

Legal Construction of Islamic Banking Dispute Resolution through Litigation in Indonesia and Malaysia

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Abstract: This legal research was aimed to compare the legal construction occurred in the establishment of authorized litigation institutions to resolve the Islamic banking dispute in Indonesia and Malaysia respectively. This research used qualitative method with approaches of legislation, concept, and history. The result was both countries had made legal construction processes in determining the jurisdiction of Islamic banking authorities with slightly different dynamics and methods. The legal construction process in Indonesia consisted of two phases. The first was positivization phase with the definition method and argumentum per analogism. The second was deregulation phase with systematic and grammatical interpretation method. Whereas Malaysia experienced two phases. First, it was the deregulation phase with systematic method and principal verbal exposition method. Second, it was the institutionalization phase with systematic interpretation method.

1 INTRODUCTION

The growth and development of Islamic economics in Southeast Asia can be regarded as highly advanced (Lebdaoui and Wild, 2016). The evident can be seen from the increasing number of Islamic financial institutions among others Islamic banking in Malaysia and Indonesia. The development of Islamic banking in Malaysia as well as in Indonesia does not rule out the possibility of dispute escalation that occurs in these banking institutions. There are various problems that may arise in the practice of Islamic banking between banks and customers (Dolly, 2013, p.561). The possibilities of dispute are usually in the form of a complaint due to incompatibility between the reality and the offer or not in accordance with the promised rules. It can also happen because of the bureaucratic service and flow that are not included in the draft of the contract. Moreover, it can as well arise due to complaint against the slow work process or any broken commitment conducted by either party.

The principles of Sharia which become the basis of Islamic banks are not only limited to ideological foundations, but also as an operational basis (Umam, 2017, p. 391-412). Related to that matter, for Islamic

banks in carrying out its activities, it is not only as business activities or products. Not only it should be in accordance with the principles of Sharia, but also it includes the created legal relationship and the arising legal consequences. The settlement mechanism is likewise included in this case if there is a case of dispute between Islamic bank and its customer.

Litigation is one of the instruments in resolving the dispute of Islamic banking (Marcom and Yaakub, 2015, pp.565-584). It is aside from the non-litigation alternative institutions that become the choice of many business people such as arbitration, mediation, and so forth. Perdana (2009, p.8) argues that the judiciary still needs to be retained as a pressure valve in a legal and democratic state. It is needed although it is only as a last resort institution when the alternative dispute resolution institutions still become the first resort. The availability of clear and applicable regulation becomes very important so that the process and result of dispute resolution of Islamic banking through litigation can work effectively and relevantly with Sharia principles (Muhammed and Ali, 2017, p. 48-64).

The legal construction process in determining the judiciary authorized in resolving the Islamic

economic dispute becomes an important issue to be noticed comparatively, including Islamic banking in both Indonesia and Malaysia. These two countries have experienced the dynamic phases of Islamic economic law system formation classified as revolutionary (Rahardjo, 2009, p. 17). There are some previous studies such as Abdullah (2017, p. 276-286) and Rashid (2013) that have compared the Islamic banking dispute settlement system between Indonesia and Malaysia on mechanism and legal framework in both countries. Therefore, this paper will comparatively describe the method used in constructing the law and legal substance of Islamic banking law in both countries related to the resolution of Islamic banking disputes through litigation.

2 RESEARCH METHOD

This research is based normative method and used legislation, concept, and history approaches. The secondary data were analyzed qualitatively by using systematic interpretation and historical interpretations methods.

3 LITERATURE REVIEW

3.1 Legal Construction Methods

In the legal state system that followed the ideology of positivism, it was required to provide a guaranteed legal regulation and to make sure it was able to be applied effectively. However, it was not impossible that the rules made in written form accommodated all the society problems which tended to be dynamic. Frequently, there were some rules found containing conflict between norms, unclear norms, and legal vacuum. Therefore, it was necessary to interpret and construct the law in the frame of law formation or legal discovery (Mertokusumo, 2009, p. 37). It was in line with Jhering's opinion that law emerged from the moral of spiritual and the culture of nation, then passed through the process of legal reconstruction. Paul Scholten who developed Jhering's notion added that in order to develop logical reasoning method, construction method was the only decisive method. There were three conditions offered by Scholten in legal construction. First, the construction should cover the entire field of related positive law. Second, a logical contradiction within the law should be

avoided. Third, the construction must be equipped with splendor requirements (Rahardjo, 1991, p. 103).

