Research Memorandum-Article:

Civil Liability and Criminal Exposure

for

U.S. Financial Institutions and Businesses

Engaged in *Shari'ah*-Compliant Finance

Prepared for:
***Shari'ah* Risk Due Diligence Project**

Center for Security Policy, Washington, D.C.

Prepared by:
Law Offices of David Yerushalmi
Washington, D.C., California, Arizona
Lead Author: David Yerushalmi, Esq.

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CAVEAT

Throughout this memorandum, the term *Shari'ah* is used to denote the authoritative and authoritarian *corpus juris* of Islamic law as it has been articulated by the recognized *Shari'ah* authorities over more than a millennium. The specifics of this body of law and jurisprudence are discussed more fully in the text and accompanying footnotes herein.

The term *Shari'ah* as used herein, therefore, does ***not*** refer to a personal, subjective, pietistic understanding of the word or concept of *Shari'ah*. This latter understanding of the word *Shari'ah* is closer to its literal meaning in Arabic without any of the legalistic connotations it has developed as an authoritative institution in Islamic history, as it is currently practiced in such countries as Iran, Saudi Arabia, and Sudan, and as it is meant when referred to in the various laws and constitutions of most Muslim countries.

Purpose:

The purpose of this memorandum is to examine *Shari'ah*-compliant finance ("SCF") in light of existing U.S. law. The result of this examination will be to highlight and to examine areas of civil liability and criminal exposure unique to SCF investments and transactions[1] in the U.S. as they have been developed and utilized by various financial institutions and facilitated and promoted by legal, accounting, and financial professionals.[2]

This analysis is a first of its kind in the published literature. To date, there has been no focused effort to identify and analyze the implications for civil liability and criminal exposure for U.S. financial institutions and other businesses engaged in any of the various manifestations of SCF from a legal and regulatory framework. While some of the SCF professional and scholarly writings published conventionally in professional journals and books and increasingly on the Internet address broad regulatory concerns[3], economic risks[4], and transactional[5] and market-related hurdles[6], scant attention has been paid to the specific civil and criminal liability implications of SCF. Necessarily, this is an introductory and preliminary effort.[7] Each specific area identified in this memorandum, and quite likely many others, require and deserve a detailed treatment by academics and legal professionals, including government attorneys involved in financial regulation and compliance, policy specialists, and most importantly practitioners advising their clients on the advisability and the logistics of SCF.

All too often the legal or accounting professional acting as a facilitator, driven by complex legal- or accounting-intensive tasks and further motivated by exorbitant professional fees and the desire to develop a specialized expertise for yet future marketing of services, loses sight of the fundamental threshold issues for any new and novel market transaction: Does the transaction or business model comply with existing civil and criminal statutory and regulatory frameworks? Does the transaction expose the client to unique and elevated civil liability and criminal exposure or regulatory intervention?[8]

Unfortunately, the history of the legal and accounting professions in properly guiding clients involved in finance-intensive industries through the legal hazards of complex and novel transactions has not been good. In just the past three decades, problematic transactions were structured and manipulated by financial institutions and finance-driven businesses and facilitated almost unimaginably by their attorneys, accountants and financial advisors.[9] The lesson professionals should have learned -- but appear not to have, given what can only be described as the blind exuberance driving SCF -- is that huge profits and explosive growth, massive public relations and marketing efforts, and popular appeal in the financial industry does not establish even a minimal baseline for legal compliance.

Whether a new financial product or an innovative structure for an existing business is compliant with the civil, criminal, and regulatory frameworks imposed on a lightning fast and fully reticulated finance-driven economy is no longer a question for a single professional. Careful analysis and due diligence across several disciplines conducted in a fully-informed, interactive environment is not a luxury of the prudent but a necessity for all but the reckless.

The watchword ought to be: Transparency. Any new financing technique or fad driven by huge profits or enormous liquidity without absolute transparency should automatically raise red flags for the financial institutions exploiting them and the professional facilitators structuring them.

Conclusion:

SCF exposes the financial institutions and other businesses which attempt to exploit this new industry to a whole host of disclosure, due diligence, and compliance issues, all of which elevate substantially the civil liability and criminal exposure such companies otherwise factor into their business risk profiles.[10] What is clear from this preliminary legal analysis of what might be called the SCF industry is that very little of this increased civil and criminal exposure has been recognized, analyzed, or guarded against in any meaningful way.[11]

The salient points of this analysis are:

- The *Shari'ah* black box syndrome: U.S. financial institutions and businesses involved in SCF risk grave consequences by willfully ignoring the endogenous elements of *Shari'ah*. Ignoring what *Shari'ah* is -- both in theory and in practice -- and its intimate connection to Islamic terror and holy war against the non-Muslim world amounts to corporate recklessness.
- Putting *Shari'ah* in a black box and treating its prohibitions as if they were benign secular and objective "screens" ignores the duty of disclosure of

the most important elements of *Shari'ah*: its purposes and its ultimate methods.

- Undoubtedly, a reasonable post-9/11 investor contemplating an SCF investment would consider (a) the goal of establishing *Shari'ah* as the law of the land and (b) the promulgation of the Law of *Jihad* to establish this goal material to the investment decision.
- To the extent that U.S. *Shari'ah* authorities or foreign *Shari'ah* authorities retained by U.S. businesses advocate the implementation of historical and traditional *Shari'ah*, they risk being charged with a violation of 18 U.S.C. § 2385.
- U.S. financial institutions and businesses have a duty to conduct reasonable due diligence investigations to be certain that their respective *Shari'ah* authorities are neither advocating crimes in the name of *Shari'ah* nor promoting the material support of terror, either through legal rulings or through the funneling of "purification" funds to terrorists. Failure to conduct such due diligence might very well lead to civil liability, if not criminal exposure.
- The *Shari'ah* black box is yet another financial fad like the sub-prime market where transparency is shrouded in opacity in the mad rush to market-share and quick profits. U.S. mutual funds are poised to embrace SCF without a word about the risks associated specifically with *Shari'ah*. U.S. banks are cavalierly promoting *Shari'ah*-compliant loans as "interest-free" when in fact they are merely repackaged loans at standard interest rates. This violates any number of consumer protection statutes. Financial institutions are underwriting *Shari'ah*-compliant loans and bond issuances without really understanding the risks associated with default and bankruptcy treatment.
- Insofar as U.S. financial institutions participate in and cooperate with the *Shari'ah* authorities' efforts to establish the rules and regulations for the SCF industry, antitrust issues such as rules collusion are likely to present yet additional issues of exposure for those embracing this new industry.
- The current structure of the SCF industry in which two dozen of the most influential *Shari'ah* authorities control the way funds go in and out of the largest financial enterprises in the world creates the paradigmatic pattern of predicate racketeering activity any aggressive prosecutor or plaintiff's lawyer looks for in a RICO cause of action.

The failure by corporate management and their legal advisors to confront these issues in any serious fashion is not surprising given the wholesale failure of the participants and facilitators in this industry to have undertaken a serious analysis of these risks. The extant legal academic and professional literature reads more like promotional material and not serious legal analysis conducted by men and women trained to protect clients from their own blind enthusiasm. The legal industry has gone down this road too many times in the past. The difference this time is that the risk is not simply financial; it is potentially existential.

I. Overview of *Shari'ah*-Compliant Finance

A. What is SCF?

According to the disclosures and representations of the financial institutions currently promoting SCF[12], and the *Shari'ah* authorities they employ, *Shari'ah* compliance means that a particular investment or financial transaction has been conducted or structured in a way considered "legal" or "authorized"[13] pursuant to Islamic law.[14] Compliance with *Shari'ah* is generally achieved by having a *Shari'ah* authority – either an individual or group of individuals who has achieved an authoritative status in matters relating to SCF[15] – approve of the particular investment or type of transaction. Most financial institutions employ or retain[16] in some fashion what is called a *Shari'ah* advisory board, which typically consists of three or more "*Shari'ah* scholars" who profess to be generally recognized as an authority in SCF.[17]

According to most financial institutions, SCF is achieved by the avoidance of interest[18], risk (typically understood as uncertainty or speculation)[19], and certain types of prohibited industries (relating to activities considered *haram* or forbidden, such as the pork and alcohol-beverage industries, pornography, gambling, and interest-based financing).[20] In addition, SCF also is said to include a focus on "purification" which has two separate elements. One, is a form of obligatory charitable contribution called *zakat* where the act of supporting the less fortunate is considered a spiritual purification[21]; and the other is the purification of a *Shari'ah*-compliant investment or financial transaction that has been tainted with forbidden revenue, whether from interest, illicit speculation such as trading in commodity futures, or a forbidden commercial enterprise such as the pork industry.[22] In the latter meaning of purification, the forbidden funds must be disgorged by donating the money to an acceptable charity but this charitable gift will not count towards a Muslim investor's *zakat* requirement.[23]

It is quite evident from even a cursory review of these most basic concepts of SCF that at least a rudimentary understanding of *Shari'ah* is required to grasp the implications of SCF relative to U.S. law. Per force, this discussion will be elementary yet true to the understanding of *Shari'ah* by contemporary and classical *Shari'ah* authorities. To begin, *Shari'ah*, or the 'proper way', is considered the divine will of Allah as articulated in two canonical sources. The first is the *Qur'an*, which is considered the perfect expression of Allah's will for man. Every word is perfect and unalterable except and unless altered by some subsequent word of Allah.[24] While most of the *Qur'an*'s 6,236 verses[25] are not considered legal text, there are 80 to 500 verses[26] considered instructional or sources for normative law. But the *Qur'an* is only one source of Allah's instruction for *Shari'ah*. The *Hadith*[27], or stories of Mohammed's life and behavior, are also considered legal and binding authority for how a Muslim in any place at any time must live. The *Hadith* were collected by various authors in the early period after Mohammed's death. Over time, Islamic legal scholars vetted the authors for trustworthiness and their *Hadith* for authenticity and there is general consensus across all Sunni schools that there are six canonical *Hadith*.[28] The legal or instructional portions of the *Hadith* together make up the *Sunna*.[29] While the *Shari'ah* authorities from the Shi'a Muslim world also accept the

Hadith as authoritative, they differ on the selection of the authors accepted as authoritative based upon mostly theological grounds.[30] For all *Shari'ah* authorities, however, the *Qur'an* is considered the direct revelation of Allah's will and therefore primary, while the *Sunna* is the indirect expression of that will and secondary. Both sources are considered absolutely infallible and authoritative.

In order to divine the detailed laws, norms, and customs for a Muslim in all matters of life, the *Shari'ah* authorities over time developed schools of legal jurisprudence adhering to certain theological and jurisprudential rules to guide their interpretations of the *Qur'an* and *Sunna*. While there is broad agreement among the schools about the rules, there are important distinctions and these differences do result in different legal interpretations and rulings, albeit typically differences of degree not of principle.[31] The rules of interpretation and their application to finite factual settings in the form of legal rulings are collectively termed *al fiqh* (literally "understanding"). *Usul al fiqh*, or the 'sources of the law', is what is normally referred to as jurisprudence. Technically, *Shari'ah* is the overarching divine law and *fiqh* is the way *Shari'ah* authorities have interpreted that divine law in finite ways.[32] It is important to note, however, that the word *Shari'ah* appears only once in the *Qur'an* in this context[33] yet it has gained the currency it has institutionally in the Islamic world only by virtue of the *Shari'ah* authorities over more than a millennium creating a *corpus juris* (i.e., *al fiqh*) based upon their interpretative understandings of the *Qur'an* and *Sunna*. As such, this memorandum uses the word *Shari'ah* to mean all of Islamic jurisprudence, doctrine, and legal rulings, much as it is used in the vernacular by the typical *Shari'ah*-adherent Muslim.

Prior to the twentieth century, there was no discipline termed *Shari'ah*-compliant financing or even a *Shari'ah* sub-code relative to commercial transactions per se.[34] There are rulings by *Shari'ah* authorities authorizing certain contract forms dating back hundreds of years, but as late as the 1900s, there was still some debate among *Shari'ah* authorities whether the prohibition against interest was absolute or just against usurious interest. When contemporary Islamic political thinkers began to confront the collapse of the Ottoman Empire after the First World War and the intrusion of Western modes of social, political, and commercial life into the heart of the Muslim world, *Shari'ah* authorities followed their lead and began to issue legal rulings to confront this new reality.[35] Beginning with the early political-theological writings of men such as Maulana Abul Ala Mawdudi who argued for an Islamic political resurgence and a unique Islamic political economy, *Shari'ah* authorities followed suit by issuing authoritative legal rulings forbidding interest on deposits and calling for the establishment of "Islamic banks". Over time, these rulings have incorporated prohibitions against transactions considered too uncertain or speculative and also rulings to prevent Muslims from investing in businesses engaged in un-Islamic behavior.[36] The development of these rules and the formalization of SCF have matured over the past three decades so that today there are entire university departments in the Middle East, Asia, and even in Western universities dedicated to the study of SCF.[37] Most observers connect this recent development to the emphasis of *Shari'ah* in the oil-producing Arab states and their wealth-driven influence throughout the Muslim world and the West.[38]

Effectively, SCF is an attempt to embrace modern interest-based commerce and finance, but to do so within a framework of *Shari'ah*-approved structures. For example, while almost all *Shari'ah* authorities forbid any transaction or investment which provides for interest income, SCF rules allow for interest in two ways. One way is to rule that a Muslim can invest in a permitted business that earns or pays interest but only if the amount is below a maximum level.[39] Any profit earned by the Muslim from that interest component, however, must be purified by contributing that portion to a *Shari'ah*-approved charity.[40] A second way to accommodate modern commercial transactions is to structure the forbidden transaction within *Shari'ah*-approved contract forms. These nominate contracts are based upon contract forms found in the classical rulings of the *Shari'ah* authorities prior to the advent of contemporary finance. Thus, a loan might be structured as a "cost-plus sale" where the lender buys the property and immediately sells it back to the borrower for a "profit". This profit is the interest component in the typical loan transaction. The purchase price with the profit component included can be paid over time to resemble an amortized loan repayment schedule. A host of other forms are available to deal with interest and also with unduly speculative transactions including sale-lease back contracts, and partnerships with variations and combinations. For the more complex transactions, these *Shari'ah* approved nominate contracts are often pieced together and used in combination to arrive at a *Shari'ah*-compliant modern commercial deal.[41]

B. Why is SCF important?

As a burgeoning industry, SCF is touted as one of the fastest growing sectors in what has been termed the global financial markets.[42] Estimates for total funds committed to some kind of SCF investment or transaction is $800 billion worldwide[43] with $200 billion of assets under management in *Shari'ah*-compliant banks.[44] Annual growth in this industry sector is estimated at between 15-20%[45] based upon current trends fueled mainly by profits and liquidity in the Muslim oil- and gas-producing countries and by a worldwide Muslim population reported to be the fastest growing among the world's major religions.[46]

Within the SCF market, *Shari'ah*-compliant bonds, known in Arabic as *sukuk*[47], are the most explosive segment driven by huge petro-dollar profits creating enormous sovereign wealth and liquidity. As of the end of the second quarter 2007, outstanding *Shari'ah*-compliant bonds totaled $80 billion with another $37.3 billion worth issued in the third quarter, which is double the amount issued during the same period the previous year.[48]

All of this growth, underwritten in the main by the mobile, highly liquid capital flowing out of the GCC states[49], has generated an entire industry of financial institutions, law firms, accounting firms, financial advisors and money managers establishing domestic and international links with the key investment figures in the GCC states in an effort to exploit the opportunities for substantial profits.[50] This enthusiasm has been translated to domestic U.S. financial industries in many ways.[51] U.S. financial institutions seek to underwrite *Shari'ah*-compliant bond issuances domestically and globally;[52] Dow Jones and Company[53] and Standard & Poor's[54] have both established *Shari'ah*-compliant indexes that screen equities based upon software filters meant to eliminate *Shari'ah*-non-compliant businesses; *Shari'ah*-compliant U.S.-based managed equity funds[55] and off-shore hedge funds[56] managed or advised by entities related to U.S. financial institutions have been established and can now peg their performances against these indexes; and U.S. banks have begun to offer *Shari'ah*-compliant home loans and other credit facilities[57] with federal banking authorities opining about their legality and at least one state tax authority issuing a ruling on the tax implications of a *Shari'ah*-compliant transaction[58].

C. Why should SCF come under special scrutiny for civil and criminal liability exposure?

A preliminary question must be asked: When making financial investments or entering into financial transactions, why should adherence to the normative principles of *Shari'ah* require any special or heightened scrutiny in relation to civil or criminal liability exposure? The most immediate answer is that, according to the proponents and practitioners of SCF, *Shari'ah* is not simply an approach to interest-free, ethical investing -- although it has been described in promotional literature as such. Instead, SCF is invariably described by SCF proponents, practitioners, and scholars, as the contemporary Islamic legal, normative, and communal response to the demands of modern day finance and commerce.[59]

As understood on its own terms or by the many constituencies who interpret it, *Shari'ah* is not predicated upon a personal or subjective understanding of what it means to be a Muslim. Neither is it simply an objective formal law or behavioral code regulating finance and commercial transactions. *Shari'ah* has been described as "holistic"[60], as "designating good order, much like nomos"[61], and definitively by Joseph Schacht, the founding father of modern scholarship treating Islamic jurisprudence as a distinct academic discipline, as "[t]he sacred law of Islam [which] is an all-embracing body of religious duties rather than a legal system proper; it comprises on an equal footing ordinances regarding cult and ritual, as well as political and (in the narrow sense) legal rules." [62]

In one of the first and still important academic presentations of this new industry, Professors Frank Vogel and Samuel Hayes, both distinguished professors at Harvard University and proponents of SCF, explain that *Shari'ah* is not some personalized, subjective, pietistic approach to Islam but an institutionalized legal-political-normative doctrine and system:

> Islamic legal rules encompass both ethics and law, this world and the next, church and state. The law does not separate rules enforced by individual conscience from rules enforced by a judge or by the state. Since scholars alone are capable of knowing the law directly from revelation, laypeople are expected to seek an opinion (fatwa) from a qualified scholar on any point in doubt; if they follow that opinion sincerely, they are blameless even if the opinion is in error.[63]

This classical understanding of *Shari'ah* has been echoed by almost all of the scholars who have written on the subject. Two prominent advocates of SCF, one a leading professor of finance in Australia and the other a senior official in the Bahrain Ministry of Finance and National Economy, describe the all-encompassing nature of *Shari'ah* in their way:

> Since Islamic law reflects the will of God rather than the will of a human lawmaker, it covers all areas of life and not simply those which are of interest to a secular state or society. It is not limited to questions of belief and religious practice, but also deals with criminal and constitution matters, as well as many other fields which in other societies would be regarded as the concern of the secular authorities. In an Islamic context there is no such thing as a separate secular authority and secular law, since religion and state are one. Essentially, the Islamic state as conceived by orthodox Muslims is a religious entity established under divine law.[64]

Shari'ah is therefore not strictly speaking a religious legal code where offending or offensive subdivisions or specific areas of law can be isolated and removed from a cauterized *corpus juris*. Instead, *Shari'ah* is understood by the authorities and scholars who interpret it as an indivisible "way of life"[65] which informs a *Shari'ah*-adherent Muslim's entire being and identity as a Muslim[66], including his relationship to his family, the poor, the stranger, the visitor, national political life, the Muslim *Umma* (or nation), religious ritual, business and financial dealings, and the enemy.[67] While *Shari'ah* most certainly includes more than a millennium of legal decisions developed through Islamic jurisprudence and informal code-like compilations developed by the different "schools of jurisprudence"[68], *Shari'ah* proper is the overarching authoritative architecture for all Islamic jurisprudence and the specific legal decisions which make up the *corpus* of what amounts to a juristic body of Islamic dictates and norms.

Understood in its proper context then, anything deemed *Shari'ah*-compliant by generally recognized Islamic legal authorities must first and foremost be within the gestalt of *Shari'ah*. It is not enough, according to *Shari'ah*, that a Muslim conducts his own affairs and business according to some narrow definition of "Islamic ethical business practices." For a *Shari'ah*-adherent Muslim to conduct his business and financial affairs properly, he must not knowingly promote through his business dealings any forbidden action or violation of a fundamental precept of *Shari'ah* or the legal rulings promulgated thereunder. This is what the scholars mean when they describe *Shari'ah* as "holistic" or a fully integrated religious, moral, and legal code.[69]

Thus, an interest-free and non-speculative commercial transaction which complies with *Shari'ah* dictates in these strictly financial and economic areas might nonetheless be forbidden because the subject matter of the business (i.e., the manufacture or sale of alcohol) is forbidden. This would be the case even though the Muslim is neither consuming the alcohol he manufacturers nor selling it to other Muslims. Similarly, leasing a building to a restaurant or bar which serves forbidden foods such as pork and alcoholic beverages, even though no Muslims frequent the establishment, would nonetheless be forbidden because pork products and alcohol are forbidden by *Shari'ah* independent of its economic or financial implications. Finally, leasing a building to a church consisting wholly of non-Muslims would also violate the dictates of *Shari'ah* because Christian worship and theological doctrine violate several tenets of *Shari'ah*.[70]

In other words, SCF is not about just finance, economics, or business ethics. To be *Shari'ah*-compliant in financial matters means to be *Shari'ah*-compliant in theological, moral, and political matters as well. From a legal or jurisprudential analytical framework, there is no *Shari'ah* sub-code or segregated legal doctrine applicable only to financial matters per se. To be sure, there are specific *Shari'ah* precepts relating to interest and uncertainty and the legal decisions promulgated in accordance with those precepts. But these *Shari'ah* precepts and the authoritative legal rulings flowing from them are not divisible or segregable from the rest of *Shari'ah* and its jurisprudence. Thus, Islamic legal rulings on apostates, holy war (*Jihad*), or forbidden sexual relations, are no less relevant to SCF than rulings on forbidden interest.[71]

It has been the duty of the *Shari'ah* legal scholars over the ages to understand these precepts and to apply them to new and changing circumstances. The degree to which individual Muslims or the political powers ruling over them have adhered to *Shari'ah* as determined by the generally accepted authoritative Islamic jurists has varied tremendously. It can be said with some historical confidence that *Shari'ah* has been honored more in the breach than in its observance.[72] But the breaches have not diminished the absolute authority of *Shari'ah* and its jurisprudence, as articulated by Islamic legal scholars and the institutions they have established over the past 1200 years, to define the legal limits of permitted and proscribed behavior among the hundreds of millions of Muslims worldwide who consider *Shari'ah* a way of life, as much religion and moral guide as civil and criminal legal code.[73]

This monopolistic institutional control over the legal doctrine of *Shari'ah* by the recognized *Shari'ah* authorities is no better evidenced than in the world of SCF. Whether one is reading from the Islamic legal treatises themselves, the academic studies of SCF produced by Muslim and non-Muslim university professors, the lawyers who publish legal journals on the subject, the media, or the myriad of Internet sites which are dedicated to the subject, no one seriously contests the exclusive role of the accepted *Shari'ah* authorities to divine what is permitted in SCF and what is not.[74]

This is more than just convention. Islamic jurisprudence codifies the important role played by *Shari'ah* authorities to reach consensus (*ijma*) among themselves on areas not previously established by the classical *Shari'ah* jurists as fixed law and immutable.[75] Thus, as new financial transactions are fitted to *Shari'ah* and its immutable "principles and rules", the only way for a Muslim concerned with *Shari'ah* to know that he is not violating *Shari'ah* is to rely upon the *Shari'ah* authorities and the level of consensus they have reached on the particular matter.

The quite obvious implication of this fuller understanding of *Shari'ah* is that one cannot speak of *Shari'ah*-compliant finance, business, or economics in the U.S. without understanding *Shari'ah* as articulated by the *Shari'ah* authorities and its ramifications for the U.S. investor. This is especially true given the legal implications in the areas of the duty to disclose for financial institutions contemplating a SCF transaction. For example, a mutual fund promotes itself as *Shari'ah*-compliant. Having licensed the use of the Dow Jones Islamic Index ("DJII")[76], which utilizes a software filtering protocol determined to be *Shari'ah*-compliant by the *Shari'ah* advisory board retained by Dow Jones & Company, the mutual fund selects a subset of the indexed listed equities for its portfolio. After a careful reading of the marketing material of the DJII and the registration statement of the mutual funds utilizing the DJII, it should be obvious to any moderately competent attorney that disclosure issues abound.[77]

Specifically, in the registration statement filed with the Securities and Exchange Commission ("SEC") for one of the first such funds, the Dow Jones Islamic Market Index Portfolio[78] ("Dow Jones Islamic Portfolio Fund"), other than a reference to certain "*Shari'ah* screens" or "filters" limiting the universe of acceptable investments, nothing is said of *Shari'ah*. For the investing public, all it learns about *Shari'ah* in the context of this *Shari'ah*-compliant mutual fund is that equities of companies involved in interest-driven profits, companies dealing with commodities such as alcohol or pork, or companies engaged in the "vice" industries such as entertainment and gambling, are prohibited. In addition, the standard disclosures also include references to various financial ratios that work to eliminate companies that might generate too much interest income on its cash reserves or pay too much interest on its debt. In other words, the DJII and the mutual funds utilizing such an index appear in many ways like other "socially responsible investing" or customized "values-based" and "faith-based" indexes.

