009) (finding that New York was the choice of law in 46 percent of 2865 contract samples derived from Form 8-K filings).

113. Eisenberg & Miller, *supra* note 112, at 1482.

114. *Id.* at 1486.

115. *Id.* at 1485–87. Commercial Division justices and court personnel are selected for their expertise in business law. *Id.* at 1486.

116. Michigan-based University Bank issued a \$2.5 million perpetual *sukuk* with a 5.75 percent profit rate. The underlying agreement is governed by New York law. *Linklaters Advises on the First Sukuk Issued Under United States Law*, LINKLATERS (Apr. 18, 2016), <https://www.linklaters.com/en/about-us/news-and-deals/deals/2016/linklaters-advises-on-the-first-sukuk-issued-under-united-states-law> [https://perma.cc/7Q2L-3J58]; *University Bank Issues \$2.5 Million 5.75% Perpetual Note*, MKT. WIRED (Apr. 6, 2016), <http://www.marketwired.com/press-release/university-bank-issues-25-million-575-perpetual-note-otcqb-unib-2112602.htm> [https://perma.cc/2JGC-CT9Z].

will likely be future issuances governed by U.S. state law. And although Dana Gas ultimately lost its dispute on other grounds,<sup>117</sup> there is a fear that the company's actions may inspire other *sukuk* issuers seeking to renege on their payment obligations to have the underlying agreement declared unenforceable based on religious interpretations and related industry standards.

The existence of the Islamic financial industry is a response to a need for Sharia-compliant financial products.<sup>118</sup> By participating in this specialized market, parties bargain for a financing arrangement that complies with certain religious requirements. This compliance is important enough that parties accept the increased cost of transacting in Islamic financial products.<sup>119</sup> It is not unreasonable for a party, willing to pay a higher price for a Sharia-compliant investment, to seek to exit a transaction after learning that the bargained-for subject matter does not exist. Had the parties desired a financing arrangement that ignored religious norms, they could have availed themselves of well-established Western capital markets, which often carry tax benefits.<sup>120</sup> Thus, it is possible that a situation like that of Dana Gas—in which one party believes the certificates are not compliant with religious law, but the counterparty disagrees—could arise and a party would seek release from its obligations.

## II. SECULAR VERSUS DIVINE: A COURT'S JURISDICTION TO RESOLVE RELIGIOUS COMMERCIAL DISPUTES

The payment obligations in *sukuk* transactions are contained in a purchase undertaking agreement, which generally relies on underlying agreements to provide the requisite triggers and avenues for performance of obligations.<sup>121</sup> Therefore, the validity of the purchase undertaking agreement depends, in part, on the validity of the underlying transaction agreements, including any investment management agreements.<sup>122</sup> Where a party seeks avoidance by virtue of the transaction's noncompliance with Sharia law, the challenge would likely be to the compliance of the underlying agreements rather than the purchase undertaking agreement itself.<sup>123</sup>

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117. See *supra* note 109.

118. Rahail Ali & Imran Mufti, *The Global Sukuk Market and Legal Structuring Considerations*, in ISLAMIC FINANCE: A PRACTICAL GUIDE, *supra* note 88, at 109, 109.

119. Islamic financial products are generally not afforded the same tax benefits as traditional capital markets products, but several jurisdictions have enacted legislation that would level the playing field with Western securities. Ken Eglinton et al., *Accounting and Taxation Implications of Islamic Finance Products*, in ISLAMIC FINANCE: LAW AND PRACTICE, *supra* note 42, at 77, 84.

120. *Id.*

121. See Ali, *supra* note 88, at 105–07.

122. See *supra* notes 80–87 and accompanying text for a discussion of *sukuk* transaction structures.

123. See *supra* Part I.D., which describes Dana Gas's challenge to the purchase undertaking agreement on the ground that the underlying *mudaraba* agreement was not Sharia compliant.

A party seeking declaratory relief, either for excuse from performance or for a statement of its right to expect performance, must avail itself of the judicial system.<sup>124</sup> If a court were to adjudicate a dispute arising from a Western financing arrangement, justiciability would likely not pose a significant barrier. For parties involved in an Islamic financing arrangement, however, justiciability may be an insurmountable hurdle to ascertaining the rights of the parties, particularly under New York law. The dispute centers on whether the subject matter of the agreement for which the parties negotiated, a Sharia-compliant financial product, exists and, if it does not exist, whether that excuses the parties' performance obligations under the agreements. To determine whether a transaction's subject matter exists, the court must resolve the question of whether a financial product is Sharia compliant. Thus, the crux of the dispute is a religious question. As such, a court must determine whether the dispute is justiciable without running afoul of the Establishment Clause.<sup>125</sup>

Part II.A examines the Establishment Clause issues that would arise if a court sought to determine the compliance of *sukuk* transaction documents with Sharia law. Part II.B examines possible outcomes if a court were to minimize the religious question of Sharia compliance and attempt to adjudicate the claim on neutral principles of law.

#### A. *Establishment Clause Bars to Adjudication*

Certainly, it is not unprecedented for American courts to apply foreign laws that codify religious laws.<sup>126</sup> Nevertheless, when adjudicating matters governed by domestic laws, New York courts have determined that the First Amendment prohibits a civil court from deciding religious disputes because doing so would violate the Establishment Clause and entangle the state in a religious dispute.<sup>127</sup> This entanglement results from a court's *de facto* endorsement of a group with a particular religious belief.<sup>128</sup> Determining the

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124. See Janet Elaine Curry & Theodore Z. Wyman, Annotation, *Further Relief Sought in Declaratory Judgment Action*, 10 Fed. Proc., L. Ed. § 23:65 (2018).

125. See *infra* notes 129–31 for a discussion of justiciability.

126. See, e.g., *Saudi Basic Indus. v. Mobil Yanbu Petrochemical Co.*, 866 A.2d 1, 31 (Del. 2005) (discussing the trial court's review of over 1000 pages of expert deposition testimony and nine expert reports on Islamic scholarship delineating the elements of the Saudi cause of action); *Bridas Corp. v. Unocal Corp.*, 16 S.W.3d 887, 893 (Tex. 2000) (affirming summary judgment against the plaintiff after relying on expert testimony that the Afghani legal system was based on Islamic law and that Islamic law does not recognize causes of action for tortious interference).

