Islamic Financing and Foreclosure

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In the past several years, the United States has seen substantial growth in a subsection of international finance sometimes called "Islamic Finance." Although conclusive data is not yet available, *Forbes* magazine recently estimated that at least $500 billion in assets around the world are managed in accordance with Islamic principles—known in Arabic as *Shari'ah*—and the sector is growing at more than 10 percent per year. Management consultants McKinsey & Company predicted that the value of assets managed by Islamic banks will grow to $1 trillion by 2010 as more Muslims seek financial services that comply with their beliefs.

Islamic finance is, in many ways, similar to socially conscious investing and is based on the principles of *Shari'ah*, which typically prohibit investment into industries such as gambling, pornography, alcohol, tobacco, defense, banking and insurance. The most well-known aspects of Islamic finance are the prohibitions of: 1) interest (*riba*); 2) speculation, betting and gambling (*maisir*), including the trade or exchange of money for debt in the absence of an underlying asset transfer; and 3) preventable uncertainty (*gharar*) occurring, for instance, in certain financial derivative instruments and forward contracts.

As opposed to conventional finance, where interest represents the agreed-upon cost for funds, the central concept of Islamic financing is the prohibition of *riba*. Most Islamic scholars agree that *riba* covers not only usury but also the charging of interest and any predetermined rate of return that is guaranteed regardless of how an investment performs. Since Islamic finance permits only those forms of finance that are interest-free, financial relationships between banks and borrowers are governed by shared business risk (and returns) from investment in lawful activities. Profits must not be guaranteed in absolute terms but in specified ratios, and can only accrue if the investment itself yields income.

Shari'ah-compliant mortgage financing emulates key economic features of secured lending through (more) complex financial structures. We first discuss the common forms of Islamic financings and how they each compare to traditional mortgage financings to understand the foreclo-

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sure issues facing courts. There are three main types of Islamic financing structures available when purchasing and refinancing real estate to replace the traditional mortgage structure: 1) *Ijarah* is the rental of a property by the bank to the customer, combining aspects of a finance with an operating lease; 2) *Murabaha* is the acquiring of property first by the bank, as identified by the customer, then the selling of it to the customer at an agreed-upon markup; and 3) *Musharaka* is used now as a primary means of a diminishing partnership between a bank and the customer. For a longer list of terms commonly used in Islamic financing and their respective definitions, please see the Islamic Financial Services Board's Web site at *www.ifsb.org*.

IJARAH

Ijarah, or lease-based transactions, are becoming increasingly popular and are a significant portion of the current Islamic banking and finance market, particularly in the U.S. *Ijarah* is a form of leasing in which the bank acquires the asset, whether real estate or otherwise, and then immediately leases that asset to its customer for a determined period of time at the end of which the customer will own the asset, either by the terms of the lease or by purchasing it at an agreed-upon nominal sales price. Both the acquisition by the bank and the lease to the customer are intended to occur at a single closing. This form of financing is used for both acquisitions and refinancings.

Regulatory agencies have examined the question of whether U.S. banks may enter into *Ijarah* transactions. The Office of the Comptroller of the Currency, for instance, has issued a detailed advisory letter guiding U.S. banks so as to lawfully enter into *Ijarah* transactions.

In purchase financings, the customer identifies the real estate for which it seeks financing from the bank. As with traditional real estate purchases, the customer will have entered into a sale contract for the real estate with a seller prior to obtaining financing. Either prior to or at the closing of the purchase, the customer obtains the seller's written consent to designate the bank to purchase the real estate. Under this designation, the bank does not typically assume any other obligations or liabilities under the sale contract. Moreover, the seller is instructed to look only to the customer for any claims it may have under the sale contract.

In refinancing transactions, the customer will sell to the bank assets already owned by the customer. The bank will then lease those assets back to the customer. The transaction is in effect substantially similar to a sale-leaseback.

At the closing of either a purchase or refinancing transaction, the bank will purchase the assets for their specified purchase price less any advances already paid by the customer and any customary adjustments that may be appropriate. It should be noted that banks many times choose to take title to the real estate in each transaction through a special purpose company created specifically for that transaction. At this closing, the bank will lease the assets to the customer.