But this is hardly the case. In a "secular" or even "ideologically" driven values-based index, a screen that filters out all tobacco and weapons businesses is just that. Even if the background social or political activism animating the screen is a "smoke-free environment" and "pacifism," the screen is marketed only as a screen that filters out tobacco and weapons industries. It does not purport to be based upon some universal theological-moral-legal system existing independently of the filters.[79]

When the mutual fund, however, markets its product as "Islamic" or "*Shari'ah*-compliant", it is making a claim that goes well beyond the disclosed screens or filters, even if all that is applied to make it "Islamic" or "*Shari'ah*-compliant" is the use of the disclosed filters. A cursory reading of the registration statement filed pursuant to the Investment Act of 1940[80] for the Dow Jones Islamic Portfolio Fund suggests that the lawyers tasked with writing the risk section of the document understood this reality, at least at some rudimentary level[81], and sought to eliminate the problem with one broad brush stroke:

> The investment objective of the Dow Jones Islamic Market Index Portfolio (the "Portfolio") is to seek long-term capital gains by matching the performance of the Dow Jones Islamic Market Index(SM) (the "Index") – a

> globally diversified compilation of equity securities **considered by Dow Jones' *Shari'ah* Supervisory Board to be in compliance with *Shari'ah* principles**. (Emphasis added.)[82]

Notwithstanding representations throughout the registration statement that various practices of the fund will comply with "*Shari'ah* principles", which are nowhere articulated in any remotely material way, the language in this section intends to sweep *Shari'ah* under the rug by reducing "*Shari'ah* principles" to whatever the Dow Jones *Shari'ah* Supervisory Board says they are. There are, however, a plethora of risk factors specifically associated with anything pegged to *Shari'ah* compliance that such a statement fails to capture. Fundamental disclosure issues for a reasonable investor would be: What is *Shari'ah*? Does applying *Shari'ah* "principles" pose any unique reputational or financial risks for the investment or might it actually pose a risk for the physical safety of the U.S. investor? In other words, if *Shari'ah* is hostile to Western political and financial institutions, would that not be important for a U.S. investor to know prior to investing in a business which promotes *Shari'ah*-compliant investing?

A still more common example of a risk that appears to have been ignored in this registration statement would apply with special emphasis to a closed-ended fund but could also affect an open-ended fund's investors. What would be the effect of a more authoritative *Shari'ah* advisory board ruling asserting that the Dow Jones *Shari'ah* Supervisory Board was gravely mistaken about *Shari'ah* principles resulting in a number of forbidden companies being improperly listed by the DJII as *Shari'ah*-compliant?[83] Precisely because the SCF industry generally represents that only authoritative *Shari'ah* scholars can divine legitimate legal rulings of *Shari'ah*, a contradictory ruling by a more austere body could pose grave financial risks. Investors who care about "*Shari'ah* principles" and who had invested in the fund, and possibly others who had invested in the underlying equities directly in reliance on the DJII, would likely feel obliged to sell their interests. The Dow Jones portfolio fund managers would likely also liquidate those equities so as not to get caught in the cross-fire between competing *Shari'ah* authorities and to thereby mitigate claims for damages arising out an allegation that the fund manager knew or should have known that the Dow Jones *Shari'ah* advisory board did not properly adhere to authoritative *Shari'ah* principles. The end result, given enough sale orders, would be a material reduction in the share price of the forbidden companies or, in the case of a close-ended fund, the fund itself. Class action lawsuits brought by investors caught "holding the bag" and predicated on failure to disclose and misrepresentation would be inevitable.[84]

The point of this one, narrowly scripted example is not to analyze the liability exposure of the registration statement of the now defunct Dow Jones Islamic Portfolio Fund, but rather to illustrate how marketing an investment product as *Shari'ah*-compliant incorporates a whole set of factual predicates, many of which are material to the investment decision. According to the *Shari'ah* authorities themselves, *Shari'ah* -- of which SCF is only a small, integrated component -- is more than just a half-dozen filters operating in the background to eliminate interest, speculation, and vice. Rather it is a motivating force and mark of Muslim identification for hundreds of millions of Muslims throughout the world, a *corpus juris* that incorporates a 1200-year old history of jurisprudence, of institutionalized legal schools with published legal decisions and other scholarly writings, together with a millennium of religious and political implications, all of which has generated in modern times a whole body of literature and scholarship on the import of *Shari'ah* in the ancient and contemporary world.

These realities comprise a dangerous minefield for the naïve or willfully ignorant financial institution seeking to capitalize on the alluringly profitable new universe of investment vehicles marketed to *Shari'ah* adherents. This minefield includes questions which these financial institutions and their professional facilitators have not even begun to ask, much less answer.[85] It is the purpose of this memorandum to begin this analysis and the necessary discussion of its implications for the U.S. financial industry, the professionals advising their financial clients on SCF, and the policy-makers in and out of government. This latter group especially has an obligation to consider the ominous implications for U.S. national and financial security of a fully integrated *Shari'ah*-compliant financial industry.

II. Analysis: Toward an Analytical Taxonomy

A. How to analyze SCF: the lawyer's role in SCF

As indicated above, *Shari'ah*-compliant financing is nomenclature describing the contemporary Islamic legal, normative, and communal response to the demands of modern day finance and commerce.[86] *Shari'ah*-adherent Muslims desire to maintain their commitment to the normative demands of *Shari'ah*. At the same time, they wish to participate in the benefits and opportunities afforded by investment in international and Western financial and commercial structures that are neither *Shari'ah*-centric nor *Shari'ah*-compliant, at least according to the overwhelming majority of *Shari'ah* authorities called upon in their institutional or personal roles to pass judgment.[87]

In many instances, both related and unrelated to SCF, transactional lawyers are required by the parties to a transaction to opine on the transaction's compliance with existing law and the enforceability of the underlying agreements in a court of law or, in some cases, before an arbitrator.[88] These legal opinions serve the purpose of assuring the parties to the transaction that there are no hidden issues that might create obstacles to enforcement. In addition, although not necessarily part of a formal legal opinion, lawyers are required by the ethics of professional responsibility to investigate compliance, disclosure, and due diligence issues in order to understand their client's legal exposure when a new and innovative approach to existing financial or commercial transactions is contemplated.[89] Lawyers and accountants themselves have direct exposure for documents submitted by a client to the Securities and Exchange Commission ("SEC") under several laws, the most recent and well-known example of which is the Sarbanes-Oxley Act of 2002.

A fundamental predicate of a lawyer's opinion and indeed the confidence of the parties to engage in large complex financial deals is the knowledge that the basic transactional building blocks of the deal are well-known, predictable, and do not pose any significant risk that a court will refuse to enforce them as intended by the parties. In simple terms, this means that the deal is structured in a way that has certainty, consistency, predictability, and transparency (what shall be referred to hereinafter simply as "Transparency")[90].

The problems legal counsel face when attempting to analyze a specific SCF transaction and to opine on compliance and enforceability issues are often directly related to the *Shari'ah* "black box" phenomenon. Attorneys, accountants, and financial advisors who wish to structure a transaction to be *Shari'ah*-compliant do so by treating *Shari'ah* precisely as *Shari'ah* demands by its own terms. For the *Shari'ah* faithful, *Shari'ah* is first and foremost the divine and perfect will of the ultimate lawgiver and necessarily there are strictures and obligations imposed on its adherents which are not subject to reasoned critique or discourse. As to the part of *Shari'ah* open to human analysis, it is reserved for *Shari'ah* authorities who cannot be challenged except by other equally authoritative *Shari'ah* authorities.[91] Further, because *Shari'ah* is understood as divine and the *Shari'ah* authorities are considered the trustees of its authority, integrity, and interpretation, the application of *Shari'ah*'s well-established and ancient doctrines to the quite modern practice of SCF necessarily lacks Transparency.

The inability of *Shari'ah* as a jurisprudence and positive law to provide Transparency is systemic. Any legal or normative system which is not articulated and enforced within a political structure of codified laws, procedures, courts, binding legal opinions providing precedence, and effective enforcement mechanisms will, by definition, lack Transparency. *Shari'ah* is at its essential core by its own terms a divinely ordained law which can never be subordinated to a secular political, legal, or regulatory system.[92] SCF is an attempt by the participants – financiers, businessmen, facilitators, and *Shari'ah* authorities – to fit the divine law within a modern secular political, legal, and financial system. But should a secular court or legislature attempt to codify *Shari'ah*'s precepts as they apply to SCF in an effort to establish Transparency, aside from the constitutional issues this would raise in the U.S., it would fail its fundamental purpose because *Shari'ah* cannot be rendered subservient to secular law.[93]

In stark contrast, domestic finance and commerce in the U.S., and indeed international financial transactions, are based upon Western legal financial structures which provide Transparency. It is Transparency which renders a complex transaction quite manageable and viable. When the parties to a transaction and the professionals facilitating it know that a given transaction format has been used before successfully after being stress tested and enforced in many forums under various circumstances, the risks of the deal are then limited to the specific business terms and market conditions rather than the formalities of the documents and their enforcement. In these transactions, the lawyer can opine safely and with confidence because he knows the rules of the game and knows they are not subject to fiat or challenge.[94]

This is not the case when a lawyer confronts a high-stakes, complex SCF transaction. In order to render a legal opinion that will satisfy the parties and necessary third-parties such as a rating agency for a bond securitization, a whole host of issues arise that cannot be rationally addressed for at least two reasons: One, certain transaction restrictions applicable to SCF are considered divine and unalterable. Two, those aspects of a transaction subject to human reason are not subject to *any* human reason, but to the reason of a *Shari'ah* authority. For example, interest income is understood by most *Shari'ah* authorities today to be forbidden. The result has been that SCF utilizes all sorts of *Shari'ah*-compliant transactional structures to convert the exact same income stream (including its variability by pegging it to an index such as the LIBOR) from interest to something else, such as lease payments. In legal parlance, this is the application of "form over substance".[95]

The use of legal fictions to change the form or the consequence of a transaction without changing its substance is certainly not new to the secular law. Liability is often determined by the form rather than the substance of a transaction.[96] But the fundamental difference between a secular use of a legal fiction to convert a problematical "form" to an acceptable one is that the problem itself and the mechanisms to overcome it can be understood, challenged openly, debated, and ultimately modified by smart lawyers, judges, and legislatures to fit changing circumstances. Moreover, if a secular court rules that a given legal fiction fails its purpose, the participants are free to return to the drafting table and restructure the deal.

The debate within *Shari'ah*, however, is in effect closed. Its principles remain divine and unalterable[97] and the application of these principles to changing circumstances are subject only to what the *Shari'ah* authorities acting independently of a secular legal and political system determine to be permitted and forbidden. Thus, *Shari'ah* informs the *Shari'ah*-adherent participants in a finance transaction involving interest that interest is divinely forbidden. The participants are also told it is forbidden because it is evil and causes the destruction of society.[98] Somehow though, interest, wrapped up in a different form where all of the elements of interest exist but for the name, exits the black box of *Shari'ah* as permissible and presumably good for society.[99]

Thus, a lawyer involved in a complex SCF transaction responsible for shepherding the participants through the process confronts serious challenges at many different levels. In this effort the diligent lawyer would likely focus on four distinct phases of a SCF transaction: (1) determining if the generic investment or type of transaction is prohibited; (2) developing an alternative (i.e., *Shari'ah*-compliant) transactional structure necessary to achieve the financial or commercial goal of the "secular" or *Shari'ah* non-compliant investment or transaction; (3) drafting the necessary legal agreements and documents to implement the alternative transaction; and (4) preparing the filing of any regulatory and compliance documents with government agencies.

At each stage of this effort, the lawyer is in effect wrapping the *Shari'ah* component of SCF in what appears from the casual observer to be a secular black box. This process begins at the first level when the lawyer turns to the *Shari'ah* authorities chosen by the client to determine whether a given investment or transaction is *Shari'ah*-compliant. In most cases, the *Shari'ah* authority issues a *fatwa* or legal determination in the form of a terse answer to a fact situation, oftentimes but not always with some rationale. For example, a client may wish to invest in a trucking business that hauls alcoholic beverages along with other commodities. While the consumption of alcohol is generally understood to be forbidden by *Shari'ah*, the question arises whether owning a business that transports alcohol which is not owned or specifically destined for a Muslim is also forbidden. Also, is there a percentage threshold of profits from the transportation of the alcohol which is relevant to the determination whether the investment is permitted or proscribed?

At this level, the attorney invariably treats the *Shari'ah* jurisprudential analysis as a black box and relies on what his client considers to be a determinative *Shari'ah* ruling from someone the client determines to be a *Shari'ah* authority.[100] In the case of a client making an investment on its own behalf and not representing that the *Shari'ah* ruling is authoritative to any third-party, and assuming there are no grounds for third-party reliance on the authoritativeness of the *Shari'ah* ruling, the lawyer's acquiescence to the black box appears reasonable.[101]

But the professional's reliance on the black box of *Shari'ah* might give rise to serious problems precisely where there is a duty of care relative to the propriety of the ruling and the legitimacy or authoritativeness of the *Shari'ah* authority issuing the ruling. The legal exposure for a breach of such a duty, as discussed above in the illustration of the registration statement of the mutual fund, will depend on the kinds of representations made and the ability to insulate the client with disclosures of the risks and with warranty and representational disclaimers.

After an investment or transaction is determined to be forbidden by *Shari'ah*, legal counsel must address the second phase of the transaction. Here the attorney must be certain that the client properly explains to the *Shari'ah* authority what the investment or transaction involves in its secular or *Shari'ah* non-compliant structure and ask the *Shari'ah* authority to suggest a structure. SCF as it has developed to date includes a range of legal structures generally acceptable in *Shari'ah* commercial transactions to bring otherwise forbidden investments into *Shari'ah* compliance. Most of these transactional structures are meant to avoid the prohibition against interest.[102]

Once the *Shari'ah* authority solves the *Shari'ah* compliance problem by suggesting an alternative structure to "rid" the transaction of the offending elements, be it interest or uncertainty, the client's legal counsel must now determine if the new structure changes the substance of the deal or merely camouflages the problem identified by *Shari'ah* through a change in the form of the deal. This analysis is fundamental in many areas, including disclosure, compliance, taxation, and notably assessing enforceability in the event of default.[103]

After having fully assessed the requirements of the *Shari'ah*-sanctioned deal structure, legal counsel begins the third phase by drafting the "secular" contracts and various other agreements to fit the demands of *Shari'ah* to conventional legal and regulatory frameworks. This process can require the drafting of certain collateral agreements which in themselves contradict the principal agreements and transactional documents and potentially violate *Shari'ah* precepts. One such example occurs when an SCF transaction is structured as a joint-venture leasing arrangement. While the intent of the parties as reflected in all of the transactional documents is to create a joint-venture leasing arrangement precisely because they do not wish to run afoul of the prohibition against interest, the parties still desire to allocate the tax burdens and benefits as if the transaction were a straightforward financing with interest.[104]

Lawyers skilled in SCF utilize what are called "tax matters agreements"[105] to have the parties decide for themselves that while the deal might look, feel, and smell like a leasing duck, it in fact is a loan turkey for purposes of tax characterizations and allocations.[106] In other words, the "form" of the deal is a joint-venture-leasing arrangement (and *Shari'ah*-compliant), but the "substance" of the deal for tax purposes is a loan with interest. While tax matters agreements are not a recent innovation of SCF lawyers, and indeed are often used for tax purposes in off-balance sheet "synthetic lease" transactions, their applicability in SCF transactions is not self-evident.[107] It is one thing for parties to a secular transaction to establish dual and even contradictory characterizations depending on whether the impact of the characterization is on the party's balance sheet or tax liability. In such dual-purpose transactions, arguably the standards are different between tax accountability and balance sheet accounting and the parties' primary intent is to achieve off-balance sheet financing without any concern for the specifics of the structure.[108] In other words, the parties are agnostic as to structure and seek only to achieve both tax and financial accounting benefits.

It is quite another matter, however, when the parties are not agnostic regarding the structure of the deal and where their true intent is to avoid the payment of interest and to establish real indices of ownership as required by SCF. In this case, the cognitive dissonance adds enormous peril to an agreement where all of the documents describe a joint-venture-lease agreement and the parties presume to tell the Internal Revenue Service ("IRS") that what looks to be the case on the surface and what the parties' actually intended is not in fact the case. While the IRS might continue to apply the economic reality test[109] and wholly ignore the intent as manifested in the *Shari'ah*-compliant transaction documents, it is also quite possible that an IRS or tax court ruling would determine that the tax matters agreement is a ruse or "form" attempting to achieve tax allocations and benefits inappropriate for the true "substance" of the deal: a *Shari'ah*-compliant joint-venture-lease agreement.[110]

The final step for the transactional lawyer dealing with the intricacies of SCF involves the various filing requirements of government agencies for reporting and compliance matters. The registration statement or prospectus of a mutual fund is but one of many such requirements where the attorney is asked to opine on the adequacy and compliance of such statements. As described above in the case of the Dow Jones Islamic Portfolio Fund, the *Shari'ah* black box exposes both client and counsel to a myriad of issues that do not otherwise exist.

B. How to analyze the civil and criminal liability exposure in SCF

1. A suggested analytical taxonomy

The challenges described above for the SCF transactional lawyer and other professionals advising clients on the intricacies of legal compliance are not inconsequential. In agreements and in law, words matter but they are given context by the intent of the parties. The inherent problem of SCF is that the intent of the parties is to comply with *Shari'ah* but the intent of *Shari'ah* generally and in any particular transaction is typically lost on the secular SCF advisors.[111] The latter, especially the lawyers, are very good at solving problems by re-structuring a transaction through word-smithing, thereby arriving at the same result in different form. But their approach necessarily is to deal only with the trees hindering the client's path to the goal within the landscape of the transaction itself.

For the typical, secular financial transaction, this is sufficient because there is no dark forest in which to get lost. An obstacle in the path can be safely circumvented because the problem is transparent for what it is and thus all of its ramifications for disclosure and compliance are understood. When the trees, however, grow out of the forest known as *Shari'ah*, it is not at all clear to these professionals why they are where they are, what dangers might lurk there, and where the forest might lead. This is so as the examples have suggested because *Shari'ah* is not essentially accessible to the secular professionals. As a consequence, the forest is packaged as a black box and effectively ignored. It is no surprise then that there has been very little attention paid by legal professionals in the published literature dealing with the civil liability and criminal exposure issues unique to a financial or business transaction fitted to *Shari'ah*.[112]

Some of the professional literature does grudgingly recognize that SCF lacks the certainty, consistency, predictability and transparency necessary to allow the legal and other professionals to treat it as one would any other secular business transaction. But because this literature is typically geared toward those fully committed to SCF, there has been very little in the way of critical analysis of the inherent contradiction or dangers in the effort to apply *Shari'ah* precepts, rooted in what one critical observer terms a "Medieval obscurantism," to Western financial transactions.[113] The potential dangers are exacerbated by the fact that finance and commerce cannot be separated in practice from the law and its institutions built on certainty, consistency, predictability, and transparency. This brings the secular Western legal institutions, understandings, and duties face-to-face with a sectarian normative legal system rooted in a world bound by the dictates of a god as determined by *Shari'ah* scholars fully wedded to the purposes of *Shari'ah*.[114]

What this analysis suggests by implication is that the first order of business for the legal practitioner advising a client on a SCF transaction is to ask what, if any, legal exposure might the client have by fitting the desired secular financial transaction to a sectarian, political, and legal institutional framework predicated upon *Shari'ah*?

2. Exposure arising out of endogenous elements

SCF is first and foremost a modality to structure modern secular financial activity in a way to comply with *Shari'ah*. While legal practitioners, for the reasons discussed above, are inclined to leave well enough alone and allow the *Shari'ah* scholars and authorities sole access to this black box, professional and fiduciary duties and responsibilities do not permit such a hands-off approach. The lawyer has an absolute duty to his client to warn of civil and criminal liability exposure when such exposure exists. This is true even when the client is not inclined to ask any questions beyond, "How do we get this deal done?"[115] Competent legal counsel understands that when the client's competitors are rushing to cash-in on the newest fad in the international financial markets with literally trillions of dollars flowing out of the ground and looking for an investment to land on, prudence tends to take a back seat to following the herd. As noted earlier, very high-priced lawyers and accountants with sterling reputations have on more that one occasion in recent history failed to brake the blind enthusiasm and excesses of their clients as they rushed head-long into exotic and innovative transactions. The criminal failure in these debacles has been the fact that without the professional facilitators' own version of blind enthusiasm – a willful acceptance of their clients' blind enthusiasm -- and with just a modicum of prudent and analytical scrutiny, the U.S. financial and legal systems would not have suffered as they have.

So it is with SCF. If the *Shari'ah* in SCF actually means something, the lawyer representing a U.S. financial institution desiring to enter this new arena needs to find out what that something is. This inquiry can be termed an analysis of the endogenous elements or aspects of *Shari'ah*.[116] To understand the risks and exposure for a financial institution contemplating SCF, the lawyer first must understand what *Shari'ah* itself says it is – that is, what the *Shari'ah* authorities understand it to be, without reference to how SCF attempts to navigate the demands of modern finance. While this inquiry will only be relevant to part of the analysis of the client's potential exposure, it will most certainly be relevant to many fundamental issues of SCF. Moreover, to the extent that *Shari'ah* compliance is determined by *Shari'ah* authorities, presumably there is something in the institution of *Shari'ah* itself that will inform the lawyer about who qualifies for such a role and how. Finally, to the extent that *Shari'ah* is in fact what its proponents say it is – a way of life combining authoritative Islamic legal, moral, theological, and normative social constructs – the attorney will likely have a responsibility to be certain that his client has conducted the necessary due diligence to be certain that these structures are not in and of themselves violations of U.S. law.

Some preliminary questions would be: What is the purpose of *Shari'ah*? Is there *a Shari'ah* with *a* purpose or are there many? If there are many, how are they distinguished and how are they similar so that they are all called *Shari'ah*? Who determines what *Shari'ah* is? Who determines what is permitted and what is forbidden in *Shari'ah* at any time? Is *Shari'ah* finance or economics a separate and distinct discipline within *Shari'ah*? Does *Shari'ah* recognize a SCF transaction even if it is utilized to undermine or destroy *Shari'ah*? Does *Shari'ah* include theological purposes? Does it incorporate the purposes or designs of any one political system over another? The answers to these and many questions like them must be part of a knowledge base available to the lawyer as he begins his analysis of specific legal duties in the context of U.S. law.

3. Exposure arising out of exogenous elements

As discussed above, SCF is a term of art used to describe the contemporary Islamic legal, normative, and communal response to the demands of modern day finance and commerce. As such, the rules and norms of *Shari'ah* are being forced to attend to the demands of a Muslim demographic which desires to exploit the opportunities available in Western financial and legal structures yet at the same time to remain faithful to a system which rejects as unlawful and evil much of the Western financial premises about political economies and structures. To achieve this seemingly impossible goal, *Shari'ah* authorities have developed a whole range of transactional structures and legal-definitional parameters to guide them in their ultimate determination whether a given transaction or investment is permitted or prohibited.

In this part of the analysis, the lawyer should begin to address the features of SCF which might raise liability exposure issues that are not inherent to *Shari'ah* principles but are adaptations of *Shari'ah* principles to fit Western financial structures and institutions. An example of a transactional structure to deal with this collision between a *Shari'ah* world and a Western one built on the time-value of money in the form of interest is the sale-lease back agreement.[117] While sale-lease back agreements are not unique to SCF and in fact are a popular vehicle in contemporary finance, in the two contexts they are not identical in structure and worlds apart in their purposes.[118] An example of the legal-definitional parameters set out by *Shari'ah* authorities to deal with the doctrinal conflicts between the two systems would be the ruling that while interest income is absolutely forbidden in *Shari'ah*, it is not forbidden to invest in a company that earns less than X%[119] from interest income which is not a core business of the company (i.e., interest earned on liquid assets or accounts receivables).

In addition to the exogenous structural and definitional efforts to fit *Shari'ah* into modern finance, another example would be the make up and structure of a *Shari'ah* advisory board and how it plays some authoritative role in the financial institution with which it is associated. Thus, while *Shari'ah* authorities have been an endogenous element within *Shari'ah* for over a millennium, private *Shari'ah* advisory boards sitting together in the capacity of something akin to an independent audit committee within the structure of a financial institution is an innovation to respond to a financial landscape understood to be exogenous to *Shari'ah*.[120] Thus, for example, the lawyer might try to understand what kind of organization *Shari'ah* requires for a *Shari'ah* advisory board and are there implications for the client or for the *Shari'ah* advisory board itself relating to the very real possibility of competing loyalties.

C. The legal analysis: overview

The legal practitioner's job is typically not theoretical; it is fact-based. The lawyer's work by its nature is to take a specific set of facts and to apply the law. At some early point in the analysis, the practitioner would be confronted by the client's desire to engage in some form of SCF. First, the lawyer would attempt to understand all of the factual elements of the business, transaction, or investment. Part of the early discussions would include the following questions: what is the client trying to achieve; how does the client wish to achieve these goals; what does the client expect if these goals are not met; who are the players; how are they involved; what decisions need to be made by the various parties; and how are the decisions implemented?

With the facts of the investment or transaction understood, the transactional lawyer must then map out not merely the transactional documents, but also the legal and regulatory issues to be dealt with to achieve the desired end. Thus, in a typical analysis, the lawyer is focused on a fact-specific transaction and would analyze each and every duty or obligation imposed by law and determine what must be done to comply and what must be avoided so as not to breach some duty imposed by statute, regulation, common law, or the contractual obligations underlying the transaction itself.