The method of legal construction or the exposition method was one of the methods in legal discovery. It was in addition to the interpretation method generally used by judges (Butarbutar, 2011 and Muwahid, 2017), law researchers and others related to cases and legislation (Mertokusumo, 2009, p. 56 and 73). In this paper, the legal construction was defined more as the process of establishing the dispute resolution in the Islamic banking legal system in litigation. It was implied to Indonesia and Malaysia respectively since these countries were full of dynamics in the determination of the authorized judicature institution.

Interpretation method was could be collaborated with legal construction method so that a new norm or law could be established. Both interpretation and construction are activities. Interpretation is the activity of identifying the semantic meaning of a particular use of language in context. Construction is the activity of applying that meaning to particular factual circumstances (Barnett, 2011, p. 66; Solum, 2011, p.95-96). Interpretation method consists of 1) grammatical (Solum, 2013, p. 67-75), an interpretation according to daily language; 2) historical, an interpretation based on law history; 3) systematic, interpreting the law as a part of the whole system of legislation; 4) teleological, an interpretation according to the meaning/purpose of society; 5) law comparison, an interpretation conducted by comparing other pandect or other law; and 6) futuristic, anticipative interpretation based on the law which had not yet possessed a legal force (*ius constituendum*) (Said, 2012, p.187-197). The construction of this law could be conducted by using logical thinking. The first was *argumentum per analogism* or frequently called "analogy" towards different but alike, akin or similar events arranged in the constitution to determine and fill the legal void that occurred. The second was the law constriction towards general regulation with explanation or construction by giving features applied to specific events or legal relationships. The third was *argumentum a contrario* or often called a *contrario*, which meant interpreting or explaining constitution based on the resistance of understanding between the encountered concrete events and the events that had been set in constitution ((Mertokusumo, 2009, p. 67-78; Shidarta, 2016).

3.2 Effectiveness of Law

In line with the legal construction requirements emphasized by Scholten, the logical contradiction in the law must be avoided in order that a definite law was established and could be applied effectively in the life of society in the form of behavior in accordance with the law. In order to create a lawful behavior, according to Lawrence M. Friedman in his book *Law and Society*, cited by Soekanto (1993, p. 43), the effectiveness of a legislation was strongly influenced by three factors, which was known as the effectiveness of the law. The first factor was the legal substance in which the legislation should be clear, firm and consistent in its formulation (Manan, 2000, p. 225). The second was the legal structure, comprising of institutions and law enforcement authorities authorized to create, supervise and uphold a regulation of applicable law. The third was legal culture, as in the attitude of the law society in which the law was implemented.

4 ISLAMIC BANKING DISPUTE AND AUTHORIZED COURTS: A LEGAL CONSTRUCTION

4.1 Indonesia

Indonesia has experienced a legal construction process in determining authorized court to resolve the Sharia economy dispute. This construction process could be classified into two phases: positivization phase and deregulation phase. The new phase of the Islamic banks development in Indonesia began with the implementation of Act Number 7 of 1992 concerning Banking. It positivised the principles of Sharia economy through dual system banking for conventional banks to run their business based on "profit sharing principle" (Articles 6 and 13) not yet called "shariah" (Duddy Yustiady in Dewi, 2006, p. 58). The position of Sharia banks was even stronger with the existence of Act Number 10 of 1998 as amendment to Act Number 7 of 1992 concerning Banking which affirmed "Bank based on Sharia principles" Article 1 paragraph (3) and (4). It was implied to the rapid growth and development of Islamic banks to this day.

At this time, there has been no strict regulation to regulate judicature institution authorized in resolving the Islamic banking dispute. Religious Court has not been authorized to handle this matter because its authorization was limited by Article 49

of Act Number 7 of 1989 concerning Religious Court. It could only handle matters of marriage, inheritance, wills, grants/*hibah*, endowments/*waqf* and alms/*infaq* among Muslim civilians (Anshori, 2009, p. 214). Islamic economics was classified as *muamalah* or civil activity in general context. Civil cases were one of the jurisdictions of General Court (Article 50 of Act Number 2 of 1986 concerning General Court). Through the definition and the *argumentum per analogiam* methods, the word "*perdata*" was linked with "*muamalah*" in Islamic economy in which they had the same meaning regarding to the relationship of human in privat law.