The price paid periodically by the customer under the lease includes a rental (or, for tax and the bank's bookkeeping purposes, an interest) component. It also includes an amount that goes toward the acquisition of the asset (or, for tax and the bank's bookkeeping purposes, a principal component). The bank may determine these periodic payments in the manner it deems appropriate (subject to applicable law). *Shari'ah* scholars reluctantly permit this calculation to be linked to interest rates such as LIBOR, although in residential mortgages they may seek to impose a floor and ceiling as a means of consumer protection. It is not uncommon in these types of transactions for the resale price determination to assume that a conventional loan was in fact being made by the bank to the customer and to incorporate the bank's usual credit evaluation processes. In fact, the customer typically signs an agreement stating that it not only agrees with tax treatment of the price but will similarly present it as such for its own tax reporting purposes.

As it would in a conventional loan financing, the customer grants the bank a security interest, whether in the form of a leasehold mortgage, security agreement, assignment of rents or otherwise, to secure its obligations to the bank.

As with conventional financings, a customer may be afforded a right to prepay, in whole or in part. However, because of certain Islamic principles, these concepts are set forth in a separate written instrument often labeled a call option. Furthermore, those instances in which the bank may seek to accelerate payment, such as situations of default or condemnation, are addressed in a written instrument often labeled a put option, where the bank has the right to put the assets to its customer for its purchase.

Banks are usually concerned with the nature and extent of their liability because of their ownership of the assets in *Ijarah* transactions. *Ijarah* transactions traditionally

provide that the bank is making no representations and warranties regarding the assets, and places the burden of inspection and all maintenance, charges, taxes and other impositions and liabilities relating to the assets solely upon the customer. In addition, the customer indemnifies the bank for any claims made relating to the property, as well as any breaches by the customer of the *Ijarah* transaction.

MURABAHA

Murabaha is commonly translated as a "cost plus markup" sale and is the most popular and most common form of Islamic financing, and has been in use in New York State by HSBC to provide home financing. A *Murabaha* transaction is initiated by a customer applying to the bank through its normal credit application process, subject to the bank's usual criteria, but also to any further considerations the bank may deem appropriate. The bank may issue a pre-approval letter or commitment letter, as it deems appropriate.

Like the *Ijarah* transactions discussed above, regulatory agencies have examined the question of whether U.S. banks may enter into *Murabaha* transactions. For example, the Office of the Comptroller of the Currency similarly issued a detailed advisory letter for how U.S. banks may lawfully proceed in *Murabaha* transactions.

In a *Murabaha*, the customer identifies real estate for which it seeks financing from the bank and enters into a sale contract for the purchase of that property from the seller. Either prior to or at closing, the customer obtains the seller's written consent to designate the bank as purchaser of the real estate. Under this designation, the bank typically does not assume any other obligations or liabilities under the sale contract. Moreover, the customer agrees in writing not only to purchase from the bank the assets in question but also to indemnify the bank should it fail to do so.

At closing, the bank purchases the assets for the prespecified purchase price pursuant to the sale contract, less any advances already paid by the customer, and any customary adjustments that may be appropriate. It should be noted that banks often choose to take title to the real estate in each transaction through a special purpose company created solely for that specific transaction. At this same closing, the bank then immediately resells the assets to the customer at a price marked up from that which the bank paid. As it would in a conventional loan financing, the customer grants a security interest to the bank, whether in the form of a mortgage, security agreement, assignment of rents or otherwise, in order to secure its obligations to the bank.

The resale price, agreed upon in advance by the customer and the bank, is paid in periodic installments by the customer. The bank may determine the period payments of this resale price in the manner it deems appropriate (subject to applicable law). As with an *Ijarah*, the periodic payments may be linked to interest rates such as LIBOR. It is not uncommon in these types of transactions for this price determination to assume that a conventional loan was, in fact, being made by the bank to the customer, and to incorporate the Bank's usual credit evaluation processes. Frequently, the *Murabaha* documentation divides the price into components of what are, for tax and the bank's bookkeeping purposes, principal and interest payments. In fact, the customer typically signs an agreement stating that it not only agrees with the bank's tax treatment of the price but will similarly present it as such for its own tax reporting purposes. As with conventional financings, a customer may be afforded a right to prepay, as the bank deems fit.