For purposes of the analysis, rather than examine any particular fact situation, and to avoid an overbroad, far-ranging analysis of the plethora of compliance issues relative to the various SCF investments and transactions, this analysis will begin instead with those specific duties and obligations that might give rise to civil and criminal liability exposure implicated in SCF. The analysis will attempt to track the endogenous-exogenous taxonomy described above. The particular duties examined are certainly not exhaustive but have been chosen because they appear to give rise to the greatest areas of civil liability and criminal exposure. Furthermore, this analysis will limit the examination of the various kinds of businesses and transactions incorporating SCF to those used most prominently in the U.S. market today.

1. Overview of the SCF markets analyzed

The nubile SCF market migrated from the GCC states via London looking for additional legitimation in the dynamic U.S. financial markets. As much as London seeks to be the SCF capital of the Western world[121], New York is still the "go-to place" for capital markets.[122] The SCF industry has already taken hold in the imagination of many, but certainly not all of the leading U.S. financial institutions, yet it is permeating into wider and deeper audiences in the industry. To date, U.S. financial institutions are engaged in *Shari'ah*-compliant stock indexes, publicly traded mutual funds, hedge funds or the so-called "fund of funds" market for sophisticated fund managers and well-heeled clients, sovereign wealth and private corporate bond issuances, consumer and commercial bank loans such as home mortgages -- including participation by Fannie Mae and Freddie Mac, car loans, residential and commercial real estate financing, and even some construction financing.[123] The analysis which follows will focus on the most common SCF products utilized in the U.S. today. The specifics of the SCF product will be discussed in greater detail within the analysis.

2. Overview of the legal analysis

The legal analysis of the SCF products to follow will examine civil and criminal liability issues relating specifically to the duty to disclose, due diligence, and other compliance issues raised by specific statutes. The examination will not be exhaustive nor will it focus on the myriad of regulatory compliance issues where there is no manifest issue of civil or criminal liability exposure.[124] Specifically, in the disclosure discussion, the analysis focuses on exposure to claims of securities fraud and various statutory and common law regimens to protect against consumer fraud. The analysis of the requirements to conduct due diligence and to meet other compliance mandates will focus primarily on the anti-terrorism statutes, which implicate the anti-money laundering statutes and the anti-racketeering statutes as amended by the USA Patriot Act ("the Patriot Act").[125] Finally, the other compliance issues will discuss antitrust issues and exposure to tort claims for aiding and abetting terrorism and the violation of internationally recognized norms of the law of nations.

D. The legal landscape

1. Common law tort action for deceit or fraud

The regulation of disclosures by businesses, and by the financial industry in particular, has a long and storied history in U.S. jurisprudence. Most of this regulation began in a way not normally considered regulatory but its effect was and continues to be most certainly to regulate. The common law of most states incorporated the tort action of deceit, commonly referred to as fraud, to allow private rights of action for misrepresentation in the context of what is now referred to as commercial speech.[126] The essential elements of a common law fraud action are: (1) a false representation (2) of a material fact (3) which the defendant knew to be false and (4) with the intent to induce the plaintiff to rely upon it and (5) the plaintiff in fact justifiably relied upon the representation (6) thereby suffering damages as a result.[127]

Most states have relaxed or altered many of the elements of common law fraud. For example, certain relationships under the common law, such as a fiduciary, might also give rise to a claim for constructive fraud which allows recovery for an omission of material fact. The *scienter* elements have also been relaxed. Thus, the intent elements noted above in (3) and (4), has been "variously defined to mean everything from knowing falsity with an implication of *mens rea*, through various gradations of recklessness, down to such nonaction as is virtually equivalent to negligence or even liability without fault (and would be better treated as creating a distinct species of liability not based on intent)."[128]

2. Federal securities laws

In addition to common law actions for fraud or misrepresentation, there are federal and state statutory regimes designed to govern disclosures in a myriad of business and financial contexts, including the sale of goods and the provision of loans; investments such as the formation of partnerships; and the sale of intangibles such as the offering of securities. In the world of SCF, the disclosure statutes most obviously implicated in civil and criminal liability issues are the federal and state securities laws.

In the main, the securities law relating to fraud and misrepresentation were modeled after common law fraud. Having said this, it is just as true to say that Congress intended the securities fraud statutes to have a far broader reach than the common law. As a result, securities laws sought to include within its enforcement orbit misrepresentations, omissions, schemes, and artifices that would not otherwise be captured by traditional common law fraud. In addition, many of the specific elements of common law fraud were relaxed or in some cases eliminated. While recent federal legislation aimed at curbing abusive class action litigation and subsequent Supreme Court case law suggest a serious trimming of the broad reach previously granted federal securities laws, the securities bar knows full well that this is counterbalanced by a concomitant movement at the state level to extend the reach of the state securities laws and to interpret them more liberally than the federal counterparts.[129]

There are principally seven federal statutes that govern securities transactions: the Securities Act of 1933; the Securities Act of 1934; the Trust Indenture Act of 1939; the Investment Company Act of 1940; the Investment Advisors Act of 1940; the Securities Investor Protection Act of 1970; and the Sarbanes-Oxley Act of 2002.[130] Civil and criminal liability under the federal securities statutes for failure to disclose, what is broadly referred to as securities fraud, is regulated by the SEC and its principal weapons are the Securities Act of 1933 ("1933 Act") and the Securities Exchange Act of 1934 ("1934 Act").[131] The 1933 and 1934 Acts target different markets. The 1933 Act regulates initial offerings and the 1934 Act regulates all subsequent trading, but the overriding public policy is the same: “full disclosure of every essentially important element attending the issue of a new security” and a “demand that persons, whether they be directors, experts, or underwriters, who sponsor the investment of other people’s money should be held to the high standards of trusteeship.”[132]

Although both the 1933 and the 1934 Acts proscribe various types of conduct, including incomplete or inaccurate disclosure of material information, as an administrative matter the SEC, through its rule-making authority and its regulatory responsibilities, dictates the specific kinds of minimal (and in some cases maximal) disclosure required by the specific provisions. Beyond the routine administration functions granted the SEC, the main weapons against securities fraud are the civil and criminal remedies. Thus, the SEC, in addition to administrative sanctions, has access to the civil courts to seek injunctive relief, disgorgement, and even civil fines, in addition to other ancillary equity-like relief. In addition, the Department of Justice (“DOJ”), often as a result of an SEC administrative investigation and criminal referral, is authorized to file criminal charges for violations of the federal securities laws when it appears the offending party had the requisite intent.[133] Finally, private plaintiffs have expressed and implied rights of action under several provisions. The most used and abused of all such provisions is Rule 10b-5[134], promulgated under the 1934 Act[135], which provides for civil litigation[136] and criminal prosecutions.[137] When you add the class-action club to the civil claims brought under Rule 10b-5, although reduced mightily by recent legislation[138], the weapons available to prosecute claims for misstatements and omissions of material fact in SEC filings and elsewhere in the public domain are considerable.

3. State securities laws

State securities laws, usually referred to as blue sky laws, essentially track the development of securities disclosure law and securities fraud liability in federal securities law. As noted above, as a result of Congress' efforts to curb private securities fraud litigation and recent Supreme Court rulings regarding the new pleadings requirements, the state securities laws will take on ever greater importance in the securities plaintiff's arsenal of litigation weapons.[139]

4. Federal and State consumer protection and anti-fraud laws

Further important weapons in the arsenal for fraud now available in most states are the consumer protection statutes. While the Federal Trace Commission Act ("FTC Act")[140] does not apply to securities, it might well be implicated where businesses market consumer products and represent that their business is run according to *Shari'ah*. Further, modeled in part after the FTC Act, the "little FTC Acts" enacted by most states are often more broadly interpreted than the FTC Act and many have an explicit or implied private right of action allowing the consumers themselves to battle fraud in the marketplace.[141]

In California, for example, a private plaintiff sued Nike, Inc., an Oregon corporation, on behalf of all California residents under the California Unfair Competition Law[142] for fraud and failure to disclose. The suit was filed after Nike had made false and misleading public statements in the wake of media reports suggesting abuse at its foreign factories. Nike claimed its speech was protected under the First Amendment. The case went to the U.S. Supreme Court after Nike's arguments to get the case dismissed on First Amendment grounds did not persuade the California Supreme Court. But the U.S. Supreme Court sent it back down to the California courts after it determined that certiorari had been improvidently granted.[143] Nike settled the case.[144] The implications of this type of state action for the SCF industry will be addressed below. Also, at least three states allow their respective consumer protection statutes to be used for securities fraud, which would bring the entire SCF industry under consumer fraud scrutiny.[145]

Additional statutes implicated are the federal Lanham Act, which regulates *inter alia* fraud in the description of goods, services, or commercial activities,[146] and laws governing consumer finance. Consumer finance in the U.S. falls within the ambit of the federal Truth-in-Lending Act ("TILA")[147] and the myriad of regulations promulgated thereunder referred to collectively as Regulation Z.[148] Banks and other lenders advertising "zero interest loans" or "*riba* free loans" might in fact run afoul of the TILA disclosure requirements and the restrictions on deceptive advertising. The Home Ownership and Equity Protection Act ("HOEPA")[149], which is part of TILA, or the state versions of HOEPA might also apply to what amounts to predatory lending to *Shari'ah*-adherent Muslims to the extent that the fees and costs are almost always higher than conventional loans.

5. Due diligence and compliance statutes

The federal securities laws in several instances incorporate due diligence as defenses to the anti-fraud provisions and as such are an integral part of any legal analysis for civil or criminal exposure.[150] In addition, due diligence is incorporated into several compliance regimes such as the Bank Secrecy Act[151] and the anti-money laundering statutes[152], many of which were modified by the Patriot Act. Insofar as SCF incorporates the *Shari'ah* obligation to tithe and also requires the "purification" of profits earned in violation of *Shari'ah*, the question for the legal practitioner is who decides what happens to the monies gifted to charities and which charities are selected. Given the historical connection between some of the largest and well-known Muslim charities and the funding of terrorist groups[153], these questions take on added focus in the context of material support of terrorism. Finally, the structure of the *Shari'ah* authority boards and their professional membership organizations also raise antitrust issues which must be addressed.

E. The endogenous elements: disclosure of *Shari'ah* in SCF

1. The preliminary analysis

The first order of business for the attorney providing advice in the context of disclosure laws to a U.S. financial institution interested in SCF should be the following question: How intimate is the connection between SCF and *Shari'ah* itself? In legal terms, how material is *Shari'ah* to SCF? If *Shari'ah* is a material part of SCF, the attorney must confront the very real likelihood that it is a material fact of SCF in the context of disclosure laws. While the answer to the question might appear self evident – that is, *Shari'ah* has everything to do with SCF – all of the extant literature by legal scholars and practitioners suggest that even if *Shari'ah* is a material component of SCF it is not material to any of the disclosure laws because *Shari'ah* is treated as a black box that merely turns out rules requiring objective filters to be coded into a software program and specific kinds of contractual arrangements to avoid non-*Shari'ah*-compliant interest and uncertainty.

But as the preceding pages have already suggested, when secular lawyers treat *Shari'ah* as a black box that does not much concern them, except in the specific rulings relative to a given investment or transaction, this amounts to a willful avoidance of material facts. Those willfully avoided material facts are the endogenous elements of *Shari'ah* that result in the "rules and principles" of SCF.[154] Indeed, as indicated above, according to the proponents and practitioners of SCF -- *Shari'ah* is not simply an approach to interest-free, ethical Islamic business practices or investing. Invariably, SCF is described by its proponents, practitioners, and scholars, as the contemporary Islamic legal, normative, and communal response to the demands of modern day finance and commerce. What makes the response "Islamic" or one pursued almost exclusively by Muslims[155] is the fact that this legal, normative, and communal response to modern finance is framed and regulated by *Shari'ah* authorities ruling on what *Shari'ah* permits and what it prohibits. Thus, whether called *Shari'ah*-compliant finance, Islamic economics and finance, or even "ethical" investing, the one unifying characteristic of SCF in all of its ramifications is the appearance of authoritative Muslim *Shari'ah* scholars who, individually and collectively through various manifestations of consensus[156], define the "rules and principles" of SCF and set out how a *Shari'ah*-adherent Muslim may "lawfully" engage in commerce, investing, and finance.

Further, the *Shari'ah* authorities are clear: SCF is not some discreet or segregable component of *Shari'ah*. It is by all accounts a fully integrated discipline within the *corpus juris* of *Shari'ah* which, in turn, is a holistic, all-encompassing way of life that sets out legal mandates, norms, custom, and preferences to guide the *Shari'ah*-adherent Muslim in every single aspect of life -- be it religious ritual, charity, business matters, family issues and inheritance, war against the infidel, political life, or the afterlife. *Shari'ah* is not divisible, moreover, in the sense that one might extract the SCF "commercial legal code" from *Shari'ah* and end up with a body of laws articulating a secular code of business conduct. This is demonstrated quite clearly by the prohibitions against businesses that trade in pork products (seemingly a strictly dietary code issue) or the leasing of a building to a church (quite obviously a theological consideration informing a business law issue).[157] Even in the legal rulings relating to whether a Muslim bank or individual may receive interest from deposit accounts, the decision turns in large part on whether the deposits reside in a jurisdiction called the "abode of war" where non-Muslims predominate or the "abode of peace" where Muslims predominate.[158]

The inclusiveness, universality, and indivisibility of *Shari'ah* are not just evidenced by the published work of the classical and contemporary *Shari'ah* authorities on the one hand and the secular academic scholars who treat *Shari'ah* and its jurisprudence as a discipline for study on the other. Especially important for the lawyer attempting to determine what if anything the "*Shari'ah*" of SCF is in the context of disclosure laws, and what if anything of this "*Shari'ah*" is material and subject to the duty to disclose, is what *Shari'ah* actually is in practice. An attorney in search of the actual presentation of *Shari'ah* as an extant and authoritative basis for law in modern times has the opportunity to examine several Muslim regimes which have implemented *Shari'ah* as the law of the land. The best examples of such implementation are Iran, Saudi Arabia, and Sudan.[159] The Taliban of Afghanistan had also imposed a fully authoritative *Shari'ah* and many other Muslim regimes have utilized aspects of *Shari'ah* to complement a non-*Shari'ah* secular code. Obviously, the more a country's laws are based upon *Shari'ah*, the better the evidence of what *Shari'ah* is in actual practice devoid of all the academic theorizing and parsing.[160]

It is not within the scope of this memorandum to determine what *Shari'ah* is in fact or what it means to the contemporary *Shari'ah* authorities sitting as the final arbiters of SCF. Examining the literature of *Shari'ah* over the course of its history, determining what *Shari'ah* is in Muslim countries which apply traditional *Shari'ah* rules and principles and, importantly, studying the published rulings by contemporary *Shari'ah* authorities on what *Shari'ah* is[161], what its purposes are, and what *Shari'ah* considers the appropriate means to achieve those ends, are, however, all part of any essential inquiry into the material endogenous elements of *Shari'ah* subject to disclosure.

2. The hypothetical: not so hypothetical

Notwithstanding a reluctance based on practical considerations to engage in a full analysis of the material endogenous elements of *Shari'ah*, in order to provide a factual predicate for the analysis of the disclosure (and other) laws that follow it will be helpful to assume a fact or two about *Shari'ah*. Therefore, by way of example and for purposes of the analysis, this memorandum assumes that after a good faith investigation, the lawyer advising the financial institution desiring to enter the lucrative SCF industry will determine that there is a reasonable basis to conclude that a consensus exists among *Shari'ah* authorities on the fundamental purpose and methodologies of *Shari'ah*: The purpose is submission. *Shari'ah* seeks to establish that Allah is the divine lawgiver and that no other law may properly exist but Allah's law. *Shari'ah* seeks to achieve this goal through persuasion and other non-violent means. But when necessary and under certain prescribed circumstances the use of force and even full-scale war to achieve the dominance of *Shari'ah* worldwide is not only permissible, but obligatory.

While this memorandum poses these conclusions as a hypothetical, they are hardly conjectural. In fact, they reflect the rulings of the classical *Shari'ah* authorities dating back almost a millennium and include the most contemporary of *Shari'ah* authorities issuing authoritative legal rulings today. Although post-9/11 scholarship on Islamic terrorism has made the point that the terrorists almost always base their actions on legal rulings by *Shari'ah* authorities,[162] a wholesale confusion remains because policy-makers and lawyers have not approached the doctrinal basis for *Jihad* or Islamic holy war objectively or analytically. Indeed, other than the reflexive, "Islam is a noble religion of peace," no government agency or department, including the Departments of Homeland Security and Defense, has undertaken a public analysis of the doctrines driving the Islamic terrorists who seek the destruction of the U.S. and its constitutional government.[163] The result has been that, until recently, no scholar from any discipline connected to this field of study has systematically examined the strategic doctrines which provide the theoretical, legal, spiritual, and traditional motivations underpinning the war on the U.S. and Western interests by the Islamic terrorist combatants.

In what amounts to a strategic and analytical tour de force, Major Stephen Collins Coughlin, assigned to Military Intelligence in the U.S. Army Reserves, has produced a study on *Shari'ah* and its foundational role as controlling doctrine for *Shari'ah*-adherent terrorists in their holy war against the infidel.[164] The unpublished study has been accepted by the faculty of the National Defense Intelligence College in partial fulfillment of the requirement for Coughlin's Master of Science degree in Strategic Intelligence. The strength of the study is that it examines meticulously *Shari'ah* as law as it is defined and interpreted by *Shari'ah* authorities themselves. Further, the analysis surveys the binding rulings of *Shari'ah* authorities from the classical periods dating back to the early days after Mohammed's death, including also the so-called Golden Era of Islamic enlightenment, through the chaotic period around the fall of the Ottoman Empire and the establishment of the secular-based military autocracies which continue to dominate most of the Muslim world today, right through to the present. The contemporary survey also includes a best-selling 7th grade text book used in Islamic day schools throughout the U.S. to validate the study's choice of authorities and to confirm that their legal rulings are used pedagogically as the foundation for understanding traditional, *Shari'ah*-centered

Islam.[165] Further, Coughlin carefully authenticates the authorities so that one is not misled into accepting either a weak authority or an "extremist" view point. Finally, the work is by far the best of any such scholarship attempted because it treats doctrinal *Shari'ah* as *Shari'ah* expects to be treated and as evidenced by the published rulings of the *Shari'ah* authorities: as a sectarian legal-political-military normative social construct sourced in divine and immutable law.

What the study demonstrates beyond any reasonable doubt is that *Shari'ah* and the doctrines of war articulated as the Law of *Jihad* are valid today as they were one thousand years ago. *Jihad* should be implemented as circumstances permit, and the contemporary authoritative *Shari'ah* scholars continue to teach, preach and issue legal rulings to this effect. What Coughlin's investigation further explicates is that, per *Shari'ah*, once the *Shari'ah* authorities reach a consensus on a legal ruling or doctrine which is based on the *Qur'an* and *Hadith*, that ruling or doctrine is considered immutable and irrevocable.[166] This adds yet further concretization to the rulings on *Jihad* because the purpose of Islam and the methodologies to achieve those ends per *Shari'ah* are universally accepted by the *Shari'ah* authorities with but relatively minor exceptions as to specifics.[167]

Based upon a consensus of legal authorities, which Coughlin carefully documents by traversing the full history of *Shari'ah*'s development across all extant legal schools, this study places the Law of *Jihad* in a milieu permeated by the consequences of the jurisprudential rule of consensus and indisputably establishes three fundamental points relevant to this memorandum's analysis:

> [1] The goal of *Jihad* to convert or conquer the entire world and the methodology to achieve this end by persuasion, by force and subjugation, or by murder is extant doctrine and valid law by virtue of a universal consensus among the authoritative *Shari'ah* scholars throughout Islamic history.
>
> [2] The doctrine of *Jihad* is foundational because it is based upon explicit verses in the *Qur'an* and the most authentic of canonical *Sunna* and it is considered a cornerstone of justice: until the infidels and polytheists are converted, subjugated, or murdered, their mischief and domination will continue to harm the Muslim nation. And,
>
> [3] *Jihad* is conducted primarily through kinetic warfare but it includes other modalities such as propaganda and psychological warfare.

These three points will serve as the background for the analysis below but will be stress-tested when the factual case studies are examined in Section III. If Coughlin's thesis is correct, there should be immediate evidence that contemporary *Shari'ah* authorities both embrace the Law of *Jihad* as an extant doctrine for action by *Shari'ah*-adherent Muslims and base their rulings on the classical *Shari'ah* authorities who fully embraced the consensus on the Law of *Jihad*.

3. The legal analysis: applying the endogenous elements of *Shari'ah* to the specific duty to disclose

As noted previously, the SCF industry in the U.S. includes a panoply of businesses which fall within the regulatory sphere of the securities laws. Mutual funds tracking one of the Islamic indexes, publicly traded bond issuances and the trading of securitized bond issuances on a secondary market, and even U.S. public companies announcing their commitment to conducting their business according to the principles of *Shari'ah* are some of the more obvious examples. Do the facts of *Shari'ah* – representing the overriding purposes of *Shari'ah* and the methods authorized to achieve those purposes – require disclosure under the securities laws?

Failure to disclose a material fact (or the material misrepresentation of an asserted fact) is the basis for administrative, civil, and criminal actions under all of the securities laws requiring disclosure. The breach of this duty might arise in a registration, prospectus or other required filing with the SEC or far more broadly "in connection with" a purchase or sale of securities. For example, the 1933 Act imposes a number of requirements upon issuers, underwriters, and dealers to make full and fair disclosures in securities offerings.[168] Section 11 of the 1933 Act ("Section 11") provides that purchasers of securities may sue for material misrepresentations or omissions in registration statements as long as they did not know of the misrepresentation or omission at the time of purchase.[169] The dragnet under Section 11 for potential defendants is fairly wide and includes: (1) any person who signed the registration statement; (2) any person who was a director or partner of the issuer at the time of the filing of the registration statement; (3) any person listed in the registration statement as a soon-to-be director or partner; (4) every accountant, engineer, appraiser, or other expert named in the statement after having consented, but only as to any liability arising from the portion of the statement attributed to the specific expert; or (5) any underwriter of the securities.[170] In addition, Section 12 of the 1933 Act ("Section 12") authorizes a purchaser of securities to sue the offeror or seller for any material misrepresentation or omission in a prospectus and adds "oral communications" to the landscape.[171] The depth of the exposure for both of these provisions is the fact that a private plaintiff need not allege or show actual reliance on the misrepresentation or show that the absence of the material omission was in fact a contributing element.[172]

The pre-eminent statutory authority for civil and criminal liability exposure for failure to disclose in securities transactions is Section 10(b) of the 1934 Act and its regulatory offspring Rule 10b-5. This is so partly because it has been the source for most of the litigation due to its breadth and the fact that it includes an implied private right of action thereby adding private plaintiff and class action claims to the enforcement suits by the SEC and by DOJ criminal prosecutions.[173] The essential elements of a Rule 10b-5 action are:

(1) a misstatement or omission; (2) of material fact; (3) with *scienter*; (4) in connection with the purchase or the sale of a security; (5) upon which the plaintiff reasonably relied; and (6) that the plaintiff's reliance was the proximate cause of his or her injury. [174]

Once these elements of the Rule 10b-5 cause of action are established, a criminal penalty can be imposed under section 32(a) if the government satisfactorily proves a willful violation of the 1934 Act.[175]

While a thorough analysis of each of the fraud elements relative to the particulars of the situation[176] would be critical for the practitioner to undertake, this memorandum will examine two of the unique elements to most fraud claims based upon allegations that the defendant omitted material information about *Shari'ah* in various public filings and representations: materiality and *scienter*. Because the discussion regarding materiality in a federal securities fraud action are also applicable in the main to fraud claims alleged under the common law, the state blue sky laws, or other anti-fraud federal and state statutes, the discussion of materiality will not treat the latter separately. These two elements of the fraud action are carved out for special attention in this memorandum because a failure to consider these particular elements properly will likely contribute to the conclusion that the *Shari'ah* black box poses no great risk to U.S. companies involved in SCF. This conclusion, if reached without due consideration of the matters raised herein, would be faulty and quite likely very costly. There will be a natural tendency by practitioners to treat materiality and *scienter* as high hurdles for a government prosecution, an SEC enforcement action, or a private civil claim because these lawyers have treated *Shari'ah* as a black box into which they have refused to peer. They will then consider the contents of that black box either immaterial in and of itself or irrelevant since they will insist that there was no requisite intent on the part of their clients to embrace the endogenous elements of *Shari'ah*.

a. Materiality

i. The Supreme Court's standards

Materiality is a fundamental element for an action alleging a failure to disclose under the securities laws and this is certainly the case for a plaintiff alleging that a defendant violated such duty by not properly disclosing the real nature, purpose, and scope of *Shari'ah*. The essential elements of such a claim might be, in addition to those set forth above in the hypothetical factual predicate for this discussion, as follows:

> (1) Plaintiff bought shares in a closed-end mutual fund which represented itself to be *Shari'ah*-compliant.
>
> (2) An important part of these representations was the high-repute of the *Shari'ah* advisory board members who were to watch over the fund's *Shari'ah* compliance.

(3) Various representations by the defendant financial institution and its agents and representatives spoke of the ethical and socially responsible nature of *Shari'ah*.

(4) It was subsequently discovered and made public that the *Shari'ah* advisory board members all treated the rulings and pronouncements of Ibn Taymiyyah, a fourteenth-century Hanbali *Shari'ah* authority and scholar "with strikingly modern-sounding views" on commerce and finance[177], as authoritative. It was also discovered and made public that Ibn Taymiyyah was a key *Shari'ah* authority for most of the terrorists associated with al Qaeda. Ibn Taymiyyah, it turns out, was a leading advocate of a *Shari'ah* centered political organization for Muslims which would declare holy war against infidels and Muslims who rejected *Shari'ah*. In fact, all sorts of "Islamists" who have declared war on the U.S. and seek the establishment of a worldwide Caliphate are students and followers of the *Shari'ah* "rules and principles" espoused by Ibn Taymiyyah insofar as he advocates Muslims to war against infidels.[178]

(5) There is a consensus among *Shari'ah* authorities from all schools of *Shari'ah* jurisprudence that forced subjugation or *Jihad* against non-Muslims is obligatory when efforts to peacefully convert the non-Muslims fail and war is a viable option.