127. *Congregation Yetev Lev D'Satmar, Inc. v. Kahana*, 879 N.E.2d 1282, 1284 (N.Y. 2007) (citing *Serbian E. Orthodox Diocese v. Milivojevich*, 426 U.S. 696, 696 (1976)). The First Amendment states, "Congress shall make no law respecting an establishment of religion." U.S. CONST. amend. I. This prohibition has been incorporated against the states by the Fourteenth Amendment. *Sch. Dist. v. Schempp*, 374 U.S. 203, 215 (1963). Therefore, New York state courts will decide religion-related disputes in accordance with the U.S. Constitution and relevant case law. *Contra, e.g., Town of Greece v. Galloway*, 134 S. Ct. 1811, 1835 (2014) (Thomas, J., concurring) (asserting that the First Amendment does not apply to the states).

128. *Congregation Yetev*, 879 N.E.2d at 1284.



prevailing party in a religious dispute requires a court to credit one party's religious interpretation and dismiss the other party's interpretation as incorrect.<sup>129</sup> In doing so, a court impermissibly puts itself in the position of declaring the "correct" practice of a religion.<sup>130</sup> If, therefore, resolution of a matter would require a court to rule on religious doctrines or practices, that dispute is nonjusticiable even though the court may otherwise retain subject matter jurisdiction.<sup>131</sup> As the New York Court of Appeals noted, however, if the court can resolve the claim based on "objective, well-established principles of secular law," a religious matter is justiciable.<sup>132</sup>

New York courts have long been troubled by the state and federal constitutional implications of resolving disputes that require the interpretation of religious doctrines.<sup>133</sup> Courts have consistently held that it is inappropriate for a fact finder to interpret or apply religious requirements to decide whether religious law has been violated.<sup>134</sup> Explaining the rationale of the prohibition, the New York Court of Appeals stated, "[C]ivil courts are forbidden from interfering in or determining religious disputes. Such rulings violate the First Amendment because they simultaneously establish one religious belief as correct . . . while interfering with the opposing faction's beliefs."<sup>135</sup> If resolution of a matter requires a determination of religious doctrines or practices, the court will decline to hear the dispute.<sup>136</sup>

Not all interactions between church and state are de facto violations of the Establishment Clause.<sup>137</sup> Rather, each instance must be evaluated for the scope of entanglement.<sup>138</sup> When determining whether it will violate the

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129. See *Milivojevic*, 426 U.S. at 718–20 (admonishing the Illinois Supreme Court for evaluating competing testimony from religious experts on internal ecclesiastical procedures).

130. See *id.* at 721 (finding that the Illinois Supreme Court substituted its own interpretation of religious procedural law in place of the proper religious hierarchical authorities).

131. See *Congregation Yetev*, 879 N.E.2d at 1282 (holding that the court could not decide an internal election dispute between members of the Jewish congregation because resolution required application of the Jewish ecclesiastical principles); *Drake v. Moulton Mem'l Baptist Church of Newburgh*, 940 N.Y.S.2d 281, 282–83 (App. Div. 2012) (affirming the dismissal of the complaint on grounds that adjudication required the court to impermissibly delve into internal issues such as church leadership, direction, doctrine, discipline, and control); cf. *Rector, Churchwardens & Vestrymen of the Church of the Holy Trinity v. Melish*, 146 N.E.2d 685, 687 (N.Y. 1957) (holding that the application of Episcopalian canon law did not require the court to decide matters of doctrine).

132. *Congregation Yetev*, 879 N.E.2d at 1285; see also *Milivojevic*, 426 U.S. at 710 (noting that courts may not resolve underlying religious doctrinal disputes when adjudicating disputes between religious parties or regarding religious property).

133. *Lightman v. Flaum*, 761 N.E.2d 1027, 1033 (N.Y. 2001) (citing New York case law holding that courts cannot interpret religious doctrine under the federal constitution); *S. S. & B. Live Poultry Corp. v. Kashruth Ass'n of Greater N.Y.*, 285 N.Y.S. 879, 890 (Sup. Ct. 1936) (noting the prohibition of judicial interpretation of ecclesiastical laws under New York law).

134. *Lightman*, 761 N.E.2d at 1033.

135. *First Presbyterian Church of Schenectady v. United Presbyterian Church in the U.S.*, 464 N.E.2d 454, 457–58 (N.Y. 1984) (citing *Md. & Va. Eldership of the Churches of God v. Church of God at Sharpsburg, Inc.*, 396 U.S. 367, 369 (1970) (Brennan, J., concurring)).

136. See *supra* note 131.

137. *Skoros v. City of New York*, 437 F.3d 1, 36 (2d Cir. 2006).

138. *Lynch v. Donnelly*, 465 U.S. 668, 684 (1984).

Establishment Clause, a court must determine whether state action “fosters *excessive* state entanglement with religion.”<sup>139</sup> This inquiry involves examining the benefitting institution’s character and purposes and the resulting relationship between the government and any religious authority.<sup>140</sup> An interaction becomes an excessive entanglement at the point where state action has “the effect of advancing or inhibiting religion.”<sup>141</sup>

Resolving a dispute regarding an Islamic financial agreement’s Sharia compliance would require a court to rule on doctrinal matters of Islam. The Establishment Clause creates a barrier between church and state that ensures the government does not favor one religion or denomination over another.<sup>142</sup> Because this principle is a cornerstone of American democracy, it is clear that a state should not be allowed to adjudicate religious doctrinal matters, even in a commercial context. With each ruling, the courts would manifest a preference for one interpretation within a religion over another. This situation would be no different than if a state enacted legislation that preferred Baptists to Lutherans or Episcopalians to Roman Catholics. If such preferences were to become entrenched through *stare decisis*, the Establishment Clause’s protection against injustice—or religious persecution—would be moot.<sup>143</sup>

This concern is particularly heightened for Islamic disputes. Unlike the Vatican in Roman Catholicism or denominational organizations in American Protestantism, Islam has no central religious authority and, therefore, no standardization in practice.<sup>144</sup> Thus, a court would need to develop a deep understanding of Islamic doctrine and jurisprudence to render a decision, which would make the court’s determination wholly discretionary. The state would be declaring what it means to commercially abide by the tenets of a faith. Apart from declaring a state religion or criminalizing the practice of a religion, it is difficult to imagine a state entanglement more excessive than declaring the elements of proper religious practice.