Banks are usually concerned with the nature and extent of their liability due to their ownership, however brief it may be, of the assets. *Murabaha* transactions traditionally provide that the bank is making no representations and warranties regarding the assets and places the burden of inspection solely upon the customer. The seller, according to the contractual documentation, agrees to look only to the customer in the event of a breach of the sale contract. In addition, the customer indemnifies the bank for any claims made relating to the property, as well as any breaches by the customer of the *Murabaha* transaction.

MUSHARAKA

Musharaka is a partnership contract—now being used as a financing mechanism—in the form of diminishing partnership, which ends with the complete ownership by the partner who purchases the share of another partner in the property by a redeeming mechanism agreed between both of them. The *Musharaka* form of financing is becoming more popular with customers and is increasingly being used for residential and, more recently, commercial, mortgage financings in the U.S.

The typical form of *Musharaka* used to purchase property is termed a diminishing partnership. In such a financing, the customer identifies real estate for which it seeks financing from the bank and enters into a sale contract for the purchase of that property from its seller. Then, the

bank and the customer form a joint ownership of sorts, which will acquire title to the property or, in some cases, the customer alone is named on the deed. Either prior to or at closing, the customer obtains the seller's written consent to designate the "partnership," or both customer and bank, as purchaser of the real estate.

At the closing, the "partnership" then acquires the property in accordance with the sale contract. Simultaneously, the bank enters into an agreement with the customer whereby the bank agrees to lease its interest in the property to the customer for an agreed term of years, and the customer periodically buys the bank's interest in the property, usually in the form of a monthly payment. As with the *Ijarah* and *Murabaha* transactions described above, Shari'ah scholars tolerate these periodic payments' being linked to interest rates such as LIBOR. The customer's equity in the property increases with every payment made towards acquiring the bank's interest. Thus, the rent payments payable by the customer to the bank will be reduced as the customer's equity in the property increases. The customer also agrees to mortgage the lease and its share in the property to the bank to secure the rental payments.

Banks are similarly concerned with the nature and extent of their liability because of their ownership in the partnership; accordingly, *Musharaka* transactions traditionally contain the same limitations on liability that *Ijarah* and *Murabaha* transactions do, including an indemnification of the bank by the customer for any claims made relating to the property.

FORECLOSURE

Our attorneys have been involved in the creation of one of the first Islamic residential and commercial mortgage financing programs in the U.S., using *Murabaha* and *Musharaka* forms. In our practice, we also have structured numerous Islamic financing transactions using the *Ijarah* form. Devon Bank, a Chicago-based bank, is one of the top-providers of *Shari'ah*-compliant products in the U.S., and currently offers residential *Murabaha* and *Ijarah* products in the states shown on page 19 in a chart from Devon Bank's website (*www.devonbank.com*).

In review of dockets across the country, very few of these Islamic financing transactions have actually gone through to foreclosure; most of those coming before the courts have been withdrawn or dismissed. One apparent reason is that Islamic financing is in its early stages in this country and the ratio to conventional financing is proportionately smaller. A less obvious but equally likely reason is that the credit strength of the Islamic finance customer, typically a Muslim, is subject to more scrutiny, and is accordingly higher, than some of the customers targeted in the recent sub-prime conventional mortgage market. A recent study also has shown that American Muslims are well-educated and affluent and have strong credit scores, as compared to the average American. [1]

However, when so many other mortgage structures are now crumbling, it is difficult to pinpoint any specific reason for the seeming endurance of the Islamic finance structures. All the same, since some Islamic finance transactions have indeed gone into foreclosure, the question becomes how a court would handle a foreclosure proceeding where the structure is *Shari'ah*-compliant. One recent transaction that was an *Ijarah* structure—involving a mortgage on the property of a condominium conversion in Greenwich, Connecticut—almost became a test case. However, the parties were able to work out a deal where the customer was able to sell the property. Without written decisions of case law on these foreclosure proceedings, it is hard to predict whether the *Shari'ah*-compliant structure played any role in the foreclosure actions.