In addition to these allegations which would support an SEC enforcement action or a private right of action for rescission, a plaintiff might opt to pursue damages. In such a case, one might anticipate the following: When the information alleged above became public knowledge, the fund suffered irreparable reputational damage and many of the U.S. investors sold their shares in the mutual fund causing the value of the traded shares to plummet. The complaint would also allege that the plaintiff purchased shares in the mutual fund without knowing anything about *Shari'ah* other than what the defendants represented to the public. Since the defendants promoted their *Shari'ah* authority board members as highly respected scholars and authorities in their field and since these authorities ruled that *Shari'ah* forbade interest and excessive speculation in investments, and also prohibited investing in various "vice" industries, the plaintiff reasonably relied on these representations in the belief that *Shari'ah* was a "socially responsible" business practice and worth utilizing as an investment "screen". Had the plaintiff known the facts about *Shari'ah* as they have now come to light, plaintiff would never have invested in a *Shari'ah*-compliant mutual fund. In addition to damages, the plaintiff would likely apply to certify the class of similarly situated investors.

The first issue confronting the plaintiffs under Rule 10b-5, the broadest of the federal securities anti-fraud statutes, will be whether the omissions of fact relating to *Shari'ah* doctrine relative to the treatment of apostates (both non-Muslims and Muslims) were material. Insofar as this question of materiality as phrased would be one of first impression for an appellate court, legal counsel advising a U.S. financial institution on the liability exposure for SCF would turn to the courts' general pronouncements for guidance. The leading decision in this area is *TSC Industries, Inc. v. Northway, Inc.*,[179] where the Supreme Court was asked to wade into the question of whether a failure to disclose in the context of a proxy solicitation was material. The case involved the acquisition of the target company TSC Industries by National Industries through the purchase of a controlling interest. After the acquisition, National Industries sought to acquire all of the assets of TSC Industries and to liquidate the corporate shell. To accomplish this, TSC Industries issued a proxy statement to its shareholders soliciting their approval. The vote passed. A shareholder of TSC Industries, Northway, Inc., sued under section 14(a) of the 1934 Act ("Section 14(a)") and the SEC rules promulgated thereunder, Rules 14a-3 and 14a-9. [180] The essential material fact at issue was who was really in control. While the Court ultimately concluded that there were sufficient disclosures to inform a reasonable investor, the analysis the Court used to get to that conclusion provides the basis today for the materiality analysis.

The Court began by clearly rejecting what it considered too low a threshold for materiality as adopted by the lower court. The Court considered a standard of "all facts which a reasonable shareholder *might* consider reasonable"[181] "'too suggestive of mere possibility, however unlikely.'"[182] The Court went on to explain in detail the objective standard it chose for materiality:

> The question of materiality, it is universally agreed, is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor. Variations in the formulation of a general test of materiality occur in the articulation of just how significant a fact must be or, put another way, how certain it must be that the fact would affect a reasonable investor's judgment.
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> . . .
>
> The general standard of materiality that we think best comports with the policies of Rule 14a-9 is as follows: An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. . . . It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.[183]

While the Court in *TSC Industries* set about to explain materiality in the context of proxy statements, this articulation of materiality has become the operative definition in many other contexts of securities fraud. In a Rule 10b-5 case alleging failure to disclose pre-merger negotiations, the Court utilized the *TSC Industries* standard in an effort to add clarity to the concept of materiality for future or contingent events. In *Basic, Inc. v. Levinson*[184], the Court confronted the question when pre-merger negotiations are material and ripe for disclosure. Negotiations over some contingent and future event may, it turns out, be quite material:

> Even before this Court's decision in *TSC Industries*, the Second Circuit had explained the role of the materiality requirement of Rule 10b-5, with respect to contingent or speculative information or events, in a manner that gave that term meaning that is independent of the other provisions of the Rule. Under such circumstances, materiality "will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." *SEC v. Texas Gulf Sulphur Co.*, 401 F. 2d, at 849. . . .
> In a subsequent decision, the late Judge Friendly, writing for a Second Circuit panel, applied the *Texas Gulf Sulphur* probability/magnitude approach in the specific context of preliminary merger negotiations. After acknowledging that materiality is something to be determined on the basis of the particular facts of each case, he stated:
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> "Since a merger in which it is bought out is the most important event that can occur in a small corporation's life, to wit, its death, we think that inside information, as regards a merger of this sort, can become material at an earlier stage than would be the case as regards lesser transactions -- and this even though the mortality rate of mergers in such formative stages is doubtless high."
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> *SEC v. Geon Industries, Inc.*, 531 F. 2d 39, 47-48 (CA2 1976). We agree with that analysis.[185]

Arguably, the question whether the *Shari'ah* in SCF is a material fact that ought to be disclosed will rest on one of two analytical approaches, or possibly both. The first approach seeks to determine the materiality of *Shari'ah* in principle. This approach might be phrased in question form as follows: Would a post 9-11 reasonable investor consider the connection between *Shari'ah* and SCF important to his or her decision to invest? In other words, would a reasonable investor looking to invest in something promoted (or in some instances simply represented) as "*Shari'ah*-compliant" want to know what *Shari'ah* and its "rules and principles" say about constitutional government, treatment of infidels, the Law of *Jihad*, and the use of suicide-homicide bombers and other acts of terrorism? Would the reasonable investor want to know about the published statements by international terrorist leaders citing *Shari'ah* authorities as justification for their holy war against the U.S. and other Western nations? These and similarly phrased questions all attempt to get at the associational link between *Shari'ah* in principle as an authoritative set of rules and principles advocating violence and SCF. If in fact such an association exists, would it be material information to a reasonable investor?[186]

The second analysis relevant to materiality goes beyond the association in principle of SCF with *Shari'ah* and its call to violence and asks whether there is enough evidence of an association in fact. In other words, is the connection between *Shari'ah* and terror and violence theoretical or is there admissible evidence of a relationship in fact. This analysis might be framed in the question: is the nexus between *Shari'ah* and terror and violence so contingent or speculative that it would render any theoretical association between *Shari'ah* and violence or the "call to violence" immaterial? This is another way of analyzing the argument often made against any association between *Shari'ah* or Islam and violence. In the context of *Shari'ah*, the argument is made that *Shari'ah* can be interpreted in peaceful ways or in violent ways and that those *Shari'ah* authorities who interpret *Shari'ah* violently and in ways that would shock the conscience of a reasonable U.S. investor (or in a lesser way, that might be simply material to the investor) are the extremists and represent such a small percentage of the recognized *Shari'ah* authorities that it would render any such theoretical or conceptual link between *Shari'ah* and violence against non-Muslims and non-*Shari'ah*-compliant Muslims so tenuous and attenuated as to be immaterial to a reasonable investor. In short, this is an argument that accepts that violence is associated in principle with *Shari'ah*,[187] but argues that the association in fact is trivial (or at least less than material) because it is not representative of *Shari'ah* as espoused by the vast majority of contemporary *Shari'ah* authorities.

While Coughlin's investigation and documentation would demonstrate this argument to be lacking evidentiary credibility, the analysis in a courtroom would likely turn on an examination of the facts and the law. As the Court opined in *TSC Industries*, "[t]he issue of materiality may be characterized as a mixed question of law and fact, involving as it does the application of a legal standard to a particular set of facts."[188] In addition to a simple factual showing that Islamic terrorists base their *raison d'être* for violence on the dictates of *Shari'ah* as expressed by the classical *Shari'ah* authorities and some contemporary ones, the fact question as presented might also be addressed by introducing evidence establishing what the contemporary *Shari'ah* authorities consider the purposes and authorized methods of *Shari'ah* to be. This question might be presented to a jury by introducing evidence (i) of the rulings of the contemporary *Shari'ah* authorities, (ii) of the rulings of classical *Shari'ah* authorities upon which the contemporary authorities have relied, and (iii) of *Shari'ah in actu*, which would include the brief on those Muslim-dominated regimes generally recognized as following *Shari'ah*, including their *Shari'ah*-based criminal codes and punishments and their track record for violations of the basic norms of the Law of Nations and human decency.[189]

The legal, in contrast to the purely factual, question presented by this second analysis will not be different in kind from the first analytical approach, which the reader recalls as the association in principle between *Shari'ah*, its call to violence, and SCF. In both, one must determine if the law requires disclosure of qualitatively material facts as opposed to strictly quantitatively material facts. Quantitative materiality requires companies only to disclose hard, empirical facts such as financial data and any criminal convictions of management personnel. Qualitative materiality requires a fuller disclosure of a whole range of behaviors that might be considered unethical or even illegal but which have not yet resulted in an actual conviction.[190]

While qualitative materiality is frowned upon by the courts and commentators because it renders the duty to disclose open to wholesale uncertainty about what must be disclosed in the first instance, the problem of disclosure for the *Shari'ah*-compliant financial institution is not circumscribed by this concern. Disclosure remains a significant legal issue for the company looking to promote its SCF business (or simply to disclose publicly the involvement in SCF) because of the difference between whether a duty to disclose exists in the first instance and what must be disclosed to make a partial disclosure not misleading to the reasonable investor.[191] Thus, to the extent a SCF business actively promotes its SCF business or includes SCF within the risk factors in its SEC filings, this disclosure opens the door to a full and accurate disclosure of all facts which a reasonable investor would find material. It hardly seems in doubt that a post-9/11 investor, in contemplating an investment in something represented as *Shari'ah*-compliant, would consider material any factual link between *Shari'ah* and the call for violence against non-Muslims and non-*Shari'ah*-compliant Muslims, or more specifically against the U.S. or U.S. interests abroad. Indeed, it would be improbable that a post 9-11 investor would not want to know what *Shari'ah* says about the Law of *Jihad* and the use of *Shari'ah* by Islamic terrorists even if the reporting company made no disclosure or representation about being *Shari'ah*-compliant. The fact of *Shari'ah* compliance would likely be sufficiently material for the duty of disclosure to exist independently of any partial representation.[192]

The confusion at a procedural level for the legal advisor attempting to weigh the materiality issue within the overall analysis of liability exposure might be the existence of counter factual claims suggesting that *Shari'ah* has a peaceful face in addition to its connection to Islamic terror. But these "counter-facts" would simply create a fact question. This suggests that a well-pled complaint alleging a sufficient nexus between SCF, *Shari'ah*, terror, and violence, would survive a motion for summary judgment. This seems especially true given the effectiveness of *Shari'ah*-inspired terrorists to convert calls for violence based upon *Shari'ah* into actual violence. Moreover, as this memorandum examines below the specific *Shari'ah* authorities and their organizational structures, the factual nexus between SCF, terror, and violence will become much clearer.

ii. Global Security Risk: a material fact?

The close nexus in the hypothetical factual predicate for this discussion between *Shari'ah* and global terrorism is, as explained above, more than just theoretical. Efforts by corporate legal counsel to dismiss these concerns will invariably run up against the wall of common understanding linking in material ways the violent and oppressive world of *Shari'ah* one hears about in the public media[193], terrorism committed in the name of *Shari'ah*[194], *Shari'ah* itself[195], and something calling itself SCF. This common understanding has already begun to articulate itself in the debate over materiality in the context of what is a material or relevant disclosure with respect to shareholder proxy statements.

In at least two instances, the New York City Comptroller ("Comptroller"), as the custodian and trustee of several major New York City employee pension funds which had acquired substantial stock in Halliburton Company ("Halliburton") and General Electric ("GE"), demanded that these two U.S. multi-national corporations doing business in Iran approve a shareholder proposal at their respective annual meetings to examine the "potential financial and reputational risks" associated with doing business in terror-sponsoring countries.[196] The first effort was directed against Halliburton and began in late 2002 and culminated in a final negative response to Halliburton's request for an SEC no-action letter in March 2003. The company argued that Rule 14a-8(i)(5) of the 1934 Act[197], the portion captioned "Relevance", provides that matters relating to operations that are financially *de minimis*[198] and are "not otherwise significantly related to the company's business" may be omitted by the company.[199] Specifically, Halliburton argued that its business in Iran was not only less than the quantitative minimum but also that the terror conducted by Iran or somehow intimately related to Iran and its status as one of the three countries designated by the State Department as "state sponsors of terror" had nothing to do with Halliburton's business per se. Also, any adverse consequences would not affect Halliburton because it was not a retail company and subject to public opprobrium. In other words, much like the materiality analysis discussed above, Halliburton would attempt to make relevance/materiality turn on a threshold quantitative test and then argue that qualitatively its business was not affected by any terror-related events even if the state and non-state actors with which it did business were engaged in terror.

The SEC refused to grant a no-action letter. What is instructive is the Comptroller's correspondence submitted to the SEC in response to Halliburton's arguments:

> The Funds [controlled by the Comptroller] assert that Halliburton's dealings with a reported terrorist state could cause a loss of consumer confidence by the individuals who purchase Halliburton's energy services -- its "consumers." The Company's reference elsewhere in its letter to the "expectations and desires of its customers" only serves to demonstrate further the significance of consumer confidence. Further, retail establishments are not the only suitable locations at which to mount a public protest -- Halliburton has offices throughout the world.
>
> Moreover, as a result of 9/11, the public has a consistent and intense interest in terrorism. On January 29, 2002, President Bush, in his State of the Union address, focused on three states, which are egregious sponsors of terrorism: Iran, Iraq and North Korea. He stated that these states constitute an "axis of evil." That focus will inevitably result in careful attention to Halliburton's dealings through the Subsidiary in one of those states.
>
> . . .

The link between Iran and Halliburton is of special interest to the public, including institutional, professional and non-professional investors, who are paying a great deal more attention to the relationship between their investments and terrorism. Thus, for example, a recent article in Barron's, "Under Scrutiny: Pension Funds Are Reconsidering Investments in Companies that Do Business With Rogue Nations," discusses the Global Security Risk database[200], which lists companies that it claims are operating in one or more of the six nations with which U.S. companies are prohibited from doing business directly. Iran is one of these nations.

Because the public has a legitimate interest in states such as Iran that sponsor terrorism as well as concern regarding the effect of terrorism on investors' assets, the (i)(5) exclusion has no application here. Halliburton does not dispute that the [Halliburton] Subsidiary conducts operations in Tehran. As such, Halliburton could be perceived as providing support to Iran. This perception could compound criticism arising from Halliburton's previous dealings, such as its $3.8 million fine and guilty plea in 1995 to charges it had exported oil-field equipment to Libya in violation of a U.S. government trade ban. See *The Houston Chronicle* (July 15, 1995). Such a perception could hurt the Company's reputation and in the end, adversely affect the Company's financial health. In fact, the Funds' Proposal is a model of a proposal that is significantly related to a company's business, and therefore, relevant, even if the matter accounts for only a low percentage of the Company's business.

Halliburton has not only failed to offer any prior authority in support of its position, it has also not mentioned its own recent failed effort to persuade the Division [of Corporate Finance of the SEC] to issue no-action relief on a similar proposal relating to Burma. In 2001, the Division denied Halliburton's request for "no-action" relief under Rule 14a-8(i)(5). Halliburton Company (February 26, 2001). The shareholder proposal in 2001 sought to have a committee of independent directors prepare a report regarding projects undertaken by the Company or any subsidiary in Burma, with an emphasis on describing steps taken to assure that neither Halliburton nor any of its subsidiaries is involved in or appears to benefit from use of forced labor or other human rights abusers in Burma.

Halliburton argued that the proposal should be excluded because assets, earnings and sales did not exceed the Rule's thresholds and the proposal was not otherwise significantly related to Halliburton's business. The Company further argued that neither the Company nor its subsidiaries benefited from the use of forced labor or human rights abuses in Burma. The proponent argued that Burma had been ruled for over a decade by a military dictatorship condemned for human rights abuses; that several years prior, the U.S. government banned new investment in Burma; and that many U.S. companies, including Texaco and Atlantic Richfield had

> voluntarily withdrawn from Burma. The proponent further stated that Halliburton once had extensive operations in Burma, which could come back to damage the Company. Of particular relevance to the subject situation, the proponent stated that Halliburton currently had an office in Burma.
>
> The Division viewed the proposal as one that was otherwise significantly related and did not grant the relief sought. We submit that the Division should follow the same approach here.[201]

Almost two years later, the SEC took the same hands-off policy when GE came knocking at the door also seeking a no-action letter to support its contention that it need not include a proxy proposal by the Comptroller at its annual shareholders' meeting which mirrored the earlier proposal submitted to Halliburton.[202] In its correspondence in opposition to GE's request, the Comptroller quoted at length from the Congressional Conference Report on the 2004 Budget, which requested that the SEC establish an Office of Global Security Risk, to evaluate the risks caused by the conduct of business operations in terrorist states:

> The Committee is concerned that American investors may be unwittingly investing in companies with ties to countries that sponsor terrorism and countries linked to human rights violations. For example, the Committee is aware of certain companies listed on U.S. exchanges that are linked to human rights abuses in Sudan. The Committee believes that a company's association with sponsors of terrorism and human rights abuses, no matter how large or small, can have a material adverse effect on a public company's operations, financial condition, earnings, and stock prices, all of which can negatively affect the value of an investment. In order to protect American investors' savings and to disclose these business relationships to investors, the Committee directs the Commission to establish an Office of Global Security Risk within the Division of Corporation Finance. The duties of this office shall include, but not be limited to: (1) establishing a process by which the SEC identifies all companies on U.S. exchanges operating in State Department-designated terrorist-sponsoring states; (2) ensuring that all companies sold on U.S. exchanges operating in State Department-designated terrorist-sponsoring states are disclosing such activities to investors; (3) implementing enhanced disclosure requirements based on the asymmetric nature of the risk to corporate share value and reputation stemming from business interests in these higher risk countries; (4) coordinating with other government agencies to ensure the sharing of relevant information across the Federal government; and (5) initiating a global dialogue to ensure that foreign corporations whose shares are traded in the United States are properly disclosing their activities in State Department-designated terrorist-sponsoring states to American investors. The Commission is

> directed to provide the Committee with quarterly reports on the activities of the Office of Global Security Risk.[203]

The Comptroller returned to the theme of a special office within the SEC designed by Congress to supervise U.S. companies association with terror and their disclosure of the "global security risk" attendant to such conduct in their public filings:

> On March 31, 2004, Chairman Donaldson testified before Congress on the Commission's progress in establishing the Office of Global Security Risk:
>
>> Additionally, as part of ongoing enhancements to our review program, we have established two new offices within the Division of Corporation Finance: The Office of Disclosure Standards, which will evaluate the review policies and review results of the Division's review program as carried out by its eleven review offices; and The Office of Global Security Risk, created in response to the 2004 appropriations report language. The Office of Global Security Risk, which will function within the traditional disclosure mission of the Commission, will have the following primary objectives: to identify companies whose activities raise concern about global security risks that are material to investors; to obtain appropriate disclosure where merited; and to share information as necessary and appropriate with, the other, key government agencies responsible for tracking terrorist financing.
>>
>> The Office of Global Security Risk will focus on asymmetric risk by assisting review staff in giving consideration to whether U.S. or foreign companies that are registered with the SEC have operations or other exposure with or in areas of the world that may subject it and its investors to material risks, trends or uncertainties. This consideration would include whether a company has operations in a country or area of activity where political, economic or other risks exist that are material, or whether a company faces public or government opposition, boycotts, litigation, or similar circumstances that are reasonably likely to have a material adverse impact on a company's financial condition or results of operations.
>
> "Testimony Concerning Fiscal 2005 Appropriations Request for the U.S. Securities and Exchange Commission", Statement of William H. Donaldson, before the Subcommittee on Commerce, Justice, State, and the Judiciary, Committee on Appropriations, United States House of Representatives, March 31, 2004.[204]

Ultimately, the SEC did establish its Office of Global Security Risk whose mission and operational tack are described on its Internet site as follows:

> The global risk environment has changed dramatically over the past few years, and continues to change almost daily as we learn of new or possible threats of terrorist activity around the world. The SEC and its Division of Corporation Finance have a unique role in seeking to enhance the investing public's access to the information it needs about any public company to make an informed investment decision, including material information about global security risk.
>
> The federal securities laws are premised on the idea that a company must disclose information that a reasonable investor would think is material, in light of the circumstances under which the disclosures are made (including the mix of information), in assessing an investment in the company. The Commission's disclosure-based regulatory approach has served the investing public and this agency well over the years, and the standard for disclosure - that of materiality - has long been the foundation of the Commission's work. We are committed to maintaining the materiality standard as the basis for our disclosure-based approach.
>
> At the direction of Congress, we have established the Office of Global Security Risk within the Division of Corporation Finance. This office works closely with our Division review staff to monitor whether the documents public companies file with the SEC include disclosure of material information regarding global security risk-related issues. The staff of the Office of Global Security Risk is taking steps to apprise our Division review staff of significant developments in this area of which it becomes aware, and is thereby assisting the Division in maintaining high standards of review in considering these issues.[205]

What is clear from this analysis is that U.S. companies can no longer consider their associations with countries or entities tainted by terror a private, non-material, or irrelevant matter. While the courts have not yet entered the fray, the executive and legislative branches have laid down some markers. This analysis suggests that the closer a company gets to a "state sponsor of terror", the more it has to disclose. Prudent counsel suggests that the closer a company gets to any association with terror, the more it has to disclose. The obvious question raised by the two proxy examples above would be: if a shareholder submits a proxy proposal to a publicly reporting financial institution involved in SCF requiring a full study of the risks associated with *Shari'ah*, will the company have legitimate grounds to argue that the risks of *Shari'ah* and its connection to terror are not relevant? Outside of the proxy arena, if a company engages in SCF and represents to the public that *Shari'ah* is a standard set by *Shari'ah* authorities relied upon by the company, has the company disclosed enough about *Shari'ah* to tell the whole story? Given the hypothetical this analysis has been working with, the answer would appear to be "no".

The tide has certainly turned and 9/11 seems to have been a significant catalyst. Congress and the SEC are focusing on what kinds of disclosure are required when a U.S. public company operates in locations and deals with parties which implicate terrorism.

Shareholders like the New York City pension funds have also voiced their view that disclosing ties to terrorism are no longer subject to theoretical discussion but have become central to what shareholders expect in disclosure statements. While the SEC's Office of Global Security Risk is focusing on links between U.S. businesses and terror-sponsoring regimes, the broader context of this focus suggests *a fortiori* that associational doctrinal relationships with terror and violence raise far more pressing issues of disclosure than mere geographical relationships.[206] Arguably, doing business in Iran is a lesser connection to terrorism than promoting a financial system initiated originally, and promulgated still, by politically minded "Islamists"[207] who seek the infusion of *Shari'ah* as a political-military mandate in the lives of all Muslims – meaning in their personal, commercial, and political lives -- and which is in fact the doctrine pursued by al Qaeda and the other regimes, groups, and individuals supporting *Jihad* against non-Muslims and apostates in one form or another. The question whether the *Shari'ah*-terror link is sufficient to create a legal duty has not been formally decided but no marginally prudent legal adviser can responsibly ignore it. Further, the fact that the duty to disclose arises in the SCF context only after some initial representation about the company's involvement with *Shari'ah* appears to lower whatever threshold question might exist in legal counsel's calculus.[208]

b. *Scienter*

Unlike materiality, which is an element in any type of fraud action, *scienter*, or intent, is a critical element of the common law and of most statutory provisions imposing liability on a wrongdoer, but certainly not all.[209] As classically understood by the common law, a plaintiff's claim for deceit could only survive a motion to dismiss (or its equivalent) if the pleadings properly alleged that the defendant knew of the falsity of the representation and that the false representation was made in an effort to induce reliance by the plaintiff. It is well known that over time, this standard has been relaxed to include not merely false representations but also half-truths. This means that having opened the door to a representation, the putative defendant must be certain to have told the whole truth, or at least, as set out above, the whole material truth.[210]

But the question still remains: Having omitted some important part of the story, and assuming that omission was material, did the defendant withhold the omitted part (a) knowingly and (b) with intent to deceive? Successful civil and criminal fraud litigation is as much about properly alleging *scienter* as it is proving it.[211] Judges will decide the former; jurors are most likely to decide the latter[212], although it is fair to say that a defendant who cannot get a judge to dismiss fraud claims as a matter of law due to faulty allegations is more than likely to settle or, in the criminal world, to accept a plea bargain, so as not to face a jury verdict looking to right a wrong.

Today, fraud claims alleging a failure to disclose might be based upon violations of federal securities laws, state blue sky laws, state consumer protection laws, and other federal and state anti-fraud statutes. While the common law has generally moved away from requiring a specific intent to defraud and toward a standard of recklessness -- and in those jurisdictions which have adopted Section 552 of the *Restatement (Second) Of*

Torts[213] the move has included even negligent misrepresentation -- specific claims under federal or state anti-fraud statutes will vary depending upon the statute, the specific jurisdiction, and whether the action is administrative, civil, or criminal.

