

ARAB COMMERCIAL LAW -- INTO THE FUTURE

by

Howard L. Stovall

Abdel-Razzaq Al-Sanhouri had reason to be pleased. He had just traveled to The Hague, to participate in what was billed as the First International Conference for Comparative Law. After deliberations, those comparative lawyers decided to give greater attention to Islamic law in their future comparative studies. Two broad themes seem reflected in that decision and, perhaps more importantly, in Dr. Al-Sanhouri's own philosophy: revitalization of Islamic law, and globalization of our societies.

Those two themes are constant features of the Arab legal landscape today -- remarkable given that Dr. Al-Sanhouri's trip to The Hague occurred almost seventy years ago, in 1932. In retrospect, that Conference was a defining moment for Western awareness of law in the Arab world. As international trade has expanded in recent decades, the twin themes of revitalization and globalization have become even more relevant in assessing Arab commercial law.

Revitalization of Islamic Law

As a species, lawyers are not considered dynamic public speakers, but experience suggests that the number of glazed eyes and drooping heads at a business conference increases geometrically when a speech turns to matters of Islamic law. There seems to be a myth that Islamic law just doesn't apply to modern commercial transactions (accompanied by a grudging recognition that payment of interest runs afoul of some relatively obscure Islamic rule). Although lawyers may indeed be boring speakers, the fact remains that Islamic law is

Mr. Stovall, currently co-chair of the American Bar Association's Middle Eastern Law Committee, maintains his law offices in Chicago and web address at www.stovall-law.com.

relevant to modern-day business throughout the Arab Middle East, and its importance is increasing.

Marriage of Laws

In some countries, Islamic law principles dominate a country's legal system -- as is the case in Saudi Arabia, the region's commercial powerhouse. There is no Saudi Arabian "law" other than Islamic law; supplemental Saudi laws are formally called "regulations". Although applicable (with the binding force of law) to various aspects of modern life, these regulations are intended to remain consistent with, and subservient to, Islamic principles.

In many other countries, the Islamic law influence is more subtle, and often best revealed in civil codes -- the backbone of most Arab legal systems. These civil codes contain the basic building blocks for commercial law, addressing a wide range of contract rules, including the elements and formation of contract; interpretive rules; breach and damages.

Dr. Al-Sanhouri, Egypt's foremost modern jurist, played a central role in drafting the 1948 Egyptian Civil Code -- which directly influenced the development of similar codes in Syria, Iraq, Libya, Kuwait and Qatar. To some observers, the most attractive feature of these codes is the blending of continental civil law rules with Islamic law principles, indigenous customs and commercial practice, which Dr. Al-Sanhouri thought would best conform with local culture and society.

Commercial lawyers generally prefer evolution to revolution, and consequently should be comforted by the incremental manner in which Islamic law has continued to be revitalized in the Arab world -- notably in the civil codes of Jordan (1976), the United Arab Emirates (1987), and Yemen (1992). Kuwait has also recently revised a number of provisions in its existing civil code, to more closely reflect specific Islamic law rules. This type of "fine tuning" should become more customary in years to come, throughout the Arab world and in laws beyond civil codes.

Irreconcilable Differences?

The myth of Islamic law's irrelevance has a sister myth, that Islamic law is inherently unsuitable for modern commercial transactions. Over the centuries, Islamic law has generally provided a stable foundation for nearly all types of business transactions -- with the exception of a few things that are absolutely repugnant to Islamic law, notably riba (types of unearned advantage, a common example of which is interest on monies lent) and gharar (types of risk or uncertainty, such as impermissible contracts of insurance). Of course, it is difficult to sweep these precepts under the proverbial carpet. Most significantly, in the face of a world banking system essentially based on interest, and a divine immutable Islamic law rule against riba, the potential for impasse is obvious.

Professor William Ballantyne (School of Oriental and African Studies, London) describes this impasse as the classical situation of an irresistible force meeting an immovable object. In most cases, practical minds have developed expedients to overcome the difficulties. Despite the prohibition against riba, most Arab legal systems draw a distinction which permits interest charges in commercial (but not civil) transactions, at least under specified ceilings. Despite the prohibition against gharar, which Abu Dhabi courts have cited in nullifying derivatives contracts, the Abu Dhabi government is establishing Saadiyat Island Free Zone as a center for financial futures and options trading, albeit "off-shore" that emirate.

An expedient might be viewed as a practical solution or an unprincipled short-cut, depending upon one's opinion of the underlying impasse. As such, expedients might not offer permanent solutions. The future is likely to bring these issues more frequently into view in the Arab Middle East.

Globalization and Law

In the legal context, globalization is pushy, intrusive, and demands an active re-examination of one's own laws and regulations. Driven by pressures from a variety of sources, such as regional initiatives (for example, through the Gulf Cooperation Council) as well as the World Trade Organization ("WTO") accession process, Arab countries are reviewing and revising laws governing a wide range of economic activity, in order to end the differential treatment of local and foreign businesses: direct investment and management in local companies; portfolio investment and stock market participation; import and distribution of products; use of intellectual property and protection thereof; and the taxation of income arising from such commercial endeavors.

In trying to assess the over-all impact of globalization on so many different laws, the grove is quickly hidden by all the palm trees. However, some of the more significant legal issues can be placed under three general headings: transparency, open markets, and the legal process.

Transparency

Many of the leading businesses in the region are closely-held (often family-run) enterprises, and there is considerable reluctance to publicly disclose the type of financial and commercial information customarily required under Western securities laws. The UAE Minister of Planning recently called for UAE companies to "commit themselves to issuing regular financial reports to ensure transparency, and these should be per the highest international accounting standards".