As described earlier, each of the *Ijarah*, *Murabaha* and *Musharaka* structures involves a mortgage that secures the Islamic financier's position. As such, it is unlikely that an Islamic financier would be less secure than a conventional bank in a foreclosure proceeding when it is secured by a mortgage, leasehold mortgage, or other security granted by the customer, such as guarantees, pledge agreements, assignments of rent and environmental indemnifications, since they are also conventional means of securing a bank's rights.

BANKING LAWS

As mentioned above, state and federal banking agencies already have examined the structures of Islamic financing transactions and established the importance of weighing the substance of the transaction over the form in determining whether the financing complies with state and federal banking law.[2]

More particularly, the Comptroller of Currency found that the Islamic financing transactions were functionally equivalent to the conventional financing transactions prevalent in the United States. The ownership of real or

STATE	RESIDENTIAL MURABAHA	RESIDENTIAL IJARA	COMMERCIAL MURABAHA	COMMERCIAL IJARA
Alabama	Yes	Not currently.	Not currently.	Not currently.
Alaska	Yes	Not currently.	Not currently.	Not currently.
Arizona	Yes	Not currently.	Not currently.	Not currently.
Arkansas	Yes	Not currently.	Not currently.	Not currently.
California	Yes	Not currently.	Not currently.	Not currently.
Colorado	Yes	Not currently.	Not currently.	Not currently.
Connecticut	Yes	Not currently.	Not currently.	Not currently.
Delaware	Not currently.	Not currently.	Not currently.	Not currently.
District of Columbia	Yes	Not currently.	Not currently.	Not currently.
Florida	Yes.	Not currently.	Not currently.	Not currently.
Georgia	Yes	Not currently.	Not currently.	Not currently.
Hawaii	Not currently.	Not currently.	Not currently.	Not currently.
Idaho	Yes	Not currently.	Not currently.	Not currently.
Illinois	Yes	Yes	Yes	Yes
Indiana	Yes	Not currently.	Not currently.	Not currently.
Iowa	Not currently.	Not currently.	Not currently.	Not currently.
Kansas	Yes	Not currently.	Not currently.	Not currently.
Kentucky	Yes	Not currently.	Not currently.	Not currently.
Louisiana	Yes	Not currently.	Not currently.	Not currently.
Maine	Not currently	Not currently.	Not currently.	Not currently.
Maryland	Pending	Not currently.	Not currently.	Not currently.
Massachusetts	Yes	Not currently.	Not currently.	Not currently.
Michigan	Yes	Pending	Not currently.	Not currently.
Minnesota	Yes	Not currently.	Not currently.	Not currently.
Mississippi	Not currently.	Not currently.	Not currently.	Not currently.
Missouri	Yes	Yes	Not currently.	Not currently.
Montana	Not currently.	Not currently.	Not currently.	Not currently.
Nebraska	Yes	Not currently.	Not currently	Not currently.
Nevada	Not currently.	Not currently.	Not currently.	Not currently.
New Hampshire	Yes	Not currently.	Not currently.	Not currently
New Jersey	Pending	Not currently.	Not currently.	Not currently.
New Mexico	Not currently.	Not currently.	Not currently.	Not currently.
New York	Yes	Not currently.	Not currently.	Not currently.
North Carolina	Yes	Not currently.	Not currently.	Not currently.
North Dakota	Yes	Not currently.	Not currently.	Not currently
Ohio	Yes	Not currently.	Not currently.	Not currently.
Oklahoma	Yes	Not currently.	Not currently.	Not currently.
Oregon	Yes	Not currently.	Not currently.	Not currently.
Pennsylvania	Yes	Not currently.	Not currently.	Not currently
Rhode Island	Pending	Not currently.	Not currently.	Not currently.
South Carolina	Yes	Not currently.	Not currently.	Not currently.
South Dakota	Yes	Not currently.	Not currently.	Not currently.
Tennessee	Yes	Not currently.	Not currently.	Not currently.
Texas	Yes	Not currently.	Not currently.	Not currently.
Utah	Yes	Not currently.	Not currently.	Not currently.
Vermont	Not currently.	Not currently.	Not currently.	Not currently.
Virginia	Yes	Not currently.	Not currently.	Not currently.
U.S. Virgin Islands	Pending	Not currently.	Not currently.	Not currently.
Washington (state)	Not currently.	Not currently.	Not currently.	Not currently.
West Virginia	Not currently.	Not currently.	Not currently.	Not currently.
Wisconsin	Yes	Yes	Not currently.	Not currently.
Wyoming	Yes	Not currently.	Not currently.	Not currently.