For example, under federal securities laws, there are statutes and rules permitting SEC administrative and civil enforcement actions and private causes of action which do not impose a requirement to plead or prove *scienter*. Thus, under the 1933 Act, which has arguably become far more important for those seeking to pursue class action claims[214], Sections 17(a)(2) and (a)(3) are free of any *scienter* requirement for SEC civil actions and to the extent that a private right of action exists, and there is authority for such, the no-*scienter* rule is likely to extend to private plaintiffs.[215] Also, Section 11, which relates to misrepresentations in a registration statement, imposes an absolute liability on the issuer without any reference to *scienter* but does provide for reasonable care defenses as a kind of substitute for *scienter* for other defendants.[216] Section 12(2) imposes liability without reference to *scienter* in public offerings[217] but provides an out for the defendant who can "sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission."[218]

Another serious avenue for enforcement which avoids the *scienter* issue arises under the Investment Advisors Act of 1940 ("Investment Advisors Act"). Fund managers who embrace SCF while ignoring *Shari'ah* as a material part of the disclosure will quite likely face serious scrutiny as the SEC and large city and state institutional investors (i.e., government worker pension funds) come to understand the intimacy between the terms "*Shari'ah*-compliant", "Islamic finance", and even "socially responsible Islamic investing" and the *Shari'ah* witnessed in Iran, Saudi Arabia, and Sudan. Indeed, a SCF investment or business which attempts to disguise the "*Shari'ah*" and utilize a less emotionally charged term has just added to its exposure exponentially since that would certainly be circumstantial evidence that the putative defendants knew of the dangers of *Shari'ah* and sought to minimize them by using a more acceptable public relations-sensitive nomenclature. In other words, the choice to avoid the word *Shari'ah* is likely to be a central evidentiary proof at trial on the issue of *scienter*.

Specifically, investment advisers under the Investment Advisors Act, including those who might otherwise fall within a registration exemption (i.e., the fund manager to an exempt hedge fund or "pooled investment vehicle"), come within its quite broad anti-fraud provisions. Thus, under Rule 206(4)-1:

> a. It shall constitute a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of section 206(4) of the Act for any investment adviser registered or required to be registered under section 203 of the Act, directly or indirectly, to publish, circulate, or distribute any advertisement:
>
> . . .
>
> 5. Which contains any untrue statement of a material fact, or which is otherwise false or misleading.[219]

Rule 206(4)-8, captures the pooled investment fund advisors:

> a. *Prohibition*. It shall constitute a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of section 206(4) of the Act for any investment adviser to a pooled investment vehicle to:
>
>> 1. Make any untrue statement of a material fact or to omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle; or
>>
>> 2. Otherwise engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle.
>
> b. *Definition*. For purposes of this section "pooled investment vehicle" means any investment company as defined in section 3(a) of the Investment Company Act of 1940 or any company that would be an investment company under section 3(a) of that Act but for the exclusion provided from that definition by either section 3(c)(1) or section 3(c)(7) of that Act .[220]

As the Supreme Court made clear in *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 195 (1963), the Investment Advisors Act was meant to safeguard the fiduciary relationship between the advisor and the investor. The nature of the SEC proceeding, the heightened duty of such fiduciaries, and the purposes of the act, eliminate the need to show intent to injure as in common law fraud.[221] The exposure of investment advisors to the claim they have a duty to disclose all of the material facts about *Shari'ah* prior to any investment in a SCF fund, securitization, or company, seems quite substantial, which is further highlighted by the complete lack of attention given the duty and its breach by the SCF industry.

While *scienter*'s common law and statutory roles appear greatly diminished in the contexts discussed above, that is not the case for implied rights of action under Rule 10b-5. It is well documented in the literature and disparate court opinions across the federal circuits that Congress and the Supreme Court have gone a long way to gut both the 1934 Act and the blue sky laws of their private class action fear factor -- in part by requiring strict pleading of all necessary elements including *scienter*.[222] What the attorney representing the financial institution must keep in mind, however, is that the SEC and large institutional private plaintiffs with significant investments at stake will continue to employ Rule 10b-5 and state securities anti-fraud provisions quite effectively. Large institutional investors with huge investment portfolios are less inclined to turn to class actions when they can bring far more manageable private civil claims which carry enough investment clout to make a difference to the defendant.

Moreover, even after the Supreme Court's decision in the oft-cited *Ernst & Ernst v. Hochfelder* case[223], while a Rule 10b-5 allegation will require far more than negligence, it is likely that a reckless disregard for the truth suffices. Furthermore, this is as much about artful pleading as it is about trying to nail down the legal standard. This is especially the case after a financial institution opens the door to a partial but misleading truth.[224] Thus, a financial institution, which recognizes the threshold duty to disclose something about *Shari'ah* and the *Shari'ah* authorities who set the standards for their particular SCF investment or business, must be extremely careful to capture all of the material facts about what *Shari'ah* is, its purposes, and methods. Failure to recognize any extant connection between *Shari'ah* and terror and violence after providing some banal representation about *Shari'ah* as divine Islamic law based on the *Qur'an*, the *Sunna*, and legal rulings of the competent *Shari'ah* authorities, will likely suffice to satisfy the *scienter* requirement at least at the pleadings stage.

Recklessness, especially in a case where a representation was made but without all the requisite material facts, is a notoriously fact-based standard which allows a showing of proof through circumstantial evidence.[225] The case law suggests a "totality of the circumstances" test where a variety of factors come into play to establish recklessness.[226] The specific factors typically cited can be characterized in rubric form to include an analysis which examines: how material the omission was; how available were the omitted facts to the defendant; was there an extant standard of care in the industry giving rise to a duty to disclose the omitted facts; how egregious was the breach; and what were the likely consequences (i.e., benefits to defendant/damages to plaintiff) of not disclosing the material facts. In the case studies presented in Section III below, these questions will be addressed within two fact-specific settings to begin to flush out the liability exposure facing a financial institution which promotes SCF but ignores *Shari'ah*.[227]

Rule 10b-5 is important because it operates as a 'catch-all' anti-fraud statute with an implied private right of action. But beyond Rule 10b-5, there are many state securities laws which require no *scienter* and are broader in their reach than Rule 10b-5. Arizona's blue sky anti-fraud provisions have been given a quite expansive reach to get at all kinds of securities fraud and without the burden of *scienter*.[228] Arizona blue sky laws also permit punitive damages.[229] In addition, at least three states provide for a securities fraud claim under their respective consumer anti-fraud statutes[230], of which two have a private right of action allowing for punitive damages.[231] Furthermore, even a state like California, which does not recognize securities fraud as a cause of action under its very expansive consumer fraud statute, will allow a consumer fraud claim relating to a "holder" of securities where the allegation is of fraud but not in connection with the "sale" or "purchase" of a security.[232] These state consumer fraud actions are devastatingly effective weapons in the hands of a sophisticated plaintiffs' bar against financial institutions treading blindly down the seemingly golden path of SCF.

4. Sedition: *Shari'ah* as the advocacy of the violent overthrow of the U.S. government

Title 18 (the federal criminal code), Section 2385 states:

> §2385. Advocating overthrow of Government
>
> Whoever knowingly or willfully advocates, abets, advises, or teaches the duty, necessity, desirability, or propriety of overthrowing or destroying the government of the United States or the government of any State, Territory, District or Possession thereof, or the government of any political subdivision therein, by force or violence, or by the assassination of any officer of any such government; or
>
> Whoever, with intent to cause the overthrow or destruction of any such government, prints, publishes, edits, issues, circulates, sells, distributes, or publicly displays any written or printed matter advocating, advising, or teaching the duty, necessity, desirability, or propriety of overthrowing or destroying any government in the United States by force or violence, or attempts to do so; or
>
> Whoever organizes or helps or attempts to organize any society, group, or assembly of persons who teach, advocate, or encourage the overthrow or destruction of any such government by force or violence; or becomes or is a member of, or affiliates with, any such society, group, or assembly of persons, knowing the purposes thereof—
>
> Shall be fined under this title or imprisoned not more than twenty years, or both, and shall be ineligible for employment by the United States or any department or agency thereof, for the five years next following his conviction.
>
> If two or more persons conspire to commit any offense named in this section, each shall be fined under this title or imprisoned not more than twenty years, or both, and shall be ineligible for employment by the United States or any department or agency thereof, for the five years next following his conviction.
>
> As used in this section, the terms “organizes” and “organize”, with respect to any society, group, or assembly of persons, include the recruiting of new members, the forming of new units, and the regrouping or expansion of existing clubs, classes, and other units of such society, group, or assembly of persons.

This is the Smith Act of 1940, as amended. The Supreme Court has taken four occasions to review cases prosecuted under the Smith Act. In the first case, *Dennis v. US*, 341 U.S.494 (1951), the Court heard appeals from Communist Party leaders who had been convicted of violating the Smith Act and whose conviction had been affirmed by the lower court. The Court examined the First Amendment and other constitutional challenges, was unpersuaded, upheld the statute as constitutional, and affirmed the convictions.

The second time the Court took a look at the Smith Act was six years later in the case of *Yates v. US*, 354 U.S. 298 (1957). By this time, however, the Court was now under the spell of Chief Justice Earl Warren and the other liberal Justices of the time. They had already tested their mettle in *Brown v. Board of Education*[233] some three years earlier. The question might have been reasonably asked, would the Court sustain a First Amendment challenge and effectively overrule *Dennis*?

The Court delivered its answer by not even addressing the First Amendment issue. What the Court did do was to limit the Smith Act to cases where the advocacy for the overthrow of the government was more than merely theoretical and to require a real nexus between the advocacy and some action that was being urged to achieve the treasonous goal.

In *Scales v. US*, 367 U.S. 203 (1961), the Court took another look at the Smith Act. In this case, the defendant sought to have his conviction for being a member of the Communist Party set aside on statutory, constitutional, and procedural grounds. While the procedural aspects are not relevant to this discussion, the statutory and constitutional parts of the case are. The first argument raised by the defendant-petitioner was based on the claim that another federal statute had been enacted that provided that mere office holding or membership in the Communist Party would not constitute a per se violation of any federal statute.[234] From this, the petitioner concocted the argument that the Smith Act's membership clause had been repealed *pro tanto*. The Court rejected this argument on several grounds but importantly because the Court found that the petitioner's Smith Act conviction was for being a member of an organization which called for the violent overthrow of the U.S. There was nothing unique about the Communist Party except its doctrine for violent overthrow; the Smith Act applied to any organization, not just to the Communist Party.

The petitioner also challenged his Smith Act conviction on *per se* constitutional grounds.[235] The petitioner argued that the membership clause of the Smith Act violated his Fifth and First Amendment rights. The Fifth Amendment claim essentially boiled down to this: Although the trial court instructed the jury that the defendant had to be an "active member" of the criminal group, in accord with the earlier decision in *Yates* which required a nexus between advocacy and action, the trial court did not require that the defendant actually participate in the criminal activity. It was enough that the defendant knew of the criminal designs of the group at large and that the defendant was an active member, even if such activity was wholly legal. As such, the petitioner argued that this violated his Fifth Amendment rights to due process because it convicts a person for mere association and not some overt criminal act. The First Amendment claim was similarly an argument that his right to freedom of association was unconstitutionally infringed by virtue of the threat of criminal prosecution for mere non-criminal membership.

The Court rejected the argument holding as it should have under conspiracy doctrine:

> Any thought that due process puts beyond the reach of the criminal law all individual associational relationships, unless accompanied by the commission of specific acts of criminality, is dispelled by familiar concepts of the law of conspiracy and complicity. While both are commonplace in the landscape of the criminal law, they are not natural features. Rather they are particular legal concepts manifesting the more general principle that society, having the power to punish dangerous behavior, cannot be powerless against those who work to bring about that behavior. The fact that Congress has not resorted to either of these familiar concepts means only that the enquiry here must direct itself to an analysis of the relationship between the fact of membership and the underlying substantive illegal conduct, in order to determine whether that relationship is indeed too tenuous to permit its use as the basis of criminal liability. In this instance it is an organization which engages in criminal activity, and we can perceive no reason why one who actively and knowingly works in the ranks of that organization, intending to contribute to the success of those specifically illegal activities, should be any more immune from prosecution than he to whom the organization has assigned the task of carrying out the substantive criminal act.[236]

Thus, the Court concluded that a Smith Act membership conviction will stand when (a) the defendant knows (b) that the group to which the membership attaches intends criminal purposes and (c) that the defendant's membership evidences a specific intent to promote the criminal goals of the organization (d) even if the defendant's membership and involvement is not itself criminal activity.

In *Noto v. US*, 367 U.S. 290 (1961), the fourth of the Smith Act cases to come before the Court and a companion case to *Scales*, the Court overturned the conviction because it found that the nexus between the theory of violence and the actual call to violence too remote. Quoting from its opinion in *Scales*, the Court explained that the advocacy must be:

> "not of . . . mere abstract doctrine of forcible overthrow, but of action to that end, by the use of language reasonably and ordinarily calculated to incite persons to . . . action" immediately or in the future. *Yates v. United States*, *supra*, at 316. In that case we said:
>
> ". . . The essence of the *Dennis* holding was that indoctrination of a group in preparation for future violent action, as well as exhortation to immediate action, by advocacy found to be directed to 'action for the accomplishment' of forcible overthrow, to violence as 'a rule or principle of action,' and employing 'language of incitement' . . . is not constitutionally protected . . .. This is quite a different thing from the view of the District Court here that mere doctrinal justification of forcible overthrow, if engaged in with intent to accomplish overthrow, is punishable per se under the Smith Act. That sort of advocacy, even though uttered with the hope that it may ultimately

> lead to violent revolution, is too remote from concrete action to be regarded as the kind of indoctrination preparatory to action which was condemned in *Dennis*. As one of the concurring opinions in *Dennis* put it: 'Throughout our decisions there has recurred a distinction between the statement of an idea which may prompt its hearers to take unlawful action, and advocacy that such action be taken.'" *Id*., at 321-322.[237]

Given this judicial backdrop to the language of the Smith Act, the lawyer representing a U.S. company which retains *Shari'ah* authorities must be critically aware of several threatening circumstances. One, if the *Shari'ah* authorities advocate the Law of *Jihad* against the U.S., this advocacy is likely to fall well within the requisites of the Smith Act as refined by the Supreme Court. The rationale for this rests on two prongs. (A) The *Shari'ah* authorities are not mere advocates of theory or theology but authorized religious leaders who have been retained by the U.S. company precisely because their legal rulings and pronouncements are authoritative and respected. Moreover, the call to violence at some point in the future when *Shari'ah*-adherent Muslims have the logistical opportunity to conduct *Jihad* is captured by the Smith Act as the Court explained when it stated that advocacy is an actual call to violence whether it advocates violence "immediately or in the future".[238]

(B) The *Shari'ah* authorities are not speaking as advocates to an empty auditorium but as jurists who issue normative and instructional commands to the members of their group – i.e., *Shari'ah*-adherent Muslims. Further, these *Shari'ah* authorities are chosen because the *Shari'ah* faithful listen and act upon their legal rulings. Thus, the call to violence is very likely to result in violence. Evidence of this direct nexus can be observed in numerous terrorist and violent events which occur immediately after *Shari'ah* authorities issue legal rulings calling for violence. One relatively recent event was the violence over the publication of cartoons in a Danish paper which satirized Mohammed. The cartoons had been public for several months and it was not until certain leading *Shari'ah* authorities called for a "day of outrage" and "worldwide protest" that protests, violence, and murder erupted *en masse*.[239]

Additionally, to the extent that *Shari'ah* authorities are employed by a U.S. corporation to issue legal rulings on *Shari'ah* and, while serving in that capacity, issue rulings which include a call to *Jihad* against the United States, the corporations will not be wise to ignore the threat of criminal exposure. The important case on this point is the Supreme Court's decision in *New York Central v. United States*, 212 U.S. 481 (1909). Federal prosecutors indicted a railroad company based on the conduct of an assistant traffic manager, who paid illegal rebates.[240] While corporations could be liable for breach of civil law duties, prior case law had established there was no criminal liability for corporations because as artifices of the law, they could not have the requisite *mens rea* and be prosecuted. The Court, however, took this opportunity to transport the concept of *respondeat superior* from tort law and import it hook, line, and sinker into the criminal law:

> Applying the principle governing civil liability, we go only a step farther in holding that the act of the agent, while exercising the authority delegated to him to make rates for transportation, may be controlled, in the interest of public policy, by imputing his act to his employer and imposing penalties upon the corporation for which he is acting in the premises.
>
> . . .
>
> . . . [W]e see no good reason why corporations may not be held responsible for and charged with the knowledge and purposes of their agents, acting within the authority conferred upon them. If it were not so, many offenses might go unpunished and acts be committed in violation of law where, as in the present case, the statute requires all persons, corporate or private, to refrain from certain practices, forbidden in the interest of public policy.[241]

One legal commenter has aptly described the legal landscape as it developed after *New York Central*:

> Thus, as the Court announced the dawn of corporate criminal liability in America with an embrace of tort law, it simultaneously signaled to generations of prosecutors that arguments of necessity and public policy would, in the realm of corporate crime at least, carry great sway. Before too long, the expansion augured by *New York Central* swelled further. The influence of public policy arguments is evident in a series of later cases whose facts compelled prosecutors to argue for ever further expansions of liability and constrictions of defenses. While, for example, the *New York Central* decision suggested that criminal liability was appropriate when the misconduct "inured to the benefit of the corporations," later decisions held that no such actual benefit was necessary to find criminal liability. Similarly, there became no limit to how low-ranking an employee could subject the employer to criminal sanction, as courts found that "the corporation may be criminally bound by the acts of subordinate, even menial, employees." In one influential appellate case, the court frankly articulated the pragmatic nature of the rules relating to corporate criminal liability, rooting its considerations firmly in the holding of *New York Central*:
>
>> These results are certainly not startling. They are part of the law of respondeat superior and accepted as established principles in civil tort situations. They are a recognition that law as a useful tool must accommodate pure theoretical logic to the demands of common sense... It is a logical paradox that this creature of the law -- the corporate entity -- is created by law with the power to violate law.

> Thus, there has been even some judicial recognition that corporate criminal law wears the garment of vicarious liability somewhat like an ill-fitting hand-me-down, but significantly, courts have accepted the tradeoffs between legal coherence and crime prevention.[242]

In the matter under discussion, it will be somewhat misguided for legal counsel to argue facilely in defense of their U.S. corporate clients that the *Shari'ah* authorities were employed strictly to issue legal rulings on financial matters and all other rulings fall outside the scope of their employment. Typically, criminal *respondeat superior* applies where the agent (i) committed a crime; (ii) within the scope of employment; and (iii) with intent to benefit the company.[243] Arguably, a crime was committed by advocating violent *Jihad* against the U.S. The problem with legal counsel's defense on the "scope of employment" element is the fact that *Shari'ah* authorities have stated time and again that there is no separation between a ruling on commercial matters and one on *Jihad*. As illustrated by the very software "filters" employed in SCF, the legal rulings on prohibited vice industries are all part and parcel of the undivided whole of *Shari'ah*.[244] This explains the SCF legal ruling by many of the *Shari'ah* authorities that Muslims, including U.S. Muslims, should not invest in U.S. defense industries yet these same *Shari'ah* authorities praise and obligate Muslim investment in weapons for Muslim nations.[245] In other words, the ruling on weapons in the context of SCF is part and parcel of the Law of *Jihad*.[246] Finally, by definition, every legal ruling by a *Shari'ah* authority is for the achievement of Allah's divine law and for the attainment of truth and therefore of benefit to all Muslims including the company's in which they invest.

While it is not necessarily the case that an aberrant ruling by an "extremist" *Shari'ah* authority will be imputed in every case to his employer, it is not a logical stretch to conclude that a company employs a *Shari'ah* authority precisely because his legal rulings are authoritative and because *Shari'ah* is a holistic and integrated legal and normative unit.[247] Thus, a ruling on *Jihad* by a *Shari'ah* authority is no less a part of his role as an internationally renown *Shari'ah* authority and his employment as such than his other rulings on SCF.

Yet another more threatening avenue of liability arises under the Smith Act. To what extent might the U.S. company have criminal exposure for "collective knowledge" of the endogenous elements of *Shari'ah*? Put differently, if *Shari'ah* is universally understood by *Shari'ah* authorities to advocate the destruction, and in some circumstances the violent destruction, of the U.S., are U.S. financial institutions and companies which employ *Shari'ah* authorities, and the lawyers expert in SCF, liable based upon a "willful blindness" and "reckless disregard" of the criminal designs and methodologies of *Shari'ah*? Legal commentators have discussed the notion of corporate "collective knowledge" as an evidentiary basis for a finding of *scienter*:

> Other cases further expanded the prosecutor's ability to charge corporations, while simultaneously constricting such defendants' ability to mount certain arguably legitimate defenses, often explicitly on policy grounds. One legal consequence of vicarious liability was the development

> of the "collective knowledge" doctrine, largely ushered into existence by a federal appellate case, *United States v. Bank of New England*. In that case, the Bank of New England was tried and convicted of a number of violations of the Currency Transaction Reporting Act, while the individual bank employees were acquitted of the charges. In charging the jury, the trial court instructed them that the bank could be found to have had the requisite guilty knowledge either through one of its agents, or through the "aggregate knowledge of its employees." Because the bank was a collective institution, its "knowledge [was] the sum of the knowledge of all of the employees." Thus, the doctrine "aggregates the states of mind of several agents within a corporation" to be attributed to the corporation itself. Consequently, "there is no question that [the collective knowledge doctrine] subjects corporations to criminal liability where there is literally no one in the organization that ever intended to commit a crime."[248]

F. The exogenous elements of SCF: disclosure, due diligence, and other compliance issues

Beyond the duty of disclosure of endogenous elements of *Shari'ah* -- facts which would be material to a reasonable investor who has been told of an investment or business transaction represented to be *Shari'ah*-compliant -- a whole host of other legal issues arise in the context of how SCF is actually structured. Thus, beyond the question of what must be disclosed about *Shari'ah* itself, the "rules and principles" of *Shari'ah* have been fitted to modern finance and business to achieve a product that is represented as *Shari'ah*-compliant. These contemporary structures are exogenous to *Shari'ah* but very much a part of how *Shari'ah* has been manipulated to accommodate modern finance and commerce. These exogenous elements reflect on how *Shari'ah* has been transformed, modeled, and presented in various SCF contexts. How these contemporary structures interrelate with various legal duties and obligations is the focus of this section.

In this analysis, it is important to keep in mind a fundamental principle of SCF and a corollary of that principle. The first is that *Shari'ah* compliance must be judged by one or more *Shari'ah* authorities. It is clear from the literature that a non-Muslim cannot determine what is *Shari'ah*-compliant and further that a Muslim who is not recognized by his peers as a *Shari'ah* authority cannot assume the role of one. The corollary of this principle is that the *Shari'ah* authorities are themselves bound by the community of *Shari'ah* authorities within which they operate. The exact nature of this community or "consensus", both in terms of its theoretical elasticity and it geographic boundaries, is only vaguely articulated in the SCF literature, but the implications of its contours both when adhered to and when breached are quite significant.

1. Disclosure

Thus, the analysis of exogenous structures and factors of SCF begin with disclosure of what it means to represent to the public that a financial institution or business has embraced SCF. Is there a duty to represent to the public what a *Shari'ah* authority is and how any given authority has obtained that status? Is it material to the investment? Is the failure to articulate the risks associated with conflicting SCF rulings from a more authoritative *Shari'ah* authority a disregard of minimal standards of disclosure?[249]

Moreover, is there a duty to disclose to the public whether the *Shari'ah* authorities chosen by a U.S. financial institution have ever issued authoritative rulings on matters that would implicate discrimination or violence against non-Muslims and non-*Shari'ah*-compliant Muslims? Is it important that a financial institution's *Shari'ah* authority relies on the *Shari'ah* rulings of authorities who have called for a worldwide Islamic Caliphate ruled by *Shari'ah*? Further, when the *Shari'ah* authorities rule that investment in a military or weapons industry are forbidden by *Shari'ah*, is it important for the U.S. financial institution to disclose to the reasonable post-9/11 investor whether there is such a *Shari'ah* ban on investments by Muslims in Muslim military industries for weapons to be sold to Muslim regimes?[250]

In this context, the *Nike* case discussed above takes on a whole new dimension. Recall that Nike, an Oregon corporation, was sued in California under its Unfair Competition Law arguing the Nike's public statements in defense of its labor practices abroad were actionable.[251] The California Supreme Court was not inclined to restrict the statute's reach and rejected Nike's argument that its First Amendment Free Speech rights were violated. Nike had argued that the extension of such business fraud statutes to generic discussions by companies that have more to do with social commentary on issues of public importance than promoting the sale of specific goods and services is to effectively deny First Amendment protections to U.S. businesses. In effect, after being attacked publicly in the media and having chosen to open its corporate mouth in its own defense, Nike had invited the lawsuit under California's Draconian consumer fraud statute. The company could have continued to litigate the case for years, attempting to prove that it had spoken truthfully about its offshore labor practices, but it understood that every new twist and turn in the litigation would amount to millions of dollars in bad publicity for a company that spent millions trying to build and maintain its brand.

Instructive is the language the court used:

> The issue here is whether defendant corporation's false statements are commercial or noncommercial speech for purposes of constitutional free speech analysis under the state and federal Constitutions. Resolution of this issue is important because commercial speech receives a lesser degree of constitutional protection than many other forms of expression, and because governments may entirely prohibit commercial speech that is false or misleading.
>
> Because the messages in question were directed by a commercial speaker to a commercial audience, and because they made representations of fact about the speaker's own business operations for the purpose of promoting sales of its products, we conclude that these messages are commercial speech for purposes of applying state laws barring false and misleading

> commercial messages. Because the Court of Appeal concluded otherwise, we will reverse its judgment.
>
> Our holding, based on decisions of the United States Supreme Court, in no way prohibits any business enterprise from speaking out on issues of public importance or from vigorously defending its own labor practices. It means only that when a business enterprise, to promote and defend its sales and profits, makes factual representations about its own products or its own operations, it must speak truthfully. Unlike our dissenting colleagues, we do not consider this a remarkable or intolerable burden to impose on the business community. We emphasize that this lawsuit is still at a preliminary stage, and that whether any false representations were made is a disputed issue that has yet to be resolved.[252]

When U.S. companies tout SCF as "ethical" and "socially responsible investing" or as simply innocuous "interest-free" and "vice-free" investing, does this amount to consumer fraud? In California at least, the groundwork for an affirmative finding has been prepared.