### *B. The Religious-Question Loophole: Neutral Principles of Law*

Although New York courts cannot resolve religious doctrinal disputes, a court may resolve disputes that touch religion if the matter can be adjudicated

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139. *Commack Self-Serv. Kosher Meats, Inc. v. Weiss*, 294 F.3d 415, 425 (2d Cir. 2002) (emphasis added). Such entanglements may be substantive and require the state to choose between competing religious or procedural views where the state and church are in a legal dispute with one another. *Rweyamamu v. Cote*, 520 F.3d 198, 208 (2d Cir. 2008).

140. *Kiesinger v. Mex. Acad. & Cent. Sch.*, 427 F. Supp. 2d 182, 201 (N.D.N.Y. 2006) (citing *Lemon v. Kurtzman*, 403 U.S. 602, 615 (1971)).

141. *Agostini v. Felton*, 521 U.S. 203, 233 (1997).

142. See *Commack Self-Serv.*, 294 F.3d at 425.

143. See *Marsh v. Chambers*, 463 U.S. 783, 803–06 (1983) (Brennan, J., dissenting) (discussing the four purposes of the Establishment Clause: to (1) guarantee the individual right to conscience, (2) prevent state interference in the autonomy of religious life, (3) prevent the trivialization and degradation of religion by being too closely involved with secular government, and (4) ensure that religion does not become the basis of political battles).

144. See *supra* notes 94–96 and accompanying text.

based on neutral principles of law.<sup>145</sup> Consider a hypothetical lawsuit in which a *sukuk* issuer seeks declaratory judgment and injunctive relief, alleging that industry standards reveal that the existing *sukuk* transaction is not Sharia compliant and the parties' previous understanding of the transaction's compliance constitutes a mutual mistake of fact warranting rescission of the agreement. Instead of diving into the question of Sharia compliance, a court could first decide whether the transaction's noncompliance, if taken as fact, would excuse performance, without deciding the merits of the fund's alleged noncompliance with Sharia law.<sup>146</sup>

On a motion to dismiss, the veracity of a well-pled complaint's factual allegations is immaterial to the court's ruling.<sup>147</sup> Thus, if a *sukuk* holder filed a motion to dismiss, the court would not need to determine the fact of compliance to decide the motion. On a motion to dismiss, a New York court will liberally construe the pleading<sup>148</sup> and "accept the facts as alleged in the complaint as true, accord plaintiffs the benefit of every possible favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory."<sup>149</sup> This standard, set forth in New York's Civil Practice Laws and Rules (CPLR) 3211, finds its federal counterpart in Rule 8(f) of the Federal Rules of Civil Procedure (FRCP), which states that a federal court cannot dismiss a complaint unless "it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations."<sup>150</sup>

If a court eliminated the question of Sharia compliance in evaluating a motion to dismiss and applied neutral principles of law, it would consider whether the *sukuk*'s noncompliance excuses performance on a theory of mistake of fact.<sup>151</sup> Under New York law, a mutual mistake of fact generally renders a contract voidable and subject to rescission, so long as the mistaken fact is substantial and existed at the time the contract was executed.<sup>152</sup> A court will order relief on these grounds only in exceptional situations.<sup>153</sup> To prevail on this claim, a mistaken fact must be so material that it goes to the

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145. *Congregation Yetev Lev D'Satmar, Inc. v. Kahana*, 879 N.E.2d 1282, 1284 (N.Y. 2007).

146. Indeed, this is the manner in which the English courts decided the Dana Gas litigation.

147. When considering a motion to dismiss, courts will presume a complaint's factual allegations are true. *See Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009); *Leon v. Martinez*, 638 N.E.2d 511, 513 (N.Y. 1994).

148. *Leon*, 638 N.E.2d at 513 (applying New York's Civil Practice Laws and Rules (CPLR) 3211, which governs motions to dismiss).

149. *Id.* at 512–13.

150. *Swierkiewicz v. Sorema N.A.*, 534 U.S. 506, 513–14 (2002) (quoting *Hishon v. King & Spalding*, 467 U.S. 69, 73 (1984)); *see also* FED. R. CIV. P. 8(f).

151. A claim for mistake of fact should not be confused with a claim for mistake of law, which likely could not be asserted. Neither New York law nor federal law recognizes Sharia as a binding system of law. Furthermore, even if Sharia law was recognized as binding, a mistake of law claim cannot be asserted on the basis of a subsequent change in law. *Anita Funds., Inc. v. ILGWU Nat'l Ret. Fund*, 902 F.2d 185, 189 (2d Cir. 1990) (citing *Lemon v. Kurtzman*, 411 U.S. 192, 207–09 (1973)).

152. *Gould v. Bd. of Educ.*, 616 N.E.2d 142, 146 (N.Y. 1993).

153. *Simkin v. Blank*, 968 N.E.2d 459, 462 (N.Y. 2012).

foundation of the agreement and constitutes a basic assumption of the contract.<sup>154</sup> In other words, it must “vitally affect the basis upon which the parties contract”<sup>155</sup> such that the mistake precluded a meeting of the minds requisite to form an agreement.<sup>156</sup> In determining the existence of a mutual mistake of fact, a court applies an objective test.<sup>157</sup>

Given the intricacies and purpose of the Islamic finance industry, the transaction’s compliance with Sharia law could constitute a basic assumption of the agreement that would vitally affect a meeting of the minds. If a court were to determine whether a mutual mistake of fact occurred, it would first need to determine whether the parties were mistaken about the transaction’s compliance with Sharia law at the time the *sukuk* transaction documents were executed. In most instances, it would be fairly clear that the parties intended to enter into a Sharia-compliant agreement<sup>158</sup> as *sukuk* transaction documents contain several references to Sharia compliance and fatwas obtained by the originator confirming a belief that the transaction complies with Sharia law.<sup>159</sup>

Even if a court were to find that these tenets of Sharia law and attendant fatwas were improperly applied, it would then have to find that mistaken reliance on these principles was material.<sup>160</sup> To evaluate the materiality of a mistaken fact, a court looks to whether the party would have been able to act on the basis of the alleged mistaken fact.<sup>161</sup> In *Simkin v. Blank*,<sup>162</sup> for example, the plaintiff sought reformation of a marital settlement agreement on the basis of mutual mistake of fact.<sup>163</sup> At the time the settlement agreement was executed, the plaintiff’s assets included a brokerage account worth approximately \$5.4 million, which was managed by Bernie Madoff.<sup>164</sup> The discovery of Madoff’s Ponzi scheme revealed that the account and its assets were illegitimate.<sup>165</sup> The plaintiff alleged that he and his ex-wife were mutually mistaken as to the existence of a legitimate brokerage account and that his true assets were less valuable than previously believed.<sup>166</sup> On that basis, he sought reformation of the assets awarded to his ex-wife in the

154. *Id.*

155. *Id.*

156. *Gould*, 616 N.E.2d at 146.