Source: www.devonbank.com

personal property by the bank is for the sole purpose of financing specific property, not to maintain an inventory of property to sell to customers. Additionally, the bank will be exposed to no greater risks than it would face in a conventional commercial financing transaction. The ownership of property was found to be merely incidental to the making of the loan to the customer. The bank does not operate the property, pay the taxes, insurance or other costs associated with the property, maintain or make repairs to the property, assume liability, or otherwise exercise control over the property. All those functions will be the obligations and responsibilities of the customers, or lessees. Fundamentally, a lease transfers substantially all the benefits and risks of ownership to the lessee or customer.[3] Therefore, a structure whereby the bank owns title to the real estate does not affect the bank's rights with respect to our banking laws, assuming it is structured correctly.

The United States Supreme Court has held that the National Banking Act provides a broad grant of power to engage in the business of banking.[4] The Ninth Circuit also has specifically recognized that banks structure leases so that they are functionally equivalent to lending secured by real or personal property.[5] Under the precedent set by these higher courts, the lower courts currently facing a foreclosure proceeding should look to the substance over form standard when reviewing the layers of documents in *Shari'ah*-compliant transactions and recognize the Islamic financier as a creditor with a valid security interest by the lease, or co-owner's agreement and mortgage, entered into for the purposes of financing the acquisition of the real or personal property.

Although no U.S. court has specifically addressed the structure involved in a typical U.S./*Musharaka* transaction, we believe a court would most likely enforce the documents as written. In these types of transactions, there is typically a mortgage granted by the customer to the bank or financier to secure the customer's obligations. We would not anticipate that this type of foreclosure would differ materially from that of a conventional mortgage foreclosure. The substance over form standard should likely apply in this situation, whereby the co-ownership and mortgage structure is deemed another vehicle to provide financing and not entered into for the purpose of owning and operating the real property. The "borrower" holds all the benefits and risks of ownership in a *Musharaka* transaction as well.

BANKRUPTCY COURTS

Since foreclosure proceedings can involve not just a standard default by the customer but also its insolvency or bankruptcy, it is also important to consider how the bankruptcy courts would sort through the creditors' rights in *Shari'ah*-compliant transactions. Bankruptcy courts have looked at sale-leaseback transactions and have set forth rules for analyzing creditor's rights in each circumstance, along with the issues of ownership of real property and whether the lease is a true lease or disguised financing. Although states vary in their real property laws, generally there is a presumption that a deed to real property, a lease and a repurchase agreement are what they purport to be.[6] To overcome the presumption, the evidence must be clear and convincing that the transaction is really a disguised financing.[7]

Bankruptcy courts "look through form to substance" in determining the nature of the transaction and whether a true lease exists as opposed to a disguised financing.[8] Some factors a court may use in determining the true nature of the transaction are whether: 1) the transaction actually transfers the normal risks and responsibilities of landlord to the lessor; 2) the payments under the lease are reasonably designed to compensate the lessor for the use of the property or simply reflect the repayment of the lessor's acquisition costs plus interest; and 3) the lessor retains an economically significant interest in the property.[9] Courts have noted a determinative factor is whether the effect of the transaction was to leave the debtor with all the risks and rewards of ownership of the real property.[10]

Most of the bankruptcy cases cited above found that the sale-leaseback transaction was really a disguised financing and therefore the "owner" of the real property was a creditor to the debtor and had a mortgage on the property instead of a lease.[11] One bankruptcy court found that the sale-leaseback transaction that included a "triple Net Lease" was not a disguised financing transaction, but in fact a true lease. This was because the underlying facts proved that the owner of the property had turned down a straight financing transaction and instead elected the sale-leaseback transaction.[12]

In our review of the analysis made by bankruptcy courts in determining whether a lease is a true lease or a disguised financing, it appears that most of those courts would find an Islamic financing transaction involving a purchase of real or personal property by the bank and a

lease to the customer, or a sale-leaseback, not to be a true lease but rather a "disguised" financing. As noted above, Islamic financiers are looking to finance a transaction to comply with Islamic law. Therefore, if a certain transaction found its way to a bankruptcy court, it is unlikely there would be an argument over the ownership of the property; instead, the parties' intent for the lease to be only a financing mechanism would presumably predominate. The consequence is that the "owner" is truly a mortgagee, in the same position as a conventional bank in bankruptcy proceedings. It does not appear that banks in Islamic financing would be any less protected.