Another exogenous factor has been addressed by the academic and professional SCF literature. A significant focus of SCF publications describes the dearth of competent *Shari'ah* authorities worldwide. This is due to the fact that while *Shari'ah* authorities are apparently available in sufficient numbers to answer the needs of the *Shari'ah*-adherent communities worldwide[253], there is a major shortage of these authorities who are sufficiently versed in modern finance and commerce and with a working knowledge of English to handle the international documentation which invariably are drafted with an eye towards institutions working out of London or New York. Insofar as there are only approximately 20-25 sufficiently trained *Shari'ah* authorities, each of these exclusive club members sits on dozens of the *Shari'ah* supervisory boards around the world. The result is a small clique which advises the lion's share of competing financial institutions on how to develop new SCF products and transaction structures.[254]

The legal advisor must evaluate the disclosure issues given the fact that a *Shari'ah* authority's rulings and artful craftsmanship in finding new transactional structures to avoid *Shari'ah* prohibitions might very well differ from one institutional client to another given the relative financial remuneration. Furthermore, are there issues that ought to be disclosed to a reasonable investor relating to confidentiality and the systems put in place to protect confidentiality? What duty of care do the *Shari'ah* authorities owe the financial institutions? Are they considered experts for purposes of the 1933 Act? Do they participate in writing the portions of the registration statement or prospectus that deals with *Shari'ah*?

In all of these areas, and more, the materiality and *scienter* issues discussed above will play into the calculus for the legal advisor as the examination of these and other exogenous elements unfold. An additional facet of the disclosure complex, especially as it relates to the *scienter* standard of recklessness, is the implication for the financial institutions and their professional advisors of a duty to conduct a reasonable due diligence to make certain that what they have said about SCF is the whole of the material truth.

2. Due diligence

The articulation of a breach of duty to disclose is closely related to the duty to exercise reasonable due diligence as either an element of *scienter* or a defense where *scienter* is not at issue. For example, under the 1933 Act, Sections 11 and 12(a)(2) provide for a due diligence defense for certain defendants who have failed to disclose all relevant material facts.[255] The case law and literature on these defenses is extensive and legal counsel for any financial institution will have to consider long and hard the implications of ignoring the exogenous structures set up for a *Shari'ah*-compliant investment or business. At the very least, each of the exogenous disclosure issues should be the subject of a carefully prepared legal opinion. Failure to rely on expert legal opinion will likely expose the financial institution and its management to far greater liability insofar as failure to do so might rise to the level of a reckless breach of the duty of care expected in the industry. The duty to rely on a formal legal opinion intimates the lawyer's exposure to liability for failure to conduct a reasonably competent investigation. In the case studies presented in Section III below, this memorandum begins to pry open these issues for further discussion among legal scholars and professionals.

3. Other compliance issues

a. Global security risks: revisited

But the due diligence requirements implied in the *scienter* element of many types of fraud actions and provided expressly as defenses under securities laws are only one component of the due diligence analysis pertinent to the question of civil and criminal liability for SCF. In the main, the effort to combat the global security risks associated with Islamic terror networks and the regimes which support those networks has incorporated many strategies, only some of which are appropriately suited to the task at hand. One approach is through trade sanctions and embargoes. These foreign policy initiatives are authorized by such laws as the Trading with the Enemy Act ("TWEA")[256] and the International Emergency Economic Powers Act ("IEEPA"),[257] which authorize the Office of Foreign Assets Control ("OFAC") of the Treasury Department to establish sanction regimes on states identified by the president as falling within the jurisdictional reach of either of the two laws.[258]

The Halliburton affair described above, which began as a seemingly innocuous inquiry by the New York City Comptroller on behalf of some shareholders into disclosure requirements of an annual proxy statement soon spiraled out of control. After Halliburton was forced to report to its shareholders on the financial and reputational risks of doing business in a terror-sponsoring state, the Comptroller was still quite unsatisfied and considered the company's disclosures inadequate. Soon thereafter, OFAC got involved and as the investigation progressed, OFAC referred the matter to the DOJ which initiated a grand jury investigation.[259] Other companies doing business in terror-sponsoring states have also run into trouble.[260] While the implications for financial institutions relying on *Shari'ah* authorities associated with or sympathetic to terrorists do not touch upon TWEA or IEEPA compliance per se, the duty of disclosure of material facts under the compliance regimes discussed above remains and the ramifications of yet other compliance issues as discussed below are significant.

i. Reverse money laundering: revisited

Another approach to the global security risk of Islamic terrorism has been through the strengthening of anti-money laundering laws and regulations. The "heavy lifting" of this effort of late has been accomplished by the Patriot Act and its amendments to the Bank Secrecy Act ("BSA")[261] and the anti-money laundering statutes.[262] But with all of the fanfare and political disputation surrounding this legislation by civil libertarians, civil rights activists, and various Muslim organizations,[263] the latter of which have argued the government's effort is unduly focused on *Islamic* terrorism, the legislation still fails to grapple effectively with the problem of money laundering in support of terrorism. Almost all of the BSA and the regulations promulgated thereunder and the anti-money laundering statutes come at the problem of terrorist financing in the traditional way, notwithstanding a dangerous new *modus operandi*. The BSA and anti-money laundering statutes are intensely focused on spotting and reporting suspicious money transfers, especially cash transfers, which have a criminal source.[264]

This approach to battling the funding of terrorism fits the traditional approach to anti-money laundering efforts which looks for money from illegal activities such as drugs and gambling, typically in the form of cash, and its laundering into clean money invested in legitimate businesses. As long as the effort is "following the money" in the form of cash from its entry and first appearance in the regulated and reporting financial system (what the experts call "placement")[265] as it winds its way to some ultimate destination, the system works at least moderately well, although most experts will admit it both misses large sums and suffers from over-reporting of perfectly legitimate cash transactions.[266] Much of the modern-day terror financing, however, is conducted through what has been termed "reverse money laundering".

This stands the classic model on its head where perfectly legitimate funds are wired or transferred to U.S. domestic charities and organizations and then to overseas charities and organizations, or sometimes just directly overseas. These transactions are very difficult to spot unless government regulators already have the specific charities and organizations in question under surveillance.[267] This kind of pro-active or prophylactic surveillance necessarily runs into all kinds of privacy and constitutional thickets. Assuming the federal government does not have sufficient evidence for a probable cause or FISA warrant[268], targeting Muslim charities would at the very least be roundly protested as racial profiling irrespective of the actual legal or constitutional infirmities of the practice.[269] As a result, while administrative "blocking orders" promulgated under the authority of the IEEPA have been an effective tool in disrupting and shutting down of the largest and most dangerous of Muslim charities funding terrorism,[270] prosecutions of terror-financing operating through charities have met with mixed results.[271]

This problem raises its ugly head with SCF in two ways. One way, although it does not yet appear to be the norm in the U.S., is through a charitable contribution made at source by a SCF financial institution or business. This would occur because faithful Muslims must gift a certain percentage of their income to charity. It appears that in the Middle East and Malaysia, SCF companies, banks, and investment funds might actually calculate the amount the individual Muslim investors owe from profits and distribute those funds automatically to Islamic *Shari'ah*-approved charities and only then would the net, after-*Shari'ah*-charitable-tax profits be distributed to the individual investor. In the U.S., although many of the reporting companies and mutual funds involved in SCF are unclear about this service, most appear to allow the individual investor to calculate and make his or her own charitable contribution.[272]

Several questions arise for those SCF businesses and investments which net the returns to the investor after this charitable payment: Which charities are *Shari'ah*-compliant? Who makes this determination? Do the businesses or financial institutions direct these contributions or are these decisions made by the *Shari'ah* authorities? Is there any vetting of the recipients of these charities to determine what they do with these funds? Why is this process not transparent?

A second form of this problem arises when some of the gross income of a business is from *Shari'ah* prohibited sources. This can occur in several ways but typically in two: The first is via what one might term the exceptional event when the *Shari'ah* "filter" misses some tainted source of income altogether. This might happen when a *Shari'ah*-compliant company in a *Shari'ah*-compliant mutual fund acquires a forbidden company, the main business of which is in a forbidden industry such as finance or hog farming. Assuming the acquired company's forbidden assets are not *de minimus*, this renders the parent company in the mutual fund's portfolio *Shari'ah*-prohibited and the equity position in that company must be sold. The proceeds of that sale will include a certain amount of profits attributed to the forbidden assets. That amount must be calculated and "purified".[273]

The second occasion for purification is more typical. For example, a mutual fund is permitted to invest routinely in companies which earn up to a fixed percentage of their income from interest. Notwithstanding this leniency, any profits to the mutual fund attributed from this forbidden income must be "purified" at some point.[274]

Because the calculation of this purification can be complex, most *Shari'ah* authorities either insist or prefer that the purification take place by the SCF institution so the *Shari'ah* authorities will have the opportunity to properly assess the amount needed to be purified and supervise the logistics.[275]

As in the charitable contribution discussion, this purification process is typically not fully disclosed in public filings of U.S. SCF financial institutions. The questions raised above about disclosure for the general charitable tax apply here *mutatis mutandis*. But since most *Shari'ah* authorities have ruled that it is more appropriate to have the purification process carried out by the SCF company rather than at the individual investor level, one might reasonably assume that this is the general rule.[276]

In both instances, the legal advisor to the SCF financial institution or business must be very careful about how these charitable contributions are made and who the beneficiaries of these funds are. Given the history of Islamic charities funneling contributions to terrorist organizations directly and indirectly through other charitable organizations in a laundering process, the anti-money laundering laws must be analyzed carefully by the attorney to be certain that the financial institution is not facilitating a criminal violation and that there is strict compliance with all reporting requirements.

The principal anti-money laundering statutes are Title 18, Sections 1956 and 1957. As indicated above, the focus of these statutes is on criminalizing the movement of funds from unlawful activity. As such, it has a limited application to the issue of charitable contributions directed by *Shari'ah* authorities related to a given SCF financial institution. The legal advisor, however, must take the following into consideration in proffering his advice. Section 1956(a)(2) criminalizes the following:

> (2) Whoever transports, transmits, or transfers, or attempts to transport, transmit, or transfer a monetary instrument or funds from a place in the United States to or through a place outside the United States or to a place in the United States from or through a place outside the United States—
>
> > (A) with the intent to promote the carrying on of specified unlawful activity; . . ..[277]

Two issues stand out. One, a purely domestic transfer of legal funds with the requisite criminal intent is not a per se violation. Arguably, if a domestic transfer took place but with the understanding that the funds would at least in part find their way overseas as part of the criminal intent, such a transfer would, it seems, be prohibited. Thus, a U.S. financial institution might very well run afoul of this provision when it "purifies" its forbidden assets by transferring funds to a terrorist-supporting charity overseas or possibly even to a domestic charity as a conduit to problematic overseas groups.

The second issue is intent. The statute requires that the defendant have the intent to move the funds to promote one of the illegal activities enumerated. Terrorism is one of those criminal activities set out in Section 1956(c)(7). The lawyer representing a financial institution contemplating "purification" must consider the possibility that the charitable gift might be going to a charity with intimate connections to terrorists.[278] In this context, the first question confronting the prudent legal counsel is who directs the funds to the charitable contribution? Are the charities or universe of acceptable charities chosen by the *Shari'ah* authorities? Is this decision binding on the financial institution? The issue here is quite obvious. If the financial institution places this decision-making authority into the hands of the *Shari'ah* authorities it has retained, it is quite possible that any criminal “intent” or “purposes” connecting the *Shari’ah* authorities to these charities will be considered the financial institution’s. The criminal culpability in this case is not unlike that which was described above in the discussion of the Smith Act.

While many financial institutions involved in SCF attempt to distance themselves from the *Shari’ah* authorities[279], the question for the lawyer weighing in on these issues is who made the decision about which charities would be considered *Shari’ah*-complaint and thus recipients for the “purification” of funds. Moreover, if it turns out these charities have ties to terrorists or are implicated in the material support of terrorism, was this fact known[280] to any agent of the company?

Quite obviously, the criminal exposure arising from the “purification” process might lead the responsible legal counsel to ask the following questions about any list of potential charities: Are these well-known non-Muslim charities? If they are Muslim charities, have they been vetted and by whom? The three largest Muslim charities in the U.S. have all been implicated in financing terror and subject to administrative blocking orders wherein their assets were frozen and they were effectively shut down.[281]

The practice of Muslim charities funneling money to terrorists is so widespread and the problem so insidious the federal government keeps an updated list and brief on the dozens of such organization world wide.[282] But, it will not suffice for the legal advisor to simply determine that the charities are “well-known” Muslim charities and not currently listed as designated supporters of terrorism. At a minimum, the following queries would need to be undertaken: Who are the ultimate beneficiaries of the contributions? In other words, who or what is the ultimate recipient of the charities’ “good deeds”? Do these charities have overseas branches? Is the financial institution wiring the funds domestically or internationally? Who or what organization founded the organizations and who controls them today?

Once these questions are asked and answered with sufficient clarity, the legal advisor will need to be careful that what ever policies are put in place to avoid criminal exposure under Sections 1956 and 1957, the client continues to monitor these “charitable contributions” carefully.[283]

ii. Material support of terrorism and related civil exposure

The material support of terrorism is a federal crime under 18 U.S.C. §§2339 (A) and (B). The Intelligence Reform and Terrorism Prevention Act of 2004[284] amended the definition of “material support” to include:

> (1) the term “material support or resources” means any property, tangible or intangible, or service, including currency or monetary instruments or financial securities, financial services, lodging, training, expert advice or assistance, safehouses, false documentation or identification, communications equipment, facilities, weapons, lethal substances,

> explosives, personnel (one or more individuals who may be or include oneself), and transportation, except medicine or religious materials;
>
> (2) the term "training" means instruction or teaching designed to impart a specific skill, as opposed to general knowledge; and
>
> (3) the term "expert advice or assistance" means advice or assistance derived from scientific, technical or other specialized knowledge.[285]

A *Shari'ah* authority issuing, promoting or advocating a legal ruling for *Jihad* to anyone for the purpose of conducting terrorism would quite clearly fall within the definition of "expert advice" "derived from . . . specialized knowledge". In addition, a New York federal district court has concluded that an attorney that passed along a legal ruling calling for *Jihad* had provided "material support" in the form of "personnel" as part of a terror-laden conspiracy. In *U.S. v. Satter*[286], the court upheld attorney Lynne Stewart's conviction for violating Section 2339(A) by merely passing along a *fatwa* or legal ruling regarding *Jihad* issued by her client, Sheikh Omar Abdel Rahman, to terrorists in Egypt who respected his authority in matters of *Shari'ah*. The court concluded that passing along a legal ruling was like providing "personnel" to the co-conspirators and amounted to material support.[287]

A U.S. company that promotes the legal rulings of a *Shari'ah* authority who is known for issuing such rulings on the Law of *Jihad* could risk extraordinary criminal exposure. While it is not likely that the company would promote the actual rulings relative to *Jihad* or do so with the actual intent to cause violence, this will not be the standard. The question will be what role does the *Shari'ah* authority occupy within the company or what relationship does he have to the company if he is an "outside advisor". To the extent that criminal *respondeat superior* implicates the corporate entity in the *Shari'ah* authority's *scienter*, a defense built upon lack of knowledge by the board of directors will not likely be effective. And, the fact that such legal rulings are published in broad daylight and available from English open sources will render the corporation's plea of lack of intent all the more unavailing to the extent it rises to the level of "willful blindness" or "recklessness".

Additional areas of criminal and civil liability exposure relate to the anti-money laundering statutes. To the extent that any "purification" funds move from the financial institution to a charity and these funds are found to support the terrorist activities, there is the additional criminal exposure under Sections 2339(A) and (B). Both of these statutes forbid the provision of material support for terrorism. The distinction between the two statutes is important. Section 2339(A) requires a showing that the defendant provided support knowing its intended purposes. Under Section 2339(B), the defendant need only know of the status of the target organization as a terrorist organization and need not know or intend that the material support is going to support terrorism.[288] The discussion above regarding corporate criminal exposure for the intent of the company's agents quite obviously applies here as well and must be considered by legal counsel.

In addition to criminal exposure, to the extent that a U.S. financial institution can be criminally linked to terrorist organizations as a result of the "purification" funds or indeed via other "material support" relationships between the *Shari'ah* authorities and the terrorists, additional statutes provide civil exposure to victims of such violence, even if the violence occurs outside the jurisdiction of the U.S. The most important of these statutes is Title 18, Section 2333, which provides for civil remedies and treble damages for any U.S. national injured by terrorists. In several circuits, federal courts have allowed private rights of action under this statute against defendants who have "aided and abetted" the offending terrorists by violating Sections 2339(A) and (B).[289]

Beyond the civil exposure in Section 2333, there is a strong argument to be made that the Alien Tort Statute ("ATS")[290] exposes companies linked criminally to terrorism to enormous civil liabilities. It is one thing to be sued by U.S. nationals for damages caused by terrorism; but the potential for mass litigation by foreigners for such damages is enormous. Once the criminal connection is made through the anti-money laundering or the material support of terrorism statutes, it is a certainty the plaintiffs' bar would then artfully allege that terrorism is a violation of some norm of the law of nations that is "specific, universal, and obligatory" and that there is a proximate cause between the "material support of terrorism" alleged and the injuries suffered.[291]

b. Antitrust

Another area of civil liability exposure related to the exogenous structure imposed by the need for *Shari'ah* authority boards arises under antitrust law. As noted above, at present approximately two dozen *Shari'ah* authorities monopolize the positions available on the *Shari'ah* authority boards of the major *Shari'ah*-compliant financial institutions worldwide. There has been a concerted effort among these *Shari'ah* authorities to impose universal standards to prevent materially divergent opinions. This effort has been spearheaded by the Accounting and Auditing Organization for Islamic Financial Institutions ("AAOIFI") and the Islamic Financial Services Board ("IFSB"), the former of which seeks to establish accounting standards for the various transactional structures and the latter to set the standards by which *Shari'ah* authorities self-regulate and interact with the financial institutions which employ them.[292]

The stated goals of the IFSB include:

> 110. Although inevitably nowadays a small number of *Sharī'ah* scholars have been providing their services globally, the current practice is considered far from professional because of some serious inadequacies, whereby in most jurisdictions:
>
> (i) the criteria for recognizing a person as a qualified *Sharī'ah* scholar is still vague; and
>
> (ii) the means of checking the legality, credibility and validity of a Sharī`ah ruling are still uncertain.
>
> Considering the juristic nature of *Sharī'ah* rulings and the legal implications they would have for the validity of contracts entered

into by IIFS [SCF financial institution], the ultimate test for their legitimacy should be the admission of such rulings into a credible court of law. The IFSB notices that, for some IIFS, the *fatāwā* have legal force by virtue of the IIFS's constitution or statutes. However, in other cases, they do not; thus, from a legal point of view, the IIFS are not bound to follow the *fatāwā*. Accordingly, an IIFS must not enter into a contract which is not *Sharī'ah* compliant.

111. Certain countries have a central SSB [*Sharī'ah* Supervisory Board], recognized by the regulatory and supervisory bodies, to issue binding *fatāwā*. Nevertheless, so far, there is little evidence of the adoption of *Sharī'ah* rulings by a credible court of law in resolving Islamic finance disputes. Even if there are some instances, more records of these are needed to ensure that the system is running smoothly and with reliable credibility.

112. We cannot set aside the idea that, in order to propel the *Sharī'ah* compliance framework of IIFS to a higher level, it may be preferable to have a professional organization or an industry association that will set professional standards for *Sharī'ah* scholars serving the Islamic financial services industry. Such a professional association might look after the interests of membership, and promote understanding and exchange through publications and regular forums. It could also establish relationships with relevant academic, commercial and professional bodies. The Islamic financial services industry appears to have matured to the point where such an association, which lay down a transparent and accountable structure for *Sharī'ah* advisory services, would be of great value to everyone involved, whether as industry players or as consumers.[293]

Thus, according to the IFSB and the independent writings of many of the *Shari'ah* authorities, there are designs to establish industry-wide minimal credentials a newcomer would be required to obtain to enter this apparently lucrative consulting business. The initial antitrust issue raised by such efforts is the problem of "group boycotts" or the implications of "self-regulation" for a small, discreet and insular group of authorities who have almost total market share deciding how one gains entry into the market.[294] Applying the standard "rule of reason", courts will look to the motivations and anti-competitive effects of such "industry standards."[295]

This is especially problematic in SCF because should a non-recognized *Shari'ah* authority attempt to market his services to the financial institutions seeking *Shari'ah* guidance, a ruling by the existing *Shari'ah* authorities that the newcomer has not satisfied their credentialing requirements would render the market closed to that newcomer as a practical matter. This is the case because financial institutions who market SCF products to the *Shari'ah*-adherent consumer are extraordinarily sensitive to the problem that public disputes among the *Shari'ah* authorities over what is permitted or prohibited could devastate both the demand for SCF products generally and certainly render any given SCF product suspect.[296]

The problem of "self-regulation" would become an issue for the financial institutions if they play some material part in this effort to control entry into the market by newcomers in a *de jure* or *de facto* collusion with the dominant group.[297] Another problem, however, which does implicate liability for the financial institutions directly, is what has been described as "rules collusion"[298]. Here, the effort by the financial institutions and their agents, the *Shari'ah* authorities, to agree upon what transaction structures and investments should be considered "*Shari'ah*-compliant", will most assuredly work to limit the development of new competitive products by the market players. This, in turn, will make it more difficult for the consumer to distinguish between SCF products, and raise the cost of searching for newer, innovative SCF products -- thereby shaping and softening competition among cartel members in order to increase the profits of the parties to the agreement.[299] The fact that such a financial market is predicated upon a consensus of the market's private rules advisors suggests that SCF within the financial industry presents substantial antitrust liability exposure.

c. Banks and consumer loans

Regulated commercial banks and private lenders have recognized the SCF market and have made significant inroads establishing this new industry. At least one U.S. commercial bank has attempted to design a *Shari'ah*-compliant depository account.[300] The unique feature of this kind of account for it to comply with contemporary *Shari'ah* rulings is that it must be "at risk" as an equity investment and not viewed as a guaranteed deposit with interest income. Although a U.K. bank has developed a regulatory work-around[301], so far U.S. regulators have not permitted such accounts although one community bank in Illinois advertises a *Shari'ah*-compliant "profit-sharing deposit account" which purportedly does not earn interest but rather a share of the bank's profits. It apparently received an exemption from some *Shari'ah* authority because the bank guarantees the principal of the deposit as is required by U.S. banking laws but such "no risk" guarantees are typically considered forbidden according to *Shari'ah*.[302]

Another impediment for commercial banks entering this market, however, does appear to have been overcome. In a typical SCF home mortgage transaction, the lender purchases the property and either resells it immediately to the borrower at a stepped-up price to be paid out over time (i.e., a cost-plus sale) or leases it back to the borrower through a sale-lease back arrangement. The problem for commercial banks in these transactions is that U.S. law does not allow banks to own real estate except in limited circumstances, such as the bank's own offices or property acquired through foreclosures on bad loans.[303] Two banks have received approval from the Office of the Comptroller of Currency ("OCC") for such SCF transactions.[304] The rationale for the approvals was a substance-over-form analysis. Since these mortgage products were in fact disguised loans with interest and the real estate was only owned for a limited purpose, the Comptroller did not see these *Shari'ah*-compliant mortgages as a violation of the prohibition against owning real estate.

The OCC also granted one of the banks approval to use the cost-plus sale transaction structure to accommodate construction loans and other consumer loans.[305]

While the Comptroller was focused on the real estate-banking regulations, one area missed in the analysis and which the attorney for any lender must pay special care to address is compliance with all of the various consumer anti-fraud statutes. The statutes implicated in traditional bank lending are found in TILA, the Lanham Act, and many of the anti-fraud statutes referenced above.