157. *Ryan v. Boucher*, 534 N.Y.S.2d 472, 473 (App. Div. 1988).

158. *But see Simkin*, 968 N.E.2d at 463 (noting that the contested agreement did not indicate intent to transact on the basis of the alleged mistaken fact).

159. *See, e.g.*, KSA SUKUK LTD., BASE PROSPECTUS cover page, i, 22, 226 (2017), [http://www.ise.ie/debt\\_documents/Base%20Prospectus\\_7418c363-8ae7-4d0a-9c55-c5c6dcb ee14f.PDF](http://www.ise.ie/debt_documents/Base%20Prospectus_7418c363-8ae7-4d0a-9c55-c5c6dcb ee14f.PDF) [<https://perma.cc/U2XX-W6E8>].

160. *Simkin*, 968 N.E.2d at 463.

161. *See id.* at 464.

162. 968 N.E.2d 459 (N.Y. 2012).

163. *Id.* at 460.

164. *Id.* at 461.

165. *Id.* For general information about Bernie Madoff’s \$60 billion Ponzi scheme, see Diana B. Henriques, *Bernie Madoff’s Essential Man*, N.Y. TIMES (May 15, 2015), <https://www.nytimes.com/2015/05/14/magazine/bernie-madoffs-essential-man.html> [<https://perma.cc/UCJ8-T5BY>].

166. *Simkin*, 968 N.E.2d at 461.

divorce.<sup>167</sup> The court held a mutual mistake regarding the existence of the account would be found only if the parties would not have been able to act upon the account—namely, whether the parties could have liquidated the account prior to the discovery of the Ponzi scheme.<sup>168</sup> Because the ex-husband was, at one time, able to draw on the account, the court held that there was no mistake of fact regarding the existence of the brokerage account at the time of the agreement.<sup>169</sup>

If the *Simkin* holding was applied in a lawsuit alleging mutual mistake of fact regarding a *sukuk* transaction's alleged noncompliance with Sharia law, the question would be whether the parties could have acted on the basis of presumed compliance with Sharia law. Surely, the answer would be yes. The very act of issuing *sukuk* certificates indicates that the parties are able to act on the basis of believed Sharia compliance: obtaining assurances of Sharia compliance, issuing and purchasing *sukuk* certificates, purchasing the underlying assets, and distributing and receiving periodic payments. Therefore, it is likely that, applying New York law, a court would not find mutual mistake of fact and would not excuse performance, despite subsequent reservations that the transaction does not comport with religious law.

Further, a New York court will not apply the doctrine of mutual mistake of fact where the party seeking rescission could have, in the exercise of ordinary care, ascertained the truth of the fact prior to consummation of the transaction.<sup>170</sup> Before the issuance of any *sukuk*, the originator's and issuer's Sharia supervisory boards confirm that the transaction complies with Sharia law, which is documented in the prospectus.<sup>171</sup> Investors are generally encouraged to consult their own Sharia experts to determine compliance.<sup>172</sup> If the parties to a transaction followed the industry norm for *sukuk* issuances and reached their own conclusions regarding the compliance of the transaction prior to executing the transaction documents, it is unlikely New

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167. *Id.*

168. *Id.* at 464.

169. *Id.*

170. P.K. Dev., Inc. v. Elvem Dev. Corp., 640 N.Y.S.2d 558, 560 (App. Div. 1996).

171. See, e.g., KSA SUKUK LTD., *supra* note 159, at 226 (listing the Sharia supervisory boards who approved the transaction structure). The Securities and Exchange Commission (SEC) requires an issuer conducting a registered offering to provide investors with a prospectus, which contains information about the total number of certificates issued, the offering price, fund objectives, investment strategies, risks, fund management, and fees and expenses. See *Information Available to Investment Company Shareholders*, U.S. SEC. & EXCHANGE COMMISSION, <https://www.sec.gov/fast-answers/answersmfinfo.htm.html#prospectus> [<https://perma.cc/66BG-7CKS>] (last visited Nov. 15, 2018). Although certain exemptions may permit an issuer to conduct a private placement, such issuers generally provide a private placement memorandum, which contains information similar to that contained in a prospectus. *Investor Bulletin: Private Placements Under Regulation D*, INVESTOR.GOV (Sept. 24, 2014), <https://www.investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-bulletin-private-placements-under> [<https://perma.cc/U2C3-7D9Z>].

172. See, e.g., KSA SUKUK LTD., *supra* note 159, at 226 (“Certificateholders . . . should consult their own *Shari’ah* advisers as to whether the proposed transaction . . . is in compliance with their individual standards of compliance with *Shari’ah* principles.”).

York law would permit an equitable rescission of the contract based on a theory that the parties were mistaken as to the fact of the transaction's compliance with Islamic law.<sup>173</sup>

Even assuming the mistaken-fact claim survived a motion to dismiss, the Establishment Clause would definitively bar any further adjudication on the religious question, leaving the issuer with a hollow victory.<sup>174</sup> Although a motion to dismiss accepts the complaint's allegations as true, prevailing on the merits of the religious question would require the fact finder to credit the allegations of noncompliance after interpreting Islamic doctrine. Attempting to do so triggers the Establishment Clause and renders the dispute nonjusticiable. Thus, the current state of the law places plaintiffs alleging religion-based claims between a rock and a hard place. The court will: (1) dismiss the complaint as meritless; (2) dismiss the complaint as nonjusticiable, thereby withholding a judicial remedy from the plaintiff; or (3) minimize the religious question to the detriment of the parties.