FORECLOSURE CASES

In an effort to see what arguments were made in a foreclosure of an Islamic financing, we reviewed the pleadings in the record of two cases where foreclosure had been ordered by the court. In each case, the structure involved a borrower and a limited liability company who co-owned a residential parcel of real property, i.e., a *Musharaka* structure. A mortgage was filed on the land records whereby the "borrower" was obligated to pay to the limited liability company for the acquisition payments and profit payments. There also was a co-ownership agreement obligating the borrower to pay the limited liability company. In both cases, the court issued a judgment for foreclosure and sale of the real estate. While there is no mention specifically of the Islamic financing structure in the pleadings, the court's judgment stated that the plaintiff had a valid subsisting lien on the property. Therefore, it does not appear that the Islamic financing structure played a role in the validity of the security interest of the lender, and the lender was treated no differently from conventional lenders in foreclosure proceedings.[13]

We expect that the commercial mortgages that are created as part of an Islamic financing structure would most likely be treated the same as commercial mortgages in conventional lending. We also expect that the layers of documents in a *Musharaka* transaction would most likely be enforced as they are written.

In another, albeit older, foreclosure case, the Supreme Court of Vermont did not permit the foreclosure of a first mortgage by the bank, as it did not secure lawful indebtedness.[14] It is important to note that the financing structure involved in this case is one not commonly used in Islamic financing. The plaintiff in that case was a subsidiary of a Saudi Arabian partnership and, therefore, the structure of the transaction complied with Islamic law by not charging interest on the loan to The Hilweh Enterprises Corp. (HEC), a New York corporation.[15]

The structure of this transaction included an agreement (the "Agreement"), a bond (the "Bond") and a mortgage (the "Mortgage").[16] In the Agreement, the plaintiff agreed to tender $1,617,000 to HEC in exchange for 231 shares of non-participatory preferred shares in HEC and a non-interest bearing Bond in the amount of $1,617,000, secured by a Mortgage on the real property in Vermont.[17] The shares entitled plaintiff to receive cumulative dividends at a rate of 14 percent out of the net profits of HEC.[18] The Bond obligated HEC to pay the plaintiff the full sum of $1,617,000 on or anytime prior to two days after the deadline for redemption of the preferred stock.[19] An acceleration of the full sum plus dividends would become due if HEC defaulted on any installment of principal or dividend due under the Agreement.[20] The Mortgage secured the payment of the principal and dividends, pursuant to the Agreement.[21]

Norstar Bank of Upstate New York, Inc., defendant, was the inferior mortgagee of the real property of HEC.[22] The defendant argued that, since HEC became insolvent, there was no obligation to pay plaintiff and therefore the Mortgage was not enforceable.[23] This argument was based on Section 513(a) of New York Corporation Law which does not permit the redemption of shares of the corporation when the corporation is insolvent or the redemption would make it insolvent.[24]

The Court relied on precedent to infer that "any security interest created to secure a stock repurchase agreement also becomes unenforceable once the corporation is insolvent."[25] The Court found the obligation created by the Agreement was not enforceable because of the insolvency of HEC.[26] The Court also found that the obligation in the Bond was conditional upon the breach of HEC's obligation under the Agreement.[27] Therefore, since the underlying obligation became invalid, the Mortgage itself could not create a new or different obligation by HEC.[28] The result was the dismissal of the plaintiff's foreclosure complaint and the award of a foreclosure judgment to the defendant.

Even though this case entails a structure that is not frequently used today by parties to Islamic financing, it is still important in two respects. First, it demonstrates how a court looks at the layers of documentation in a transaction that is *Shari'ah*-compliant. Second, it demonstrates

that, when structuring a *Shari'ah*-compliant transaction, the parties must remain aware of the state law in which they are working. Due diligence must be performed to check the underlying grant of security interest in the real or personal property to ensure that the obligation of the customer does not become invalid or unenforceable for any reason. However, in the case the underlying security interest is deemed invalid, the remaining documents must be drafted in such as way as to provide a "back-up" obligation to ensure the validity of the lien by the bank.