For example, commercial banks and other lenders must comply with TILA[306] and its complex Regulation Z.[307] TILA prohibits specific types of misrepresentations or misleading omissions in advertising.[308] TILA's provisions require lenders to make standardized disclosures whenever other price terms are advertised. For example, any advertisement that states an interest rate must state the annual percentage rate ("APR").[309] An oral response to consumer inquires about closed-end loans, however, may only state the APR.[310] Advertisements quoting a down payment by percentage or amount; the amount of any monthly loan payment or finance charge; the number of payments; or the period of repayment must also state the APR, the terms of repayment, and the amount or percentage of any down payment.[311]

The problem lenders have is that they are marketing the SCF products as interest-free and therefore *Shari'ah*-compliant.[312] In fact, and as scrutinized by the OCC and likely by the IRS and state tax authorities[313], these various interest-free transactions are merely disguised loans. In other words, the banks are treating these products and representing them to the government authorities as conventional loans with interest income while marketing them to the public as interest-free *Shari'ah*-compliant non-loan transactions.[314]

At the very least, full disclosure requires these banks to indicate that the loans are not interest-free and to fully disclose in all of their advertising the true annual percentage rate ("APR"). This would require an explanation that while a loan might be considered "riba-free" for *Shari'ah* purposes, it is considered a standard loan with interest for all secular legal purposes because that is what it is. Unfortunately, even this might not be true. For example, it is not clear at all how a bankruptcy court would treat the transaction. Much would depend on whether the debtor was in bankruptcy or the lender. How the lender's attorney navigates these issues in print advertisements and on the Internet will likely come to a regulator's or court's attention.[315]

An additional concern for *Shari'ah*-compliant consumer loans is that they are typically more costly than conventional loans. This is true because of the machinations inherent in the transactional documents and because much of the documentation must be duplicated – one set to track *Shari'ah* compliance and one set to track government regulations. In addition, *Shari'ah* supervision adds a cost in most cases as do some extra taxes attributed to the transfer of title as required by *Shari'ah*.[316] Because these consumer loans are marketed to a specific minority community with a unique cultural affinity to *Shari'ah*, and because the added costs of these loans have no economic value per se, it is quite possible that the marketing of these products will fall within the scope of the antipredatory loan laws, such as the Home Ownership and Equity Protection Act ("HOEPA")[317] or the state versions of HOEPA which are typically more aggressive and have lower thresholds for offending predatory high-cost loans.[318]

III. Two Brief Case Studies:

Legal analysis is fact-specific. To crystallize just some of the issues raised in this memorandum, two brief case studies follow. While neither will be considered exhaustive, they will deal with the major issues raised by the public filings and other open source information available. As in most cases, the attorney for the business client engaging in SCF will have access to confidential, privileged, or non-public information which might change materially the analysis. But what is often the case, the most important material for assessing a prima facie case of civil or criminal liability is that which has been disclosed to the public. The relevant information kept from the public tends to be inculpatory rather than exculpatory.

A. Caribou Coffee

1. Factual background

Caribou Coffee ("Caribou") began as the dream of John and Kim Puckett, a young couple on a backpacking trip to Alaska. They wanted to change their life around and decided upon a new start-up venture: a coffee cafe chain envisioned as a competitor to the industry giant, Starbucks. In 1992, they opened up their first store in Minneapolis with an initial investment of $50,000.[319] By December 2000, the upstart chain had raised $40 million through several private investment rounds and had opened 149 stores in a half-dozen markets, a distant second to Starbucks' more than 3,000 stores. But poor management systems, board issues and a host of other problems prevented the company from exploiting the market and raising capital for further expansion. The company needed money badly; the investors were not going to invest further; and they were even threatening to exercise their put options to get their money back with interest.[320]

By the end of the year, the Pucketts had arranged for an exit strategy, agreeing to sell approximately 84% of Caribou Coffee to an Atlanta, Georgia based company called Crescent Capital Investments, Inc. ("Crescent"), for a price tag of approximately $84 million.[321] Crescent was owned by a Bahrain-based investment bank called First Islamic Investment Bank, which was funded by mostly wealthy Arab investors from the GCC states.[322]

Over the next five years, with the added capital, Caribou grew substantially and by July 2005 was operating 337 coffeehouses. Notwithstanding the company's continued operating losses, the time apparently was ripe for a public offering to raise an additional $90 million from the U.S. investing public. In July 2005, the company's lawyers and accountants began the registration process under the 1933 Act for an initial public offering.[323]

One of the issues the lawyers for Caribou confronted was if and how to disclose the fact that its principal shareholder, Crescent and its parent First Islamic Investment Bank, which had changed their names to Arcapita Inc. and Arcapita Bank B.S.C.(c)[324], respectively, were *Shari'ah* observant and required that Caribou also operate its business according to *Shari'ah*. Ostensibly, this would have implications at the very least on what risks arose out of the prohibitions which precluded the company from incurring interest-based debt; limited the kinds of foods it could serve its customers; and forbade it to utilize traditional yet speculative hedging strategies to guard against the future price increases for its principal commodity, coffee.

But the problem with which the attorneys had to wrestle did not end there. Three years earlier in 2002, a public relations firestorm erupted forcing Caribou Coffee to respond publicly to accusations that it had aligned itself with a supporter of terrorism. [325] In July of 2002 an Internet-based campaign began accusing Caribou Coffee and its principal shareholder of being associating with and employing a *Shari'ah* authority named Yusuf Al-Qaradawi, who was well known for his statements in favor of *Jihad*, including suicide-homicide attacks against Israeli citizens by Palestinian terrorists and legal rulings supporting the *Jihad* carried out by Hamas and Hizballah against Israel.[326]

At the time, both Hamas and Hizballah were designated as "Foreign Terrorist Organizations" ("FTO") in the "2001 Report on Foreign Terrorist Organizations released by the State Department's Office of the Coordinator for Counterterrorism."[327] This designation effectively criminalizes any person or organization which provides material support to the FTO. A flurry of main stream media stories appeared and Caribou Coffee was inundated with bad press and angry customers, including talk of a boycott by some Jewish groups.[328] Apparently, Arcapita had retained a *Shari'ah* advisory board and the head of the advisory board was Qaradawi. After weathering the storm for several months, Arcapita severed its relationship with Qaradawi stating that Qaradawi had resigned.[329]

Another ramification of this affair was an accusation that Arcapita was funneling charitable contributions, presumably from its *Shari'ah* charitable tax contributions or its purification of forbidden profits, to terrorist organizations with connections to Qaradawi. When the Jewish Community Relations Council of Minnesota and the Dakotas heard about the possible connection between Caribou and Qaradawi, they initiated an investigation and the Minneapolis-based company cooperated. According to local media, Caribou and its Bahrain-based majority shareholder even offered to allow the Jewish community organization to investigate all of the company's charitable donations. According to the story, Arcapita hired the well-known law firm of Gibson, Dunn & Crutcher to certify that no charitable contributions were transferred to groups banned under U.S. law. According to news reports, that certification was made.[330]

In the first draft of the registration statement filed with the SEC pursuant to the 1933 Act in preparation for its initial public offering seeking to raise $90 million, the company lawyers settled on the following disclosures[331]:

> [Under the "Risk Factors" rubric beginning:] **Arcapita will continue to have substantial control over us after this offering, ...**
>
> . . .
>
> **Our compliance with *Shari'ah*h principles may make it difficult for us to obtain financing and may limit the products we sell.**
>
> Our majority shareholder operates its business and makes its investments in a manner consistent with the body of Islamic principles known as *Shari'ah*h. Consequently, we operate our business in a manner that is consistent with *Shari'ah*h principles and will continue to do so for so long as Arcapita is a significant shareholder. *Shari'ah*h principles regarding the lending and borrowing of money are complicated, requiring application of qualitative and quantitative standards. The negotiation and documentation of financing that is compliant with these principles are generally complex and time consuming. As such, if we have immediate liquidity needs, we may not be able to obtain financing that is compliant with *Shari'ah*h principles on a timely basis. A *Shari'ah*h-compliant company is prohibited from engaging in derivative hedging transactions such as interest rate swaps or futures, forward options or other instruments designed to hedge against changes in interest rates or the price of commodities we purchase. Also, a *Shari'ah*h-compliant company is prohibited from dealing in the areas of alcohol, gambling, pornography, pork and pork-related products.
>
> **We may be subject to adverse publicity resulting from alleged statements about Arcapita or complaints or questions from our customers arising from such adverse publicity.**
>
> During 2002, we were subject to adverse publicity due to attempts to connect Arcapita with inflammatory and controversial statements made by one of its former outside advisors, in his individual capacity, regarding a variety of subjects, including events in the Middle East. We may be subject to similar adverse publicity in the future. Even if unfounded, such adverse publicity could divert our management's time and attention and adversely affect the way our customers perceive us, our net sales or results of operations, in the aggregate or at individual coffeehouses, or the market price for shares of our common stock.[332]

No other disclosures were made relating to SCF other than some basic disclosures of the company's sale-lease back financing arrangements which were treated as capital leases as required by generally accepted accounting procedures ("GAAP").[333] The SEC commented on the recitation of the 2002 affair in the registration statement requesting the following: "Please tell us, with a view to disclosure, more background about the statements, such as describe the statements made and identify who made them. Also revise the risk factor to clarify the risk."[334]

Caribou filed its first amended draft of the registration statement on August 15, 2005. While there is no change to the description of the 2002 affair, some additional risks are disclosed relative to financing:

> . . . We may, however, enter into a new lease financing arrangement or other financing arrangement or amend our current lease financing arrangement to provide us with additional liquidity. We expect that any such financing arrangement would be structured in a manner that would be compliant with *Shari'ah*h principles. *Shari'ah*h principles regarding the lending and borrowing of money are complicated, requiring application of qualitative and quantitative standards. The negotiation and documentation of financing that is compliant with these principles are generally complex and time consuming. As such, if we have immediate liquidity needs, we may not be able to obtain financing that is compliant with *Shari'ah*h principles on a timely basis.[335]

The SEC commented on the first amended registration statement by asking for some additional clarity on the "disclosure concerning the majority shareholder to briefly discuss the shareholder and compliance with Shari`ah principles."[336] Notwithstanding the written comments by the SEC, no material changes regarding *Shari'ah* or the 2002 affair were made to any of the subsequent four amendments to the registration statement or to the final prospectus.[337] No changes to these disclosures have been made in any of the interim filings through the last Form 10-K annual report.[338]

A cursory examination of the civil liability and criminal exposure issues confronting Caribou suggests that the company and its legal counsel opted to bury the *Shari'ah* black box and to ignore what it knows or most certainly should have known are the facts that require at the very least some further due diligence on their part and fuller disclosure.

2. Analysis

To begin, to the extent that the examination in this memorandum of the civil liability and criminal exposure issues surrounding the endogenous and exogenous elements of *Shari'ah* and SCF, respectively, are valid, this memorandum would expect to find implications for both in specific examples. Caribou certainly fits. A U.S. retail chain of coffeehouses is principally owned and operated by investors from the GCC states. These investors have organized themselves as an investment bank in Bahrain and incorporated a subsidiary in the U.S. The financial structure of this company with numerous off-shore entities is complex and convoluted utilizing literally dozens of Cayman Island offshore entities to hold the stock of Caribou. The parent company adheres to *Shari'ah* and to be certain of this has retained a *Shari'ah* advisory board. The *Shari'ah* rulings of this advisory board control not just the parent company but also the operations of the retail chain.

The former chairman of the *Shari'ah* advisory board was forced to resign following the public exposure of his open support of Palestinian and Lebanese Islamic terrorist groups. The accusations of funneling charitable contributions from the principal shareholder's profits to terrorist groups were sufficiently alarming that the company requested a major U.S. law firm to make certain that none of the beneficiaries of the charitable contributions were specifically designated as terrorist organizations by the U.S. government.

But given all of the above, and the extant literature copiously collected by Coughlin (and others) on the intimate connection between *Shari'ah*, the Law of *Jihad*, and the actual conduct of *Jihad*, the question must again be asked whether the lawyers for Caribou have willfully blinded themselves to this connection even as they disclose and represent to the investing public that their client abides strictly by *Shari'ah*. Given the Qaradawi affair described above, the company and its legal counsel were certainly on notice that one of the world's most respected *Shari'ah* authorities had issued legal rulings based upon *Shari'ah* calling for terrorist acts against innocent civilians in Israel.[339] Are the partial disclosures in the company's prospectus sufficient to provide the unsuspecting post-9/11 investor with the material information that *Shari'ah* advocates *Jihad* as a general, historical, and traditional matter against unbelievers who reject the "invitation to Islam"?

Moreover, after having experienced the 2002 affair over Qaradawi, have the company's legal advisors fulfilled their fiduciary duties to conduct sufficient due diligence of the other *Shari'ah* authorities to determine if they adhere to traditional, historical, and authoritative *Shari'ah* as it relates to the Law of *Jihad*? After a ten-minute Google search on the Internet, the only conclusion one could reach would be that neither the company nor its lawyers conducted even a minimal investigation, or if they did, they willfully ignored the results.

For example, one of Arcapita's long-standing *Shari'ah* authorities and indeed one of the most respected in the world today is Mufti M. Taqi Usmani. Born in Deoband, India, Usmani was a judge on the *Shari'ah* Court in Pakistan and on the *Shari'ah* Appellate Bench of the Pakistan Supreme Court, a position he occupied for more than 20 years. He currently sits on numerous *Shari'ah* authority boards and chairs the *Shari'ah* board for the most authoritative of the standards boards for the SCF industry, the AAOIFI.[340]

Usmani is hardly an unknown entity. He has published and spoken prolifically on the evils of the West, America, and the obligation for offensive Jihad. Much of this literature has been summarized by Alex Alexiev, vice president for research for the Center for Security Policy[341], in his short dossier on Usmani. Drawing on open source research, Alexiev exposes Usmani as a *Shari'ah* authority fully committed to the Law of *Jihad*.[342]

The most telling of Usmani's legal rulings on *Jihad* is found in the last chapter of his book, *Islam and Modernism*, published in 2006.[343] In that chapter, Usmani responds to a Syed Badrus Salam of Jedda, Saudi Arabia, who has submitted an inquiry for a legal ruling to Usmani. In his query, Salam seeks to interpret the various authoritative *Shari'ah* scholars who ruled in favor of aggressive *Jihad* against non-Muslims in a historical context. He attempts to suggest to Usmani that aggressive *Jihad* against non-hostile, non-

Muslims was no longer required as a practical matter. Arguing that while aggressive *Jihad* was effective in the days of Mohammed and the Caliphates as the most effective way to convert the world to Islam, he opines that today this was no longer the case. When Muslims are without military power and live in Western societies which allow freedom of religion and grant Muslims the opportunity to convert non-Muslims peacefully, Salam maintains that the best approach to spreading the "Message of Allah" is through "[c]ompromising relations and amicable treatment".

In his written response, Usmani rejects any such suggestion. His response is provided below in full for three reasons: (1) it sets out in clear terms the standard, traditional *Shari'ah* doctrine on the Law of *Jihad*; (2) the response is a private response that Usmani purposefully made public by including in a book which was originally published in Urdu and which he subsequently had published in English; and (3) providing only a partial quote and allowing the reader to access the original at some other time would lessen the stark and startling impact of the legal ruling by one of the world's most authoritative *Shari'ah* scholars and one of the most important *Shari'ah* authorities in the SCF world. His response was as follows:[344]

> I am in receipt of your esteemed letter. Whatever you have written about Jehad can be summarized as this "If a non-Muslim state allows for preaching Islam in its country, Jehad against it does not remain lawful." If this is what you mean, my humble self does not agree with it. Obstruction in the way of preaching Islam does not mean only a legal obstacle, but greater power or domination of a non-Muslim state against Muslims is by itself a great obstacle in the propagation of Islam. There are no legal restrictions in most of the countries today on preaching Islam, but since their grandeur and authority is established in the world, it has led to developing a universal feeling which forms a greater obstacle than the greatest legal binding in the way of free propagation of Islam.
>
> For this reason the most important purpose of Jehad is to break this grandeur so that the resulting psychological subordination should come to an end and the way of accepting the Truth become smooth. As long as this grandeur and domination persists the hearts of people will remain subdued and will not be fully inclined to accept the religion of Truth. Hence Jehad will continue. The Qur'an said in Sura Tauba:
>
>> Then, when the sacred months have passed, slay the idolaters wherever ye find them, and take them (captive), and besiege them, and prepare for them each ambush. But if they repent and establish worship and pay the poor-due, then leave their way free. Lo! Allah is Forgiving, Merciful.[345]
>
> Here, killing is to continue until the unbelievers pay Jizyah[346] after they are humbled or overpowered. If the purpose of killing was only to acquire permission and freedom of preaching Islam, it would have been said "until

they allow for preaching Islam." But the obligation of Jizyah and along with it the mention of their subordination is a clear proof that the purpose is to smash their grandeur, so that the veils of their domination should be raised and people get a free chance to think over the blessings of Islam. Imam Razi has written the following commentary on this verse:

> The purpose of "Jizyah" is not to let the unbelievers stay in their contumacy against Islam but sparing their lives to give them a chance for a time during which they may hopefully get convinced of the truth of Islam and embrace it. So when an unbeliever is given time wherein he would be observing the respect and honour of Islam, and hearing the arguments of its validity, and also observing the baselesness of disbelief, these things would convince him to turn towards Islam. This, in fact, is the real purpose of legalizing Jizyah.

The other question worthy of notice is: Do we find an example that the Prophet (PBUH)[347] and his companions ever sent any missionary groups in other countries before Jehad and waited for their reaction to allow or disallow the missionary work? Did they go for Jehad only when they were refused to carry out the missionary work for Islam? Was any mission sent to Rome before attacking them? Was any attempt made to avoid Jehad against Iran and did they contend on seeking a permission for preaching Islam for that purpose? Obviously it was not so. Thus there can be no other conclusion that only a permit for missionary activities was not the aim. If that would have been the only aim many of the bloody combats could be stopped only on one condition that no obstacle would be placed in the way of the mission of Islam. But at least in my humble knowledge there has not been a single incident in the entire history of Islam where Muslims had shown their willingness to stop Jehad just for one condition that they will be allowed to preach Islam freely. On the contrary the aim of Muslims as declared by them in the battle of Qadsia was, "To take out people from the rule of people and put them under the rule of Allah". Similarly, the Our'an said:

> And (you O Believers) fight them until persecution is no more and the Din is all for Allah.

In the exegesis of this verse my reverend father Mufti Muhammad Shafi has written:

> The meaning of religion is "Authority and domination". Thus the meaning of this verse would be that Muslims should continue until the Muslims are safeguarded against their contumacy, and the religion of Islam becomes a dominating power so that it offers protection to Muslims from the atrocities and mischiefs of others.

He further said:

> The nutshell of this explanation is that Jehad against the enemies of Islam is obligatory on Muslims until the danger of their mischief or evil-doings is over, and the domination of Islam is established over all other religions. Since this will occur only near the end of the world, the command of Jehad remains till the last day. (Ma'arif-ul-Qur'an vol 4, p. 233)

In short, my humble self is of the view that the purpose of Jehad is not just to get the right of missionary activities in any country, but it aims at breaking the grandeur of unbelievers and establish that of Muslims. As a result no one will dare to show any evil designs against Muslims on one side and on the other side, people subdued from the grandeur of Islam will have an open mind to think over the blessings of Islam. Factually, this aims at safeguarding Islam. It is for this reason that the scholars who have called Jehad "A Protection" must be looked in the above context. But the basic element of this "protection" is to break the grandeur of unbelievers and establish the authority of Islam. Hence this basic element cannot be excluded from it. I think that all Ulema (Religious scholars) have established the same concept about the purpose of Jehad. Moulana Idrees Kandhalvi stated:

> By commanding Jehad Allah does not mean that all the unbelievers be killed outright, but the aim is that the religion of Allah should dominate the world, and Muslims live with honour and dignity, and obey and worship Allah in peace and tranquillity and there be no danger from unbelievers to interfere in the religion of Islam. Islam is not in enmity with the personal existence of its enemies. It resists such a grandeur and power that may become a threat for Islam and Muslims. (Seerat-ul-Mustafa vol: 2, p. 388)

At another place he writes:

> The implication of this verse is an obligation imposed on Muslims to fight against the unbelievers till the disorder and mischief cease to exist and the religion of Allah become supreme. By 'mischief in this verse is meant the mischief anticipated from the grandeur and power of disbelief. And "The religion is all for Allah" means the exhibition and domination of religion, while in another verse it is stated,
>
> > [Arabic verse in the original inserted here.]

> that is, the religion of Islam should gain so much domination and power that it may not be subdued by the power of infidelity and the religion of Islam becomes fully secure from the mischief and danger of disbelief (Ibid vol. 2, p.386)

If the need for Jehad was abandoned just on getting the permission of Tableegh (Missionary activities), then we see that Muslims already have this permission in most of the non -Muslim countries of the world (It is a pity that this permission is not given in some Muslim countries) which implies that Muslims should never have to lift the sword. As a result disbelievers may establish and hoist flags of grandeur all over the world and their awfulness and supremacy on the people would stay dominating. The policies will be theirs, the commandments will be theirs, ideologies will be theirs, views will be theirs and the strategies will be theirs, yet the Muslims would have to be conten[t]ed with the permission for their missionaries to enter those countries. The question arises how many people would be prepared to listen to the Muslims or give a serious thought to their speeches and writings in an atmosphere where disbelief had established its grandeur and awe throughout. How can the efforts of Muslim missionaries be effective in an atmosphere where anti-Islamic doctrines being spread on the strength of political power with full vigour, and their propagation carried out with means not possessed by Muslims?

If, however, Islam and Muslims attain such a power and grandeur against which the power and grandeur of disbelievers be subdued or at least it may be unable to create sedition and mischief mentioned above, then, of course, mutual compromise through peace treaties with non-Muslim countries is not against injunctions of Jehad. Likewise as long as the required capabilities for breaking the grandeur of disbelief are not possessed by Muslims, peace agreements with other countries, along with all efforts to accumulate the sources of power, are indeed lawful. In other words, there can be two types of agreement with non-Muslims.

> 1) Mutual compromise and peace agreements can be made with countries that have no power which could threaten the grandeur and domination of Muslims. This will be enforced as long as they do not become a threat to the Muslims again.
>
> 2) If Muslims do not possess the capability of “Jehad with power” agreement may be made till the power is attained.

My article published in March, 1971 as referred to by you pertains to these particular types of agreements. The excerpts of article published in June, 1981 pertain to the state where the grandeur of unbelievers dominates over the Muslims. Hence your expression that, “Aggressive Jehad is obligatory against hostile, and non-compromising non-Muslim states subject to capability, so that their power breaks and they do not form obstacles in the way of Muslim Missionary works. Jehad is not advisable against non-hostile and compromising non-Muslim states who allow freedom of missionary activities" ..... It is correct if it means what I explained above.

But if it means that just by permitting missionary activities a non-Muslim state becomes "non-hostile and compromising" and Jehad against them does not remain lawful or desirable, then in my view this is not correct. Arguments in favour of my view have already been advanced.

As for your deliberation that "... Particularly these days when territorial expansion is generally condemned contrary to the times when conquering the land was common which was regarded as a credit to the attribute of the kings and rulers. The Aggressive Jehads forming the major parts of Islamic history all belong to the same era." .... With all the respects for you I strongly condemn it, because, if this is taken to be correct it would mean that Islam does not have a measure to determine a thing as good or bad. If a bad thing is counted as an "essential attribute" at the particular time Islam would begin to march on the footsteps of this practice and when people begin to condemn it at another time Islam would also follow the suit. The question is whether Aggressive battle is by itself commendable or not? If it is, why the Muslims should stop simply because territorial expansion in these days is regarded as bad? And if it is not commendable but deplorable why Islam did not stop it in the past. Did it continue to practice because this was regarded as a creditable attribute of the kings"?

In my humble opinion this interpretation of the Aggressive Jehad of Islamic history is extremely incorrect and far away from the facts. Even in those days when this thing was considered to be a creditable "Attribute of the kings" Aggressive Jehads were waged not because it was customary for that period of time but because it was truly commendable for establishing the grandeur of religion of Allah. There were other "Attributes of the kings" that in the excitement of victory they never made any distinction between women, children and old people when persecuting them. But Islam did not encourage it just because it was customary. On the contrary Islam not only framed such military rules and regulations but also practically enforced them as could not even be imagined by the "kings". These were a matter of great surprise and rather unbelievable for the people who had not only become used to the barbarism of those kings but also became their admirers.

Aggressive Jehad is lawful even today for the purpose it was lawful in those days. Its justification cannot be veiled only because the peace-loving inventors of Atom Bombs and Hydrogen Bombs label it as "Expansionism" and resent those who have put the chains of slavery around the necks of the people of Asia and Africa. They are still bleeding under these heavy chains.

With due apologies, I may point out that it seems to me the result of the grandeur of the paganism that people have fixed their standard of good and bad on the basis of the propaganda which produces a lie as truth and truth as lie and then causes it to work into the minds of people to the extent that, to say nothing of non-Muslims, the Muslims themselves are overawed and inclined to adopt an apologetic attitude. If breaking such a grandeur of falsehood and evil comes under the definition of "Expansionism" we should venerate the blame of this expansionism with complete self-confidence, rather than stand humble before them as though saying, "when you thought that Aggressive Jehad was good we practised it, but since you have started condemning it in your books..... and only in books.....we have also forbidden it on ourselves."

My humble self can never agree with this way of thinking.

Humbly yours.,

Muhammad Taqi Usmani.

Usmani's condemnation of a peaceful, non-aggressive approach to non-Muslims in the West is beyond debate or doubt. He advocates violent and aggressive *Jihad* even against peaceful non-Muslims if they don't heed the call to Islam and he bases his legal ruling explicitly on legal verses in the *Qur'an*, the actions of Mohammed and the successor Caliphates, and a consensus among *Shari'ah* authorities. By doing so, he has rooted his doctrine of *Jihad* within traditional and authoritative *Shari'ah*.

Had the lawyers for Caribou bothered to conduct even a minimal due diligence, they would have been confronted with three sobering facts:

[1] Usmani, as a *Shari'ah* legal authority, has issued an absolute grant to Muslim terrorist combatants and their financial and logistical supporters to wage aggressive *Jihad* against the West. Further, because Usmani is a *Shari'ah* authority, his publication of this responsive letter is not theory or theological; it is binding Islamic law and must be taken as such by *Shari'ah*-adherent Muslims.