As Middle Eastern markets open to greater foreign participation, the demands increase for greater transparency. Nonetheless, many financial experts believe that more energy has been expended liberalizing Middle East capital markets than in ensuring the integrity

of those markets -- although new securities regulations have been enacted recently in Jordan and Egypt, and are being finalized in Kuwait, to combat insider trading and other activities harmful to market integrity. In the near-term, however, the effectiveness of these regulations is open to question, particularly given deeply entrenched prior practices.

Over the years, foreign contractors have also expressed concern about the lack of transparency in some Middle Eastern government tenders and contract negotiations. Mistrust is inevitable where government procurement involves mixed signals, changing policies, and unwritten conditions. In the context of media criticism against projects launched under the former government of Kamal El-Ganzouri, and the new government's top-to-bottom re-evaluation of such projects, one lawyer was prompted to advise: "Anyone who isn't confused doesn't understand the situation". Greater transparency might be achieved through a statutory reduction in a government's broad discretionary authority, whether in awarding contracts, issuing licenses, or approving foreign investment. In other cases, the lack of transparency springs from political and government practices that are currently beyond any likely attempt at legal reform.

Open Markets

Various obstacles may prevent a market from opening to the global economy. One such obstacle that has drawn the ire of Western businessmen for many years is the multitude of Middle Eastern rules requiring local sales agents, distributors and sponsors. In many Arab countries, for example, government procurement laws require foreign contractors to have local agents before participating in tenders -- this requirement, taken together with the lack of transparency in some such procurement, can create an incentive for influence-peddling that is difficult to resist. (With enactment of the OECD Convention to Prevent Bribery, European businessmen must now grapple with some of the same legal strictures that have long faced their U.S. brethren, under domestic Foreign Corrupt Practices Act rules.)

Trading is at the core of the Arab world's commercial heritage, and consequently every Arab country has special laws and practices encouraging foreign suppliers to use local sales agents (and distributors). Most of these laws contain so-called "dealer protections", notably entitling the local sales agent to claim compensation if the foreign party fails to provide adequate justification for termination or non-renewal of the relationship. This statutory right parallels, and in fact is derived from, European laws. However, in other respects, the protections available in many Middle Eastern countries exceed that available in Europe. For example, in some Middle Eastern laws, a sales agent is given the exclusive right to import the relevant product, to receive compensation for any parallel import of the product by others -- and even to block the foreign supplier's direct import of the product into the sales agent's territory.

Arab government officials are becoming increasingly sensitive to the disadvantages of these more extreme protections, which impede the free market, in essence allowing a sales agent to hold the supplier and consumers hostage, even in minor commercial disputes. In the past few years, both Oman and Bahrain amended their law to abolish the statutory requirement of exclusivity for local sales agents. Other Middle Eastern countries are likely to follow suit; interestingly, the UAE (with its reputation for free trade) currently has the most onerous dealer protection law in the region.

Legal Process

"The antithesis of good rules is not bad rules, but rather no rules," a businessman once told his lawyer. While conversations between businessmen and lawyers often amount to the proverbial ships passing in the night, in this case the lawyer thought he understood what the businessman meant: financial calculations can be made for known risks, and prices can then be adjusted accordingly. Among the necessary elements of the equation, however, is a reliable legal system.

One important component of a legal system is reliable law-making. In this regard, shortcomings abound in the Middle East, even recently in Egypt (which has otherwise basked in much success) -- ill-timed policies as to duty-free stores immediately after privatization, and ill-conceived policies as to publishing houses in the free zones and as for certificates of origin on imported goods. The new Egyptian Commercial Code contains another troubling example -- technology transfer requirements that seem like a heavy-handed throw-back to Egypt's command-economy days. Some legal observers believe that such legislative mis-steps are inevitable, given the insular fashion in which laws are usually drafted in the Middle East.

Another important component of a legal system is reliable dispute resolution. In this regard, some Middle Eastern countries fall short in even basic measurements -- like the publication of court decisions. Less frequently, a country's entire court system has been subject to criticism; for example, the chairman of the Yemeni Judicial Inspection Board described as "deplorable" the condition of the local judiciary, including disorganized administration, lack of due process, and corruption. More frequently, complaints are heard (as Moody's Investor Services warned in the context of Arabian Gulf lawsuits to collect bad loans) that "Major political figures are often effectively above the law". Some improvements are being made -- in late 1999, for example, the Omani judicial system underwent significant restructuring, integrating the sharia, criminal and commercial courts, and establishing an administrative court for cases in which the government is a party. Similarly, the Saudi Arabian government in recent years has strengthened the authority and operation of the Board of Grievances. Nonetheless, the courts in many Arab countries remain works in progress.

Into the Future

Like most things, commercial laws are influenced by environment. The economic environment in many Arab countries has been changing: governments are no longer trying to protect their economies from the rest of the world, but rather seeking the advantages of participation in the global economy. As a result, Arab legal systems are facing new challenges, and at an ever-increasing pace.

Will the Arab world be able to match that pace? As Middle East commercial lawyers caution in their legal opinions, the outcome "is not entirely free from doubt". Most Arab governments have expressed strong support for membership in the WTO -- although some Arab members benefit from lengthy grace periods before domestic preferences and protections must be lifted. The future will tell whether the Arab world's commitment to globalization is sound, or mere sound. It seems, however, that Arab and Western nations increasingly recognize that their best interests are served through mutual understanding, accommodating each other's peculiarities, and continuing to expand their interaction -- objectives that build upon the legacy of Dr. Al-Sanhouri's trip to The Hague many years ago.

16March2000