CONCLUSION

Islamic financing is a fast-growing trend in America, and the different types of structures used for *Shari'ah* compliance should be studied closely by the parties entering into such transactions to determine which would serve them best. The *Ijarah, Murabaha* and *Musharaka* transactions are structured so as to secure the bank in virtually the same way as is done in conventional financing. However, there may be some nuances applicable to a specific part of a transaction, so it is important to carefully structure the transactions not only to be *Shari'ah*-compliant, but also to comply with all federal, state and local laws. As more Islamic financing transactions occur in the U.S., more courts will likely be looking at the layers of documents involved and making decisions on the bank's security interest. Accordingly, those involved in Islamic financing may need to tweak any structures currently in place in order to survive such scrutiny.

NOTE: The views expressed by Murtha Cullina LLP in this article should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only. ■

ENDNOTES

1. See "Marketing to Muslims Report" by JWT.
2. See Interpretive Letter #867 issued by the Comptroller of the Currency Administrator of National Banks dated June 1, 1999; Interpretive Letter #806 issued by the Comptroller of the Currency Administrator of National Banks dated Oct. 17, 1997; Staff Interpretations NYSBL 96(1) issued by the State of New York Banking Department dated April 12, 1999.
3. See Interpretive Letter #867 issued by the Comptroller of the Currency Administrator of National Banks dated June 1, 1999.
4. See *NationsBank of North Carolina, N.A. v. Variable Annuity Life Insurance Co.,* 513 U.S. 251, FN 2 (1995).
5. See *M&M Leasing Corp. v. Seattle First Nat'l Bank*, 563 F.2d 1377 (9th Cir. 1997).
6. See *Fox v. Peck Iron and Metal Co., Inc.*, 25 B.R. 674, 688 (Bankr. S.D.Cal. 1982); *contra In re Big Buck Brewery & Steakhouse, Inc.,* 2005 U.S. Dist. LEXIS 10754, at *30 (E.D. Mich. 2005).
7. *Fox*, 25 B.R. at 688; *In re Omne Partners II*, 67 Bankr. 793, 795 (Bankr. D.C.N.H. 1986); *contra In re Big Buck Brewery & Steakhouse, Inc.,* 2005 U.S. Dist. LEXIS 10754, at *30 (used a preponderance of the evidence standard).
8. *In re Omne Partners II,* 67 Bankr. at 795; *see also Fox*, 25 B.R. at 688.
9. See *In re Big Buck Brewery & Steakhouse, Inc.,* 2005 U.S. Dist. LEXIS 10754, at *20-21; *Fox*, 25 B.R. at 688.
10. See *In re Big Buck Brewery & Steakhouse, Inc.,* 2005 U.S. Dist. LEXIS 10754, at *18; *Fox*, 25 B.R. at 690.
11. See *In re Big Buck Brewery & Steakhouse, Inc.,* 2005 U.S. Dist. LEXIS 10754, at *18; *Fox*, 25 B.R. at 690, 693.
12. See *In re Omne Partners II*, 67 Bankr. at 795-797.
13. See *Guidance Residential, LLC v. Rabah,* Docket No. 07CH09021 (Cir. Ct. Cook County, Chancery Division May 30, 2007); *Guidance Residential, LLC v. Khaja,* Docket No. 08CH18407 (Cir. Ct. Cook County, Chancery Division May 20, 2008).
14. *Al Baraka Bancorp (Chicago), Inc. v. Hilweh*, 656 A. 2d 197, 202 (1994 Vermont).
15. *Id.* at 198, 200.
16. *Id.* at 198.
17. *Id.* at 198-199.
18. *Id.* at 199.
19. *Id.*
20. *Id.*
21. *Id.*
22. *Id.* at 198.
23. *Id.* at 199.
24. *Id.*
25. *Id.* at 201; citing *In re Dino & Artie's Automatic Transmission Co.,* 68 B.R. 264, 269 (Bankr. S.D.N.Y. 1986).
26. *Id.*
27. *Id.*
28. *Id.*