Based on the principle of *muamalah*, everything was permitted until there was a proposition forbidding it (opening system of Islamic economy (Yasin, 2015, p.181-204). On this basis, to fill the legal void, civil law was used in General Court to resolve disputes related to Islamic Banking. In the end, District Court was chosen to handle the Sharia economic dispute in accordance to the clause agreement approved by the parties. This condition ran until 2006 by implementing amendment of Act Number 7 of 1989 to Act Number 3 of 2006 concerning Religious Court. Finally, it had been changed to Act Number 50 of 2009. The authority of Religious Court expanded to the field of Islamic economics including Islamic banking (Article 49 paragraph (i) and its explanation in Act Number 3 of 2006). As for the special area in Banda Aceh Province, the authority was in the Sharia Court (Basir, 2012, p.148).

The enactment of Act Number 3 of 2006 apparently could not escape from a conflict. In this phase, the reconstruction of the law was re-established due to the legal norm in Article 55 paragraph 2 of the Act Number 21 of 2008 concerning Sharia Banking. It was inconsistent with Article 55 paragraph 1 of the Sharia Banking Law and Article 49 letter i of Act Number 3 of 2006 towards the Amendment of Act Number 7 of 1989 concerning Religious Court which established the settlement of Islamic banking dispute conducted by Religious Court. Religious Court carried the duty and authority to examine, decided upon and resolved cases at the first level among Muslim civilians (including persons or legal entities who voluntarily submitted themselves to Islamic law even though their religious status was not Islam) in the areas of: marriage, divorce, repudiation, inheritance, bequest, gift and Sharia economics (including Islamic Banking). In the explanation of Article 55 paragraph 2 of Islamic Banking Act, it provided an opportunity for the disputed parties to resolve their case outside Religion Court if it was mutually agreed upon in the contents of the contract. This provision was considered to result in legal uncertainty since there

was a dualism of authority between Religious Court and District Court so that it may harm the interest of the parties.

Therefore, systematic method and grammatical interpretation method were used to describe legal disorder and confusion caused by the provision of Article 55 paragraph 2. It could be seen from the Constitutional Court Decision Number 93/PUU-X/2012 on 29 August 2013 concerning the annulment of the Article (www.mahkamahkonstitusi.go.id). The arguments were as followed:

1. Islamic Banking used Sharia contracts. If the dispute was brought to a General Court that did not use Sharia rules and principles, there would be a de-synchronization between the practices of the contract with the resolution of the dispute which was fatal to the court decision;
2. The existence of *ta'arudh al-adillah*. It was regarding to the contradiction of two regulations when paragraph (2) and paragraph (3) of *a quo* constitution still existed generating in legal uncertainty and contradicted the principles, objectives and functions of Islamic Banking law (Article 2 and 3) Article 28 D paragraph (1) of the 1945 Constitution. Thus, it was undermining the legal system of Sharia economy in national legal system;
3. The emergence of chaos prior to or in practice of the contract. It possibly happened when one intended to sign a contract in a Sharia Bank; the bank wanted a dispute resolution in the District Court, whereas the client wanted to be settled in Religious Court. Thus, it would certainly cause problems in the contract;
4. The existence of forum choice. It emerged legal disorder and decision disparity from two different verdicts between Religious Court and General Court.

Based on the decision of the Constitutional Court, deregulation was carried out. The cancellation of Article 55 paragraph 2 of the Islamic Banking Act and constitutionally Religious Court became the only judicial institution in the resolution of Sharia economic disputes in Indonesia.

4.2 Malaysia

The legal construction process also took place in Malaysia in two phases (Kassim, 2016, p.66-76). In the first phase namely deregulation phase, the settlement of Islamic banking disputes in Malaysia prior to 2009 was within the jurisdiction of Civil

Court, not Sharia Court. The authority of Civil Court was based on Court of Judicature Act 1964 (Act 91) regulating the Civil Court expansive authority in criminal law (section 22) and civil law (section 23 and 24).

The legal construction through systematic method and principal verbal exposition method was carried out through Article 121 (1A) Federal Constitution (amendment in 1988). It determined the judicial authorities for the courts existed in the Constitution including Civil Court and Sharia Court. Through this provision, Civil Court no longer had the authority to deal with matters within the authority of Sharia Court as it has been enacted beforehand (Othman, 1996, p. 229 and Majid, 1997, p. 112-147). It aimed to avoid any conflict of decisions on cases made by the Court (Shuaib, 2008, p. 50-51) so that Islamic principles could be applied holistically (Towpek and Borhan, 2006, p. 83-84).