[2] If Usmani's legal ruling is in fact traditional and authoritative, the *Shari'ah* black box of SCF has just become a weapon in the *Jihad* to destroy the Western world's refusal to submit to *Shari'ah*. Usmani's ruling strongly suggests by implication that SCF is hardly an embrace of the West's domination, but rather a kind of treaty with the Western world until the Muslims will have the opportunity to wage violent *Jihad*. In this

> context, SCF is part of the *Jihad* to end the "psychological subordination" Muslims suffer when Islam is not the dominant religion in the world.
>
> [3] To the extent that terrorists will use Usmani's legal rulings to justify attacks against Western interests, and in view of Caribou's indirect financial support of Usmani as a paid advisor to Arcapita and given Arcapita's relationship to Usmani and its absolute control over Caribou, should Arcapita be charged with the material support of terrorism, Caribou and its assets could very well be on the blunt end of an executive blocking order or post-conviction forfeiture proceeding.[348]

At the very least, the fact must be fully disclosed that Caribou is principally owned and operated by a company which embraces *Shari'ah* authorities such as Qaradawi and Usmani. And, it will hardly be sufficient to characterize Usmani and his legal rulings through some vague or oblique reference as an "outside advisor" to its principal shareholder. Usmani is a highly regarded and respected *Shari'ah* authority by all of the *Shari'ah* authorities in the world. He sits on all of the important *Shari'ah* boards and is a leader in the industry's standards associations. His rulings cannot be marginalized because his role, along with the other co-members of the Arcapita *Shari'ah* board, in setting the *Shari'ah* policies for Caribou are absolute given Arcapita's controlling interest.

A final note regarding the third of the sobering facts above. According to Arcapita's public representations, it pays both a *Shari'ah* charitable tax on its profits and purifies any forbidden "interest" income by contributing those funds to charity.[349] For the 12 months ending June 30, 2007, Arcapita had set aside more than $2.4 million for such charitable contributions.[350] While Arcapita reportably hired a law firm to confirm that it did not make charitable contributions to organizations designated as terrorist organizations by the U.S. government, this listing is hardly exhaustive of Muslim charities involved in funneling aid to terrorists. While Arcapita's lawyers might have taken a list of charitable contributions *provided by Arcapita* and cross-checked them against the designated terrorist organizations, this is only a first step. Given the public record regarding the purpose and methodologies of *Shari'ah*, the published statements, writings and legal rulings from two of Arcapita's esteemed *Shari'ah* authorities on the Law of *Jihad* and the support of violence against Western or Israeli targets, such a casual due diligence of the beneficiaries of Arcapita's charitable contributions would be negligent at best and quite possibly reckless.

B. Dow Jones

1. Dow Jones Islamic Index

As discussed at the beginning of this memorandum, the Dow Jones Islamic Index ("DJII") provides a standardized universe of *Shari'ah*-compliant publicly-traded companies. Private investors and mutual funds who wish to invest in only *Shari'ah*-

compliant companies can select the DJII or any of the other Islamic indexes established by Dow Jones for U.S., non-U.S., and specialty markets. One such mutual fund which has licensed the right to utilize the Dow Jones Islamic U.S. Index ("DJII-US") and the Dow Jones name is the Dow Jones Islamic Fund ("the Fund"). Before proceeding to an examination of the Fund, it would be worthwhile to pause briefly to understand what Dow Jones & Company (and their lawyers) deem reasonable due diligence and disclosure for one of the world's premier financial research companies in the context of an index marketed to the world of *Shari'ah*-compliant Muslims as authoritative.

Dow Jones & Company ("Dow Jones"), which was recently acquired by News Corporation[351], was the first company to offer *Shari'ah*-compliant indexes. Standard & Poor's has created its own suite of such indexes. Dow Jones represents itself as "a leading provider of global business news and information services."[352] It markets "Dow Jones Indexes [as] a leading full-service index provider that develops, maintains and licenses indexes for use as benchmarks and as the basis of investment products."[353] DJII describes its "Key Attributes" as follows:

> ***Shari'ah* Law Compliance:** The Dow Jones Islamic Market Indexes are stringently monitored to ensure their continued compliance with *Shari'ah* Law. The independent *Shari'ah* Supervisory Board supports index integrity by conducting periodic reviews.
>
> **Liquidity:** The Dow Jones Islamic Market Indexes include only actively traded stocks that are easily accessible to investors. The selection universe for the family is the Dow Jones World Index, which covers approximately 95% of underlying market capitalization and expressly excludes the very smallest and most thinly traded stocks.
>
> **Comprehensive Coverage:** The DJIM Index provides broad coverage across countries, regions, market cap ranges and *Shari'ah*-compliant industries. Subindexes allow the individual tracking of these various market segments.
>
> **Systematic Methodology:** The Dow Jones Islamic Market Indexes are created and maintained according to a systematic and published methodology. The selection universe is constructed based on a quantitative set of rules, and stocks must pass consistently-applied industry and financial-ratio screens to be included in the index.[354]

According to the DJII Internet site, the sum and substance of these "screens" are:

> The DJIM Index includes all securities in the Dow Jones World Index that pass the following screens for Islamic compliance:

Industry Type: Excluded are companies that represent the following lines of business: alcohol, tobacco, pork-related products, financial services, defense/weapons and entertainment.

Financial Ratios: Excluded are companies whose:

- Total debt divided by trailing 12-month average market capitalization is 33% or more.
- Cash plus interest-bearing securities divided by trailing 12-month average market capitalization is 33% or more.
- Accounts receivables divided by 12-month average market capitalization is 33% or more.[355]

In all of its public disclosures and representations, Dow Jones informs the public that the DJII *Shari'ah* Supervisory Board "was established to counsel Dow Jones Indexes on matters relating to the *Shari'ahh* [sic] compliance of the indexes' eligible components."[356] One question that comes to mind is why the DJII needs any *Shari'ah* authority on retainer if the "filters" are "quantitative rules" applied presumably by a software program? Assuming Muslim investors might not trust the DJII to maintain the "filters" and some supervision is required to keep everyone honest, why does the DJII keep six world-renowned *Shari'ah* authorities on retainer? The answer suggested by the questions themselves is that there is still some component of *Shari'ah* supervision of the DJII that is not simply "quantitative".[357] If this is indeed the case, this fact is disclosed nowhere by the DJII or by any publicly reporting fund that licenses the DJII and is required to disclose the filters the fund has licensed.

Yet, it is possible that the answer is simpler than that. Perhaps, the DJII, seeking to be the "gold standard" in the industry, maintains an illustrious board to gild its reputation among *Shari'ah*-adherent investors. Indeed, the *Shari'ah* supervisory board members are listed prominently on all of the DJII promotional literature, a veritable who's who in the *Shari'ah* authority world:[358]

Name	**Country**
Shaykh Abdul Sattar Abu Ghuddah	Syria
Shaykh Justice Muhammad Taqi Usmani	Pakistan
Shaykh Nizam Yaquby	Bahrain
Shaykh Dr. Mohamed A. Elgari	Saudi Arabia
Shaykh Yusuf Talal DeLorenzo	United States
Shaykh Dr. Mohd Daud Baker	Malaysia

On the DJII Internet site, the short resumes of each *Shari'ah* authority follows. The disclosures relating to Usmani are limited to his professional and legal associations:

> Mr. Usmani has been a member of the Supreme Court of Pakistan since 1982. He is also the vice president of Darul Uloom Karachi and the vice chair and deputy chairman of the Islamic Fiqh Academy (OIC), Jeddah. Mr. Usmani edits the monthly magazines Albalagh and Albalagh International. He is a chairman or member of the Shari'ahh supervisory boards of a dozen Islamic banks and financial institutions worldwide.

As indicated above, Dow Jones has been a publicly-traded company. News Corporation, the company which recently acquired Dow Jones, is also a publicly-traded company. After a careful review of all of the Dow Jones filings with the SEC and the filings by News Corporation relating to its acquisition of Dow Jones, there is absolutely no mention of any reputational, financial, or national security risks associated with operating a *Shari'ah*-compliant index. No mention is made of the purposes of *Shari'ah* and its methodologies beyond describing the "objective filter" or "screen" used to develop the DJII. No mention is made of the fact that one of its key *Shari'ah* authorities has called for violent Jihad against non-Muslims in the U.S. -- even during peaceful times where Muslims are provided with the First Amendment right to freely exercise their religion and to convert non-Muslims through lawful means. The question regarding all of the disclosure and due diligence issues raised in this memorandum now confront not simply the Dow Jones' lawyers, who appear to view *Shari'ah* as a beneficent black box, but the News Corporation lawyers.

Without going into an intricate analysis of all of the Dow Jones representations and disclosures relating to *Shari'ah* and SCF, one area is of interest because it confirms the earlier analysis of the intimate and integrated relationship between SCF, *Shari'ah*, and the Law of *Jihad*. The DJII describes its "screens" as of two kinds. One screen is for the forbidden "vice" industries such that companies engaged in any of the forbidden industries will be excluded from the universe of potential indexed companies. The second-level screen eliminates companies from within the permissible industries whose financials indicate they carry too much debt or maintain too much liquidity which would suggest they are paying or receiving, respectively, too much interest. (As indicated earlier, a minimum amount of interest is permitted but the *Shari'ah*-compliant mutual fund or the individual *Shari'ah*-compliant investor must "purify" the portion attributed to forbidden profits such as from interest and donate that portion to a *Shari'ah*-compliant charity.)[359]

In its various public representations, Dow Jones states that the following industries are forbidden and excluded from the DJII: "alcohol, tobacco, pork-related products, financial services, defense/weapons and entertainment."[360] Elswhere, Dow Jones explains that neither tobacco nor defense/weapons are strictly forbidden:

> Although no universal consensus exists among contemporary Shari`ah scholars on the prohibition of tobacco companies and the defense industry, most Shari`ah boards have advised against investment in companies involved in these activities.[361]

The question for the U.S. publicly-traded company is: Does it have a duty to disclose why it is that *Shari'ah* would prohibit the defense industry? Does the *Shari'ah* prohibition apply to Muslims investing in a Muslim defense industry? There is of course no legal issue relative to an index or a mutual fund which chooses not to invest in military or defense industries, whether out of a conviction that such industries are sources of evil or out of a moral position against war of any kind. The question, in this instance, however, does not arise in a vacuum but in a setting flowing from the black box of *Shari'ah*. That black box, once pried open, exposes a hostile and even violent doctrine targeting non-Muslims in the West for conversion, subjugation, or war. There are literal armies of *Shari'ah*-driven combatants at war with the West based upon that doctrine. It is in this context that the question about the motives for the prohibition becomes material to a post-9/11 U.S. investor in the context of disclosure laws.

Further, the question hardens into an indictment when juxtaposed against the published legal edicts of the classical and contemporary *Shari'ah* authorities. Logically, to suggest that *Shari'ah* is opposed to the defense industry is on its face absurd given the history of *Shari'ah*-based empires waging war against their enemies. The evidence, however, is more than historical as the contemporary evidence of *Shari'ah*-based regimes illustrates. Iran, Saudi Arabia, Sudan, and the Taliban-led Afghanistan all have acquired massive weapons arsenals and, at least in the case of Iran, have developed an "Islamic defense industry".[362] The adoption of such a military posture on the part of these Muslim countries is not simply grounded in a geo-strategic policy. It is also demanded by *Shari'ah*, at least according to the leading *Shari'ah* authorities of our day. In Usmani's book, *Islam and Modernism*, he makes the careful point that *Shari'ah* has no objections to science and technology per se. In fact, *Shari'ah* requires Muslims to invest in and to utilize all of modern warfare technology for its mandatory *Jihad*:

> The Grand Mufti of Pakistan, Mufti Muhammad Shafi, President, Darul Ulum, Karachi, has written in his treatise "Jihad" as under,
>
>> Indeed, the Patience, the fear of Allah and total belief in and submission to Allah is the real and unconquerable strength of Muslims. Along with it, however, it is also essential that equipment of war and ammunition proper to the time and place should be acquired and stored. The Prophet (SA) always arranged for war exercises, and issued instructions to collect and acquire all those weapons that were in vogue anywhere in those days. . . . [citing the case where two companions of Muhammad were excused from fighting because they were studying how to manufacture modern war weapons].

> This incidence also proves that it is obligatory for the Muslims to make their countries self-sufficient in war weapons and technology and should not depend on others. . . . We are bound to think it seriously how much our country is in need of all the equipment and weapons of war used in modern warfare so that we may not be lagging behind. We must put all our energy and resources to fulfill the aim that we become self-sufficient in the nearest possible future.

. . .

And Moulana Zafar Ahmad Usmani, Sheikh-ul-*Hadith*, Darul-Ulum-al-Islamiya, Tando Allah Yar, writes in one of his recent articles,

> War weapons and technology against the enemy should be raised to the extent that the enemy is overawed with them . . . our earlier Caliphs and Sultans religiously followed this rule. . . . The Muslim nations should join together to build up factories for ammunition and other weapons, and a continued process of research and inventions must be carried out. All these efforts are in conformity with Qur'anic injunction (Monthly Al-Balagh, p.44 J.A. 1387 (H).

Moulana Muhammad Yusuf Binouri, Sheikh-ul-*Hadith* Madrasah Arabiyah, New Town, Karachi, writes:

> There is no scarcity in the Islamic world, rather there is an abundance of natural resources, material reserves and wealth, but how great a tragedy it is that a major portion of their wealth is utilized by the enemies through deposits in foreign banks, or spent in extravagance, debauchery, undue luxuries, and immoralities. But defense stability, military training and ordnance factories are practically negligle, while the enemies of Islam are contructing airports, naval fleets, military cantonments and large ordnance factories. . . . (Monthly Baiyyenat, Karachi, R.S. 1387 (H), p.4)[363]

Investors are, of course, entitled to decide whether or not to take a stance against investing in defense industries. Muslim nations are also free to purchase or manufacture armaments. But there is a threshold disclosure issue for a U.S. company that is promoting SCF, which forbids investment in the defense industry. If that prohibition is due to the fact that *Shari'ah* considers Islam at war with the West, the promotion of *Shari'ah* and its "opposition" to defense industries is hardly full disclosure. The very fact that Dow Jones hints at this by explaining that there is no consensus that the defense industry is a forbidden industry in and of itself suggests that someone in the inner circle at Dow Jones understands that its *Shari'ah* authorities are using SCF to weaken its enemies (i.e., the non-Muslim West) while mandating through their legal rulings (applied selectively) that *Shari'ah*-adherent subscribers should embrace the weapons industry in the Muslim world in the service of *Jihad*. This rather patent implication suggests more than a reckless disregard for the duty to disclose material facts to the investing public.

It is unreasonable to argue that this omission of purpose (i.e., *Shari'ah* hegemony) and methodology (i.e., *Jihad*) in the disclosures and representations by Dow Jones as a U.S. public company is not material to the reasonable U.S. investor. Furthermore, one has to conclude that there has been a wholesale failure to conduct even a minimally acceptable due diligence by legal counsel on this issue. Alternatively, it would seem inescapable that legal counsel knows full well the purposes for such prohibitions and indeed of *Shari'ah* and its methodologies and has consciously buried this political-military agenda deep inside the black box.

2. Dow Jones Islamic Fund

The Fund is an open-ended mutual fund marketed publicly mostly to the Muslim American community. Most of the Fund, however, is owned by one shareholder, the North American Islamic Trust ("NAIT"), which owns 69.8% of the Fund. Charles Schwab & Co., Inc., is the next largest investor with 9.65%.[364] The Fund Advisor, Allied Asset Advisors, Inc. ("AAA"), is a subsidiary of NAIT.[365]

On its Internet site, NAIT represents itself as follows:

> The North American Islamic Trust (NAIT) is a waqf, the historical Islamic equivalent of an American trust or endowment, serving Muslims in the United States and their institutions. NAIT facilitates the realization of American Muslims' desire for a virtuous and happy life in a *Shari'ah*h-compliant way.
>
> NAIT is a not-for-profit entity that qualifies as a tax-exempt organization under Section 501(c) (3) of the Internal Revenue Code. NAIT was established in 1973 in Indiana by the Muslim Students Association of U.S. and Canada (MSA), the predecessor of the Islamic Society of North America (ISNA). NAIT supports and provides services to ISNA, MSA, their affiliates, and other Islamic centers and institutions. The President of ISNA is an ex-officio member of the Board of Trustees of NAIT.[366]

At the outset, the lawyer for the Fund must confront the fact that NAIT, and its founder the Muslim Students Association of U.S. and Canada ("MSA"), and the successor to the MSA, the Islamic Society of North America ("ISNA"), all have close ties to organizations involved in the material support of terrorism. For example, prior to the start of the terror-financing trial of the Holy Land Foundation ("HLF")[367], the Government submitted a trial brief[368] with a list of unindicted co-conspirators ("the List of Co-Conspirators")[369] who had allegedly participated in some way in the conspiracy to fund Hamas' terror-related activities against Israel. Hamas was at the time a designated FTO. In its trial brief, the government characterized Hamas as follows:

> Hamas' founding charter makes clear that Hamas is, in fact, the Palestinian branch of the Muslim Brotherhood, and calls for the annihilation of Israel through "jihad" (holy war), and the creation of an Islamic state in its place. Hamas defines jihad as including violent activities, with such violent activities being carried out by Hamas' military wing, commonly known as the Izz Al-Din Al-Qassam Brigades ("Al-Qassam Brigades"). The charter also calls for charity as [a] means of securing the population's loyalty. Through charitable support, the charter explains, "congeniality will deepen, cooperation and compassion will prevail, unity will firm up, and the ranks will be strengthened in the confrontation with the enemy."
>
> . . .
>
> As evidenced by documents seized in 2004 from the Virginia home of unindicted co-conspirator and fellow Palestinian Committee member Ismail Elbarrasse, as well as other evidence, the Muslim Brotherhood directed its Palestinian Committees throughout the world, including the United States, to carry out the mandate of assisting Sheik Yassin's newly-formed Hamas.[370]

NAIT and ISNA were both on the List of Co-Conspirators as "individuals/entities who are and/or were members of the US Muslim Brotherhood." Evidence at the trial linked these organizations to Hamas.[371] Although the trial ended in a mistrial, the Government is preparing to retry its main case.[372]

The legal advisor to the Fund has a minefield of issues to navigate relating to due diligence and disclosure. Beyond the disclosure of the endogenous elements of *Shari'ah* the Fund inherits from the DJII, the first and most obvious problem relative to the Fund's exogenous aspects is the documented evidence provided by the federal government at the largest terror-financing trial in U.S. history. Their evidence makes clear that its client, and the successor to the founder of its client, have been linked to the material support of terrorism. Moreover, NAIT's founding organization, the MSA, has a public record of embracing the goal of a worldwide *Shari'ah* hegemony. In a devastating dossier by the Investigative Project on Terrorism, based wholly on open sources, the MSA is exposed as suspiciously aligned with the goals of the Muslim Brotherhood and Hamas.[373]

Other disturbing connections to the funding of terrorism arise. The Fund's portfolio manager, Dr. Bassam Osman, who has also been the President and Chairman of the Fund Advisor for the past six years,[374] was a director to another suspect Muslim charity. As Senator Charles Schumer stated during a hearing of the Senate Judiciary Committee on Saudi-funded Islamic terrorism:

> Meanwhile, a number of ISNA board members appear to have checkered pasts. One member, Siraj Wahhaj, was named as an unindicted co-conspirator in the WTC, in the World Trade Center, '93 bombings.

> Another member, Bassam Osman, was previously the director of the *Qur'an*ic Literary Institute, an Oak Lawn, Illinois, organization that had $1.4 million in assets seized by the Justice Department in June '98 on the grounds it was used to support Hamas activities.[375]

Finally, it appears that NAIT's ownership of so many U.S. mosques contributes further to its ties to the material support of terrorism. In April 2004, the founder of an Albany mosque and the imam he had recruited to serve as the spiritual leader of the mosque were arrested for participating in "a plot to import a shoulder-fired missile and assassinate a Pakistani diplomat in New York City."[376] It turns out that NAIT owned the Albany mosque. Several other NAIT-owned mosques have been named as suspected centers of terrorist activity.[377]

In light of the adverse publicity and constant tension of a client linked so intimately to the material support of terrorism, the twin issues of due diligence and disclosure should be front and center for the Fund's lawyers. On the due diligence side, the Fund has the obligation to protect against any of the monies coming in or going out of the Fund being exploited in the cause of terrorism. In fact, in the Fund's prospectus, the Fund promoters make the standard representation of compliance with the Patriot Act's anti-money laundering provisions:

> **Anti-Money Laundering.** The Fund has established an Anti-Money Laundering Compliance Program (the "Program") as required by the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 ("USA PATRIOT ACT"). To ensure compliance with this law, the Fund's Program provides for the development of internal practices, procedures and controls, designation of anti-money laundering compliance officers, an ongoing training program and an independent audit function to determine the effectiveness of the Program.
>
> Procedures to implement the Program include, but are not limited to, determining that the Fund's Distributor and Transfer Agent have established proper anti-money laundering procedures, reporting suspicious and/or fraudulent activity and a complete and thorough review of all new opening account applications. The Fund will not transact business with any person or entity whose identity cannot be adequately verified under the provisions of the USA PATRIOT ACT.[378]

Given the documented record creating at least associational ties between the Fund's principal owner (including the Fund Adviser) and individuals and organizations tied to the material support of terrorism, a pro forma recitation of compliance with the Patriot Act will likely fall well short of the due diligence required by the relevant statutes. For example, what exact monitoring protocols does the Fund have in place to make certain that neither the Fund Advisor nor the Fund's principal shareholder have utilized any of the Fund's distributions for criminal activity? Further, has the Fund conducted a thorough investigation into the tens of millions of dollars raised by NAIT in tax-exempt contributions for the purchase of the Fund shares? Were these monies from domestic or overseas sources? Has anyone attempted to source these contributions? While the Fund might argue that sourcing an investment from NAIT is sufficient, given the history of NAIT, its associations, and more importantly its role as a "trust" holding as a fiduciary the funds and property of individual Muslims, associations of Muslims, and Muslim organizations, regulations promulgated under the Bank Secrecy Act will likely require that the Fund verify the source of NAIT's funds.[379]

C. Case studies: a conclusion and final note

Given the panoply of civil liability and criminal exposure issues analyzed at various levels in this memorandum, and given the preliminary nature of any such effort of first impression, legal minds will most certainly approach the specifics of any fact pattern cautiously and differently. But what should be viewed in a clearer light as a result of this analysis is that any U.S. company or its legal counsel which cavalierly assumes the black box of *Shari'ah* and the many exogenous issues surrounding it are not serious legal matters will likely discover at some point down the road that willful blindness only postpones problems; it never eliminates them. And, as most good lawyers know, postponing problems is a sure way to exacerbate them.

From the brief examination of some of the issues as they relate to the case studies, the lesson learned is that -- much like the sub-prime meltdown, where financial institutions had placed credit risks and ballooning values into a black box of securitizations, out of sight and out of mind, all with the approval of their legal and accounting professionals -- the SCF industry is the latest rage engaging in the same subterfuge. But, instead of bad credit risks and overvaluations, the industry is flirting with a black box the contents of which include a legal doctrine bent on the destruction of the very civilization which has created modern debt-driven finance. While the sub-prime disaster – which followed on the heels of the accounting and fraud scandals of the Enron era, which in turn followed the savings and loan debacle of the last century – should have warned bankers and their facilitators away from black boxes and a lack of transparency, this lesson seems to have been lost on even the most prudent of these professionals.

In fact, the next level of fraud has already been hatched. If, for example, an investor would visit the Internet site of Azzad Asset Management ("Assad"), the investor would find a host of funds marketed around "ethical investing".[380] With but one or two clicks of the mouse, the investor finds that "ethical investing" includes the application of an "ethical screen" that looks exactly like the DJII screen: the same vice industries are excluded and the same financial ratios (with one minor exception) are used to avoid interest.[381] Nowhere in the marketing material or in the SEC filings for the Azzad funds is the word Islam or *Shari'ah* even mentioned.

Assuming the Azzad screens did not correlate with the requirements of *Shari'ah* coincidentally, the questions are: Why would Azzad fail to disclose its adherence to *Shari'ah*? Did they rely on *Shari'ah* authorities to develop their screens? Are there no reputational or financial risks specifically associated with the fact that the Azzad funds adhere to *Shari'ah* rules and principles that ought to have been disclosed? Here one sees the *Shari'ah* black box repackaged almost entirely into an "ethical" vehicle, presumably as a way to entice non-Muslims to invest in accord with *Shari'ah*, or to avoid appropriate scrutiny. Disclosure laws in the financial industry simply do not countenance such deception.

A final note for what might be considered the "nuclear exposure" of the SCF industry. As described above, the leading two dozen *Shari'ah* authorities who occupy all of the important positions in the SCF industry effectively establish all its rules and regulations. If, in fact, these men have as their ultimate and collective goal the implementation of a *Shari'ah*-based Caliphate in the U.S. and elsewhere in the non-Muslim world and their methodologies include the Law of *Jihad*, meaning violence when necessary or possible and otherwise fraud and misrepresentations about the true purpose of *Shari'ah*, the prima facie case for a massive lawsuit under the Racketeer-Influenced and Corrupt Organizations Act ("RICO") is almost unavoidable. This is especially true now that the Patriot Act has added the federal terror-related crimes to the RICO predicate offenses and beefed up the predicate offenses relating to money laundering.[382] It does not require more than a cursory examination of the elements of a viable RICO prosecution to recognize the enormous exposure.

RICO is violated when a defendant, or in this case a cadre of defendants acting as *Shari'ah* authorities, engage in a "pattern of racketeering activity" and by having:

(1) **Invested income** from a pattern of racketeering activity