### III. PROPOSALS FOR LIMITED INTEGRATION OF CHURCH AND STATE

That courts will dismiss a commercial claim on grounds that it presents a nonjusticiable religious question is deeply dissatisfying. Under the status quo of Establishment Clause jurisprudence, courts will resolve property disputes between religious parties because the state has a legitimate interest in adjudicating such disputes where a civil court is the appropriate forum.<sup>175</sup> Similarly, New York has a legitimate interest in resolving commercial contract disputes, and a civil court is an appropriate forum for resolution of contract disputes.<sup>176</sup> New York's interest is not diminished even though the dispute touches religion. Further, unlike the ecclesiastical organizations usually involved in religious property disputes, the parties to a *sukuk* transaction are entities that are not part of a hierarchical body with established doctrines and laws for dispute resolution. As the parties lack an organized avenue for resolution, New York arguably has a *greater* interest in resolving the dispute, yet the law currently offers no satisfactory relief to these parties.

Though some have argued that the First Amendment should not be incorporated against the states,<sup>177</sup> the U.S. Supreme Court is unlikely to

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173. In a way, this mirrors the English court's rationale in determining that the risk of noncompliance had been allocated to a specific party. The idea of allocating all the risk to one party directly contradicts the Islamic risk-sharing model, in which all parties bear the loss. *See supra* notes 58–61 and accompanying text.

174. As a matter of public policy and resource allocation, it remains an open question whether a court would undertake an extensive analysis of any claims on a motion to dismiss. Whether the court grants or denies the motion, the result is dismissal of a complaint containing a religious question.

175. *See, e.g.,* First Presbyterian Church of Schenectady v. United Presbyterian Church in the U.S., 464 N.E.2d 454, 458–60 (N.Y. 1984).

176. *See supra* note 11 and accompanying text.

177. *See supra* note 127; *see also* Van Orden v. Perry, 545 U.S. 677, 692–93 (2005) (Thomas, J., concurring) (arguing that the First Amendment should not be incorporated against the states); Elk Grove Unified Sch. Dist. v. Newdow, 542 U.S. 1, 49–51 (2004) (Thomas, J.,

reverse decades of state-related Establishment Clause precedent.<sup>178</sup> The Court's interpretation of the Constitution is firmly entrenched in federal and state court decisions and the fundamental societal norm of separation of church and state.<sup>179</sup> Since the Court's position on judicial adjudication of religious disputes is unlikely to change, this Note proposes alternatives for parties to an Islamic finance agreement who seek judicial remedies under New York law. Part III.A proposes a legislative remedy applicable in both state and federal courts, while Part III.B highlights court-sanctioned extrajudicial alternatives currently available to contracting parties who wish to execute agreements that may present nonjusticiable religious questions.

### A. Certification of Religious Questions

Like most states, New York has a procedure for the certification of questions of state law to the state's highest court.<sup>180</sup> The New York Court of Appeals will consider questions certified by federal circuit courts, the U.S. Supreme Court, or the highest court of another state and will resolve issues of law that are outcome determinative and for which no controlling precedent exists.<sup>181</sup> The U.S. Court of Appeals for the Second Circuit generates the

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concurring); *Zelman v. Simmons-Harris*, 536 U.S. 639, 678 (2002) (Thomas, J., concurring). Permitting state courts to adjudicate religious disputes would arguably further New York's interest in resolving contract disputes that arise under New York law, provide a judicial forum for resolution of all contract disputes, and further New York's interest in being the preferred choice of law in commercial agreements. *See supra* notes 11, 112–15 and accompanying text. However, the practical implications of researching religious doctrine and packaging its intricacies into understandable expert witness testimony or jury instructions, tasking a fact finder with applying those instructions, and the effects of stare decisis weigh heavily against permitting a secular court to interpret religious doctrine. Further, concerns about the timeline and cost of litigation caution against secular adjudication of religious disputes. *See Saudi Basic Indus. Corp. v. Mobil Yanbu Petrochemical Co.*, 866 A.2d 1, 31–32 (Del. 2005) (noting that a court tasked with determining the elements of a Saudi cause of action undertook months of Islamic studies, hired its own expert witness who traveled to Saudi Arabia for further research, and read over 1000 pages of expert witness deposition testimony and nine expert reports before issuing its ruling); Andrew White, *Dispute Resolution and Specialized ADR for Islamic Finance*, in *ISLAMIC FINANCE: LAW AND PRACTICE*, *supra* note 42, at 306, 314 (noting that even basic, fundamental principles of Islamic law are elusive to Western legal scholars who lack expertise).

178. The incorporation of the First Amendment against the states was articulated as early as 1940. *See Cantwell v. Connecticut*, 310 U.S. 296, 303 (1940). Even if the Establishment Clause was not incorporated against the states, New York law bars the adjudication of religious disputes. *See S. S. & B. Live Poultry Corp. v. Kashruth Ass'n of Greater N.Y.*, 285 N.Y.S. 879, 890 (Sup. Ct. 1936) (holding that New York courts would not "assume to dictate or to interpret ecclesiastical doctrine" (quoting *Harlem Church of Seventh Day Adventists v. Greater N.Y. Corp. of Seventh Day Adventists*, 260 N.Y.S. 517, 522 (Sup. Ct. 1932), *rev'd on other grounds*, 280 N.Y.S. 828 (App. Div. 1935), *modified*, 198 N.E. 615 (N.Y. 1935) (per curiam))).

179. *See Green*, *supra* note 8, at 443.

