



Gauging The Opportunities and Challenges Surrounding Shariah-Compliant Technology-Related IP Financing[©]

By

Lawrence A. Kogan

The Kogan Law Group, P.C.

For Presentation on the Panel

Islamic Financial and International Trade: Challenges & Issues

Delivered at the

22nd Annual Meeting & Conference of the Inter-Pacific Bar Association

“Legal Trends, Thoughts and Times”

March 2, 2012

(Donated to the Institute for Trade, Standards and Sustainable Development (ITSSD))

ABSTRACT

Since the onset of the 2008 global financial crisis, technology inventors, entrepreneurs and investors, whether public or private, have faced challenges securing institutional risk-based capital from conventional sources. ‘Shariah-compliant’ financing offered by Islamic Financial Institutions (IFIs), in certain instances, may present such parties with a viable funding alternative. This presentation will address the key legal and non-legal opportunities and challenges associated with the Islamic (Shariah-compliant) financing of technology-related IP taking into account, among other issues, the divergent treatment of IP-based assets in different Islamic jurisdictions for purposes of assessing Shariah-compliance related litigation and IP regulatory risks.

Page | 2

I. INTRODUCTION

- A. Summary Observations
- B. Shariah-Compliant Financing Options Offered by Islamic Financial Institutions in Certain Instances, May Present Capital-Seeking Western Inventors, Technology Entrepreneurs and Investors With a Viable Funding Alternative
- C. Shariah-Compliant Venture Capital Financing Currently Remains Largely Unavailable, But is Being Developed/Expanded

II. SHARIAH-COMPLIANT FINANCING AND STRUCTURES

- A. Shariah-Compliant Financing Defined
- B. Common Shariah-Compliant Financial Structures
 - 1. Profit-sharing contract (Shirkah)
 - 2. Non-Participatory Profit-sharing With Entrepreneur (Mudharabah)
 - 3. Participatory Enterprise Profit & Loss Sharing – General Partnership/Joint Venture (Musharakah)
 - 4. Trade With Markup/Cost-plus Sale (Murabahah)
 - 5. Lease Financing/Licensing (Ijarah)
 - a. Operating Lease
 - b. Finance Lease
 - c. Hire-Purchase
 - d. Lease Subject Matter Must Be Shariah-Compliant
 - 6. Legal Certificate of Ownership or Ownership Right (Sukuk)
 - a. Certificates issued on standalone assets identified on the balance sheet (Ijarah Sukuk)

III. SHARIAH TRANSACTIONAL LIABILITY/LITIGATION RISK

- A. General

B. Substantive Issues Arising With Shariah-Compliant Financing of Technology-Related IP

1. Does the Subject Matter of the Financial Instrument (Exchange Contract) Constitute Shariah-Compliant Property (Mal)?
2. Does the Financial Instrument Involve the Charging of Interest or Usury/Excessive Profit (Riba)?
3. Does the Financial Instrument Disclose Too Little About the Transaction and Underlying Assets That the Instrument's Indefiniteness/Uncertainty May Be Characterized as Excessively Risky (Gharar)?
4. Is the Financial Instrument's Profit Component Reflective of the Effort Exerted to Develop the Subject Matter or is it Excessive (Maisir)?
5. Does the Activity Serving as the Subject Matter of the Financial Instrument Promote Community Wellbeing/the 'Public Interest' (Maslahah) and Yield Charity (Zakat)?
6. Does the Subject Matter of the Financial Instrument Involve Sinful Activities (Haram)?
7. Does the Financial Instrument Evidence Sufficient Risk-Sharing Between the Parties?

C. Process-Based Issues Arising With Shariah-Compliant Financing of Technology-Related IP

1. IFIs' Narrow Invocation of Shariah Principles to Certify Financial Instrument Shariah Compliance Can Raise Noncompliance Risk
2. IFI Shariah Corporate Governance Weaknesses, including Lack of an Adequate Shariah Audit Compliance Process, Can Raise Noncompliance Risk
3. IFI Customer Failure to Carefully Select & Draft Governing Law, Forum and Arbitration Clauses Can Exacerbate Noncompliance Risk

D. Accounting-Based Issues Arising With Shariah-Compliant Financing of Technology-Related IP

1. General
2. Islamic Accounting Principles Used to Record Shariah-Compliant Financing Transactions Differ From Conventional Accounting Principles in Several Ways
3. Islamic Accounting Standards Are Based on the Principles Established by One or More International Islamic Accounting Standards Bodies
 - a. Institute of Chartered Accountants of Pakistan ('ICAP')
 - b. Indonesian Accounting Institute ('IAI') Shariah Accounting Standards Board
 - c. Accounting and Auditing Organization for Islamic Financial Institutions ('AAOIFI') Bahrain
 - d. Malaysian Accounting Standards Board (MASB)