However, the provision of Article 121 (1A) was causing a dualism of authority between Civil Court and Sharia Court instead. According to Federal Constitution in Paragraph 4 List I (Federal List), the cases related to the Commercial law were included under the authority of the Federation as well as banking, as it was stated under Paragraph 7 in the same list. Since Islamic banking and finance were categorized under Commercial law, therefore it became the authority of Civil Court (Suruhanjaya Sekuriti Malaysia, 2009, p. 58). According to Hassan (2008), there were several juridical arguments that could be pointed out regarding the authority of Civil Court against Islamic financial disputes, namely:

1. Although the term "Islamic law" was incorporated in the applicable laws of Malaysia, it should be understood that its application was limited to those who embraced Islam. Therefore, the enforceability of Islamic law was very limited, whereas in the Islam financial business transactions, many people from various religious backgrounds were involved. Even the number of non-Muslims was relatively great in the composition of customers in Islamic banking in Malaysia.
2. The business of finance and banking was managed by federal legislation, and so far, there was no regulation regarding financial and banking business in legislation in the state. That was the reason why the state could not manage financial and banking matters, thus only the regulation that came from the state (federal government) was nationally applicable. Meanwhile, federal legislation (national) was

attached by the provision that the financial and banking business were subject to Civil law regulation. Therefore, the dispute over Islamic finance businesses would automatically fall under the authority of Civil Court. On the contrary, if this dispute was to be settled on Sharia Court, substantial amendments should be made. It happened because Sharia Court, especially in its authority, was governed autonomously by the state. Consequently, to make an amendment, another amendment must be made through state parliaments statewide, in which in Malaysia there were 13 states plus a special Federal Territory.

The above arguments used the method of extensive interpretation, which meant interpreting broadly the scope of trade including Islamic banking.

For the above legal disorder, legal construction was carried out in the second phase (institutionalization). It was to create a special judicature institution in the field of Islamic finance. One of the recommendations of Malaysia Financial Sector Masterplan 2001-2010 was the development of Islamic banking and takaful system in Malaysia supported by judicature institution specialized in handling cases stated in related laws (Bank Negara Malaysia, 2001, p. 79-83). In order to resolve the disputes related to Islamic banking and finance so that it could work effectively and consistently, it was advisable to establish a special division in High Court. The establishment of this division aimed to ensure that the case was controlled by an expert judge in a related field (systematic interpretation method). At the same time, it encouraged lawyers in order to have particular expertise in Islamic banking and finance so that they were more likely to provide advices and insights in the cases they handled.

The establishment of the Muamalat Court was in accordance with the aspirations of the Kingdom to promote Malaysia as the center of Islamic Banking and Finance. As a result, a positive step has been made by Department of Justice and Law by forming a special section under Civil Court to deal with Islamic banking and dispute related to financial matter based on Practice Direction Number 1 of 2003, issued by the Chief Justice, Dato' Haidar Mohd Nor (as he then was). Since 2003, muamalat disputes have been registered at High Court Commercial Division 4 and were granted a special reference code. Prior to this, the dispute resolved in High Court Commercial Division 4 was a mixture of Islamic banking and other commercial cases.

The special Muamalat Court started its first operations in February 2009. In terms of structure,

Muamalat Court was a part of the Commercial field of Kuala Lumpur High Court and was formed to handle all issues related to Islamic banking and finance (Chen, 2017, p. 133-156).

The Muamalat Court was comprised of the first level (original jurisdiction) and the same appeal level (appeal jurisdiction) as High Court in Malaysia in accordance with the provision of Act 91. In addition to the authority, this court also had specialization in handling Islamic banking and finance disputes. It shall be referred to Sharia Advisory Council of Central Bank of Malaysia in accordance with the provision of Section 56 Act 701 (The Central Bank of Malaysia Act 2009).

The establishment of the Muamalat Court was also a practical approach to resolve debates regarding the appropriate authority of Sharia Court and a proper forum to deal with disputes concerning Islamic finance. Thus, the establishment of Muamalat Court was the best resolution in the meantime in Malaysia by giving a special authority in Islamic banking and finance.

5 CONCLUSIONS

The development of Islamic banking industry in Indonesia and Malaysia has experienced constructive law dynamics. On the basis of consistency in running the principles of Islam that has been conducted operationally up to the mechanism of dispute resolution, it became the reason why the legal construction and reconstruction process has been gradually implemented. The different methods that have been used in Indonesia and Malaysia in constructing the law of court jurisdiction in resolving disputes of Islamic banks show the advantages and disadvantages of both.

This comparison is important not only for both countries but also for the other countries to improve the Islamic banking dispute resolution system by taking the effective method of legal construction. Indonesia is more progressively reformed the law in determining the religious court jurisdiction of the settlement of the Islamic economic disputes than Malaysia, that is why Indonesia have a more consistent and coherent court structure to deal with cases involving Islamic banking system disputes.

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