180. N.Y. CONST. art. 6, § 3(b)(9); N.Y. COMP. CODES R. & REGS. tit. 22, § 500.27(a) (2018).

181. N.Y. CONST. art. 6, § 3(b)(9). The Court of Appeals may also consider certified questions submitted indirectly by federal district courts through 28 U.S.C. § 1292(b), which allows district courts to certify issues of state law to federal appellate courts, which may then certify the question to the N.Y. Court of Appeals. ADVISORY GRP. TO THE N.Y. STATE & FED.

majority of the certification requests for the New York Court of Appeals and has a mechanism in place that allows certification upon either the request of a party or sua sponte.<sup>182</sup> Regardless of whether a party's certification request is accepted or rejected, there is no formal procedure for a party to appeal the decision, although it may submit letters supporting or opposing certification.<sup>183</sup>

Similar legislation and procedures could be enacted to permit the certification of religious questions to a religious tribunal.<sup>184</sup> A tribunal would then render an opinion on the religious question, which would decide the matter for the secular court without requiring the judiciary to delve into doctrinal matters. Since a court could not designate a religious tribunal on its own, the parties would need to agree to certify the religious questions to a tribunal.<sup>185</sup> The parties could include a provision in the transaction agreements designating a tribunal and its members or a process for choosing a tribunal and its members. A provision that designates a tribunal would not be substantially different than an arbitration provision that designates an organization from which an arbitration panel may be chosen, such as the American Arbitration Association. As this would be a secular provision of the agreement, a court need not be troubled by entanglement concerns.<sup>186</sup> Alternatively, a tribunal could be chosen during the pretrial case-management process. Many courts require parties to mediate before

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JUDICIAL COUNCIL, PRACTICE HANDBOOK ON CERTIFICATION OF STATE LAW QUESTIONS BY THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT TO THE NEW YORK STATE COURT OF APPEALS 6 (3d ed. 2016) [hereinafter ADVISORY GRP.], <https://www.nycourts.gov/ctapps/forms/certhandbk.pdf> [<https://perma.cc/Y7BU-B245>].

182. *See id.* at 2.

183. *Id.* at 10.

184. This Note acknowledges the difficulties that may be associated with enacting this proposed legislative remedy particularly at the federal level, given recent anti-Sharia sentiments in state legislatures. *See* S.D. CODIFIED LAWS § 19-8-7 (2018) (“No court . . . may enforce any provisions of any religious code.”); *Awad v. Ziriax*, 670 F.3d 1111, 1116 (10th Cir. 2012) (affirming a district court order granting a preliminary injunction to prevent certification of the results of a voter-approved constitutional amendment that would prevent Oklahoma courts from applying international or Sharia law); H.B. 2582, 50th Leg., 1st Reg. Sess. (Ariz. 2011) (proposed legislation prohibiting the judicial application of foreign law or ratification of any private agreement based on foreign or religious law, including Sharia law, canon law, Halacha, and karma); *see also State Legislation Restricting Judicial Consideration of Foreign or Religious Law, 2010–2012*, PEW RES. CTR. (Apr. 8, 2013), <http://assets.pewresearch.org/wp-content/uploads/sites/11/2013/04/State-legislation-restricting-foreign-or-religious-law1.pdf> [<https://perma.cc/7LDE-BHYF>] (noting that between 2010 and 2012, thirty-two states introduced ninety-two bills restricting judicial consideration of religious law). New York has not introduced similar anti-religious-determination legislation. However, proposed legislation that would create a *sukuk* investment vehicle known as an alternative finance instrument bond has died in committee each session. *See, e.g.*, S.B. 3637, 2017–2018 Leg., Reg. Sess. (N.Y. 2017).

185. Court-designated religious tribunals would likely pose the same Establishment Clause issues as judicial interpretations of religious law and promote the beliefs of one religious tribunal over another. *See supra* notes 127–30 and accompanying text.

186. *Avitzur v. Avitzur*, 446 N.E.2d 136, 138–39 (N.Y. 1983) (finding that neither law nor public policy prevented the court from enforcing the secular terms of a religious agreement).



continuing the litigation.<sup>187</sup> In the same way that a mediator is not selected until the case is referred to mediation, a tribunal need not be designated until the court certifies a religious question.<sup>188</sup>

Just as the New York Court of Appeals retains jurisdiction over whether to accept or reject a certification request, a religious tribunal would retain the right to reject a court's request.<sup>189</sup> Under such circumstances, a court may permit the parties to select a different tribunal that would accept the certification request, or a court may dismiss the case as nonjusticiable because denial of the certification request leaves a court with no path to adjudication without violating the Establishment Clause.<sup>190</sup>

Like any extrajudicial adjudicatory process, certification requests present some concerns.<sup>191</sup> First, there is no guarantee that a religious tribunal would be willing to accept a certification request from a secular court. Such organizations may prefer that parties present disputes directly to the tribunal for full adjudication, not merely the certified question. Certainly, if religious tribunals abstain from certifying requests, devout parties would have no choice but to appear before such tribunals for adjudication of their disputes because resolution would otherwise be unavailable.<sup>192</sup> While this furthers the parties' interest in having matters adjudicated according to their religious beliefs, it undermines a state's interest in resolving disputes that arise within its borders, under its laws, and involving its citizens.<sup>193</sup> Particularly as applicable to Islamic finance, this outcome would undermine New York's interest in adjudicating commercial disputes, as devout parties would have no incentive to include New York in choice-of-law or forum-selection provisions.<sup>194</sup> This would weaken New York's position as a commercial center in the financial industry, even as the Islamic finance industry continues to grow.

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187. See S.D.N.Y. LOCAL CIV. R. § 83.9(d) (requiring parties to eligible cases to consider mediation and report to the court the perceived usefulness of mediation to resolve the dispute); N.Y. COMMERCIAL DIV. N.Y. CTY. ALTERNATIVE DISPUTE RESOLUTION R. 3 (stating that the presiding justice refers a case for mediation by order of reference); Administrative Order (N.Y. Sup. Ct. Apr. 19, 2017), <https://www.nycourts.gov/courts/ComDiv/NY/PDFs/AO-MandMedshort42017.pdf> [<https://perma.cc/CG26-P4YP>] (ordering mandatory mediation for all commercial disputes filed outside the Commercial Division).

188. See *Procedures of the Mediation Program*, U.S. DISTRICT CT. S. DISTRICT N.Y. (Dec. 9, 2013), <http://www.nysd.uscourts.gov/docs/mediation/Mediation%20Program%20Procedures.12.9.13.pdf> [<https://perma.cc/X4PE-L5L5>].

189. See N.Y. COMP. CODES R. & REGS tit. 22, § 500.27(d) (2018) (implying that the acceptance of certified questions is a discretionary decision by the New York Court of Appeals).