4. Islamic Financial Accounting Standards Treatment of Shariah-Compliant Transactions
 - a. Operating Lease With Subsequent Transfer of Ownership (Ijarah Muntahia Bittamleek)
 - i. Similarity to evolving IASB/IFRS Proposed Rule Changes Concerning
 - A. Leases
 - B. IP License Revenue Recognition
 - C. Revenue from Customer Contracts
 - b. Profit Share Contracts (Musharakah, Mudarabah)
 - c. Purchase/Sale Contracts (Murabahah)
 - d. Sukuk instruments (Ijarah with SPE Transfers)
 - i. Similarity to evolving IASB/IFRS Proposed Rule Change Concerning ‘Derecognition’
 - ii. Contrast with UK Rules of Derecognition
- E. Tax-Based Issues Arising With Shariah-Compliant Financing of Technology-Related IP
1. General
 2. The Malaysia Government Has Enacted Legislation Providing Tax Neutrality for Shariah-Compliant Financial Transactions
 3. The UK Government Has Modified its Legislation to Provide Tax Neutrality to ‘Alternative Finance Arrangements’ (Certain Shariah-Compliant Financial Transactions)
 - a. Purchase and Resale (Murabaha)
 - b. Diminishing Share Joint Ownership (diminishing Mushakara)
 - c. Profit Share Return/Deposits (Mudarabah)
 - d. Profit Share Agency (Wakala)
 - e. Alternative Finance Investment Bonds (Sukuk)
 4. The Irish Government Has Modified its Legislation to Provide Tax Neutrality to ‘Specified Financial Transactions’ (Certain Shariah-Compliant Financial Transactions)
 - a. Murabahah
 - b. Diminishing Musharaka
 - c. Ijarah
 - i. Operating Lease
 - ii. Finance Lease
 - iii. Hire-Purchase
 - d. Sukuk Investment Transaction

IV. TECHNOLOGY-RELATED IP REGULATORY/POLICY/ENFORCEMENT RISKS

- A. Shariah and Non-Shariah Sources of Law in Islamic Jurisdictions

1. Jurisdictions in Which Shariah is the Source of Law
 - a. Islamic Republic of Iran
 - b. Oman
 - c. Pakistan
 - d. Saudi Arabia
2. Jurisdictions in Which Shariah is a Source of Law
 - a. Bahrain
 - b. Kuwait
 - c. UAE
 - d. Egypt
 - e. Qatar
 - f. Morocco

B. Treatment of IP Rights in Islamic Jurisdictions

1. Shariah Generally Holds Treaty Obligations, Like Contract Obligations, as Sacrosanct
2. Shariah Neither Prohibits Nor Mandates IP Protection
3. Shariah Principles of Equity, Prohibitions Against Excessive Profit, Unjust Enrichment and of Misleading and Dishonest Representation Inform Enforcement of IP Rights Subject to WTO TRIPS Flexibilities
4. Shariah Jurisdictions With Legislation Permitting the Compulsory Licensing and/or Expropriation (EXP) of Technology-Related IP on 'Public Interest' Grounds, Without Evidence of Any Legal Violation
 - a. Egypt
 - b. Indonesia
 - c. Jordan
 - d. Kuwait
 - e. Malaysia
 - f. Morocco
 - g. Pakistan
 - h. Saudi Arabia
 - i. UAE

V. SOURCES OF SHARIAH LAW APPLIED TO ISLAMIC FINANCE TRANSACTIONS, INCLUDING IP ACQUISITION & LICENSING RIGHTS AGREEMENTS

A. General

B. The Four Sources of Shariah Law

1. Qur'an (Divine Law)
2. Sunnah/Hadith (Prophetic Tradition and Narrative)
3. Fiqh (Islamic Scholars' Legal Opinions Derived from Qur'an and Sunnah/Hadith)

4. Ijma (Islamic Legal Scholars' Unanimous Consensus on a Point of Law)
5. Qiyas (Clear Undisputed Rule Reasonably Inferred from Qur'an and Sunnah/Hadith Extended by Analogy to Cover New Circumstances)

C. Doctrinal Aides in the Application of Shariah Law

Page | 6

1. Maslaha - General Good or Public Interest
2. Istihsan – Fairness and Fair Practices for the Community
3. Darura – Justifying New Rules Based on 'Need'
4. Istishab – Status Quo Maintained Unless Compelling Reason for Change

VI. RECOMMENDATIONS; ISSUES FOR FURTHER CONSIDERATION

- A. Recommendations
- B. Issues for Further Consideration