190. See *supra* Part II.

191. See *infra* Part III.B.2 for a discussion of problems inherent in ADR.

192. See *infra* Part III.B.2 for a discussion of extrajudicial resolutions.

193. *Cf.* Piper Aircraft Co. v. Reyno, 454 U.S. 235, 241 n.6 (1981) (listing the public interests in a diversity case, which include local interest in deciding localized controversies at home, conducting a trial in a forum at home with the law governing the dispute, and ensuring jurors have an interest in the case when completing jury duty).

194. See *supra* notes 11, 112–15 and accompanying text.

Second, certification lengthens the timeline of litigation.<sup>195</sup> A court has an administrative interest in clearing its docket. Certification removes some of a court's power to quickly resolve disputes.<sup>196</sup> A religious tribunal may be slow to accept or reject certification or render an opinion, which would effectively give the tribunal power to stay secular court proceedings by preventing a case from moving forward on the merits.<sup>197</sup> However, this scenario is unlikely because religious tribunals have a vested interest in rendering speedy opinions. Moreover, as the tribunals would be selected by the parties rather than appointed by the court, economic competition would motivate the tribunals to establish a reputation for issuing fair and timely opinions.

Third, the scope of the questions posed for certification, and the attendant answers, varies widely. The New York Court of Appeals may answer the certified question as framed by the requesting court or may rewrite the question to consider relevant state law issues.<sup>198</sup> If religious tribunals followed that example, the opinion rendered may be broader than the question posed and may encroach on a court's adjudication of the secular issues in the case. This potential problem can be remedied by including language in enacting legislation that limits the scope of the opinion to the certified question. Further, a court need not apply an overly broad opinion just as a court need not follow dicta.

#### *B. Alternatives Currently Available Under New York Law*

While a legislative remedy may be ideal, it is currently unavailable for transacting parties. The legislative process can be long and tedious, which means any legislative relief is unlikely to come quickly enough for parties currently grappling with these concerns. As parties must make do with what is available, this Note highlights two viable options for contracting around the Establishment Clause: stipulation of Sharia compliance and ADR—specifically arbitration.

##### 1. Stipulation of Sharia Compliance

One of the most effective ways to preempt a mutual-mistake claim is to warrant the existence of a fact or circumstance.<sup>199</sup> Before any *sukuk* issuance, the originator and issuer obtain a fatwa from their Sharia

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195. For reference, the Court of Appeals generally renders a decision to accept or reject a certification request within twenty-seven days, but the average time for the court to render an opinion on the certified question is about seven months. ADVISORY GRP., *supra* note 181, at 10.

196. *See Piper Aircraft*, 454 U.S. at 241 n.6 (recognizing that congested dockets present administrative problems for a court).

197. ADVISORY GRP., *supra* note 181, at 3.

198. *See Sec. Inv'r Prot. Corp. v. BDO Seidman, LLP*, 222 F.3d 63, 81–82 (2d Cir. 2000) (clarifying that the New York Court of Appeals was not limited to answering only the certified question).

199. *See Dana Gas PJSC v. Dana Gas Sukuk Ltd.*, [2017] EWHC (Comm) 2928 [63].

supervisory board declaring the *sukuk* Sharia compliant.<sup>200</sup> Currently, warranties of compliance are disclaimed by the issuer, and investors are instructed to consult their own experts to determine the transaction's compliance with Sharia law.<sup>201</sup> To share the risk of a mistake, the parties could stipulate and mutually warrant that the transaction accords with Sharia law. By entering the transaction, the parties would agree that they believe the transaction is Sharia compliant at the time of execution or that they are waiving any concerns about Sharia compliance. If the parties memorialized that understanding in a binding stipulation, performance would be required even if market practices shift and render the transaction noncompliant with the revised standards. Thus, transaction disputes would not require a court to delve into religious doctrine because the stipulation would have the effect of barring a party's claim of avoidance due to noncompliance. This solution would eliminate a court's Establishment Clause problem and enable the court to adjudicate the parties' contract claims.

Despite the fact that this solution removes excessive entanglement for the judiciary, is unlikely to be a satisfying resolution for parties who truly care about Sharia compliance. Parties bargain for a Sharia-compliant financial product and, in the process, incur additional transaction costs and forgo financial benefits available in Western financing because of the importance of Islam in their personal lives. If evolving standards render a transaction noncompliant, it is unlikely that an observant Muslim would want to be bound to continued performance of contract obligations that knowingly violate Sharia law.<sup>202</sup> A stipulation of compliance would arguably clash with *ijtihad*, which requires a de novo review of all issues, because the stipulation removes all further inquiry.<sup>203</sup> By creating a prior agreement that the transaction will be deemed compliant, the parties prevent the requisite determination, pursuant to Islamic law, that the transaction is, in fact, compliant. This path could create a transaction that is merely facially Sharia compliant. Although stipulation is a viable alternative, it does not present an ideal solution.

## 2. Alternative Dispute Resolution

As in cases involving Jewish law, the parties could submit their dispute to the authority of an extrajudicial forum for resolution.<sup>204</sup> To do so, the transaction agreements would need to include a provision mandating that religious questions be decided through an agreed-upon form of ADR. To the extent that parties seek judicial resolution of religious questions, a court

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200. See *supra* notes 159, 171–72 and accompanying text.

201. KSA SUKUK LTD., *supra* note 159, at 226.

202. In a situation where there is bilateral agreement about noncompliance, the parties could agree to release each other from continued obligations or restructure the transaction to align with revised standards, but that is not addressed in this Note.

203. Eisenberg, *supra* note 42, at 18.

204. See, e.g., *Avitzur v. Avitzur*, 446 N.E.2d 136, 138–39 (N.Y. 1983) (enforcing parties' prenuptial agreement to appear before a religious tribunal); Helfand, *supra* note 1, at 1247–49 (discussing trends in Jewish arbitration).

could enforce an extrajudicial forum's resolution of the religious question.<sup>205</sup> Contracting around the Establishment Clause in this manner would best serve the parties' needs and protect the judiciary's integrity. Most importantly for New York, this approach frees courts of a potential excessive religious entanglement.<sup>206</sup> Courts would be called upon to adjudicate secular provisions of an agreement in accordance with secular law, not religious questions.<sup>207</sup> Further, courts could enforce a tribunal's determination as a secular provision of the parties' original agreement, subject to public policy.<sup>208</sup>

An extrajudicial forum would best serve the needs of the parties to conduct their commercial transactions in accordance with Sharia law.<sup>209</sup> By preselecting a tribunal or arbiter, the parties could choose an adjudicatory authority known to adhere to a particular set of religious beliefs. Given the variance within Islamic scholarship across schools of thought, the parties could agree to have matters decided by a tribunal comprised of scholars that best reflect the parties' beliefs.<sup>210</sup> The parties could choose to have the matter decided by certain prominent Islamic scholars or their local imams.<sup>211</sup> If desired, the parties could agree to have the religious tribunal decide all matters of breach and awards to ensure that all components of the dispute resolution process adhere to Sharia law.<sup>212</sup>

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205. See *Avitzur*, 446 N.E.2d at 138–39 (finding that neither law nor public policy prevented the court from enforcing the secular terms of the religious agreement requiring the husband to appear before a religious tribunal).

206. Helfand, *supra* note 1, at 1244–45.

207. See *Meshel v. Ohev Sholom Talmud Torah*, 869 A.2d 343, 354 (D.C. 2005) (holding that an order to compel arbitration before a rabbinical tribunal did not violate the Establishment Clause because the determination did not require the court to even address the parties' underlying religious dispute); *Jabri v. Qaddura*, 108 S.W.3d 404, 408, 413 (Tex. 2003) (holding valid and enforceable an agreement to appear before a three-imam arbitral panel of the Texas Islamic Court).

208. See *Zeiler v. Deitsch*, 500 F.3d 157, 169–70 (2d Cir. 2007) (enforcing arbitral determinations of a Jewish rabbinical tribunal pursuant to the Federal Arbitration Act); *Elmora Hebrew Ctr., Inc. v. Fishman*, 593 A.2d 725, 731 (N.J. 1991) (noting that one party was bound by the rabbinical arbitral determination so long as the party agreed to submit the issue to the tribunal); *Berg v. Berg*, 926 N.Y.S.2d 568, 570 (App. Div. 2011) (upholding a rabbinical arbitration award where the plaintiff failed to prove prejudicial impropriety or misconduct or duress); Helfand, *supra* note 1, at 1260 (“U.S. courts cannot enforce arbitration awards that violate public policy.”).

209. See *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 34 (1991) (holding that the purpose of arbitration is to give effect to the intent of the parties); *Avitzur*, 446 N.E.2d at 138–39 (noting that the religious question was appropriately left to the extrajudicial forum chosen by the parties).

210. Michael C. Grossman, Note, *Is This Arbitration?: Religious Tribunals, Judicial Review, and Due Process*, 107 COLUM. L. REV. 169, 179–80 (2007) (describing Canadian Islamic arbitral proceedings in which parties choose which school of Islamic jurisprudence will govern the proceedings).

211. See *Zeiler*, 500 F.3d at 157 (accepting, without review, the parties' selection of rabbis for an arbitral tribunal).

212. Helfand, *supra* note 1, at 1249–50 (detailing distinctions in Islamic law regarding evidentiary standards and discovery). Sharia law limits the amount of damages awarded to a party. *Saudi Basic Indus. Corp. v. Mobil Yanbu Petrochemical Co.*, 866 A.2d 1, 35–36 (Del. 2005).

It is possible that allowing a religious tribunal to decide the entire dispute would jeopardize the correct application of New York law because the tribunal may have differing interests from secular law.<sup>213</sup> Further, courts are highly deferential toward arbitral awards and will modify or vacate awards only on narrow grounds.<sup>214</sup> These problems are, however, not unique to religious arbitration and are present in any arbitral proceeding, and there remains a strong push for arbitration in secular disputes nevertheless.<sup>215</sup>

Importantly, New York courts will not enforce arbitration decisions that contravene public policy. Consequently, there are safeguards in place to ensure that arbitral decisions do not greatly disadvantage the parties.<sup>216</sup> And even if the tribunal only decided matters of Sharia compliance, the parties would benefit from a forum that renders decisions consistent with Sharia law, which makes this solution the most feasible—and beneficial—option currently available.<sup>217</sup>

#### CONCLUSION

New York law has a strong interest in adjudicating disputes appropriate for resolution in a judicial forum, including Islamic commercial disputes. The Establishment Clause, however, presents an impenetrable bar to the adjudication of matters that require a court to determine religious doctrine. Such rulings would result in courts preferencing one religious interpretation over another and would create an excessive religious entanglement that violates the First Amendment. Absent legislative intervention that would permit a court to certify religious questions to a tribunal, the parties to an Islamic commercial agreement should consider contracting around the Establishment Clause by stipulating to a transaction's compliance or directly submitting to the jurisdiction of an extrajudicial forum capable of deciding religious disputes in a manner consistent with the parties' beliefs. The resulting extrajudicial determination would generally be enforceable by a secular court, which could still hear claims relating to the secular provisions of the agreement. Failure to contract around the Establishment Clause exposes the parties to the risk of being denied a remedy for breach of contract,

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213. See Helfand, *supra* note 1, at 1260–68 (discussing the restricted rules of procedure common in religious arbitration).

214. 9 U.S.C. § 10(a) (2012) (permitting vacatur of arbitral award in only four circumstances); N.Y. C.P.L.R. 7511 (2018) (stating the limited grounds for modification or vacatur of award).

215. *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 443 (2006) (“[T]he Federal Arbitration Act . . . embodies the national policy favoring arbitration and places arbitration agreements on equal footing with all other contracts.”).

216. See Helfand, *supra* note 1, at 1254–60 (outlining the rationale and examples of public policy vacatur of arbitral awards).

217. While Islamic arbitral tribunals are generally unestablished in the United States, there has been a recent movement to establish Islamic arbitration courts. Helfand, *supra* note 1, at 1249–50 (noting the creation of the Fiqh Council of North America and the Council of Masajid of the United States); see also *Jabri v. Qaddura*, 108 S.W.3d 404, 407–08, 413 (Tex. 2003) (holding an arbitral agreement to appear before a three-imam panel of the Texas Islamic Court valid and enforceable).

whether declaratory, injunctive, or monetary, or granted a remedy that does not address the heart of the dispute, which would ultimately hinder the growth of the Islamic finance industry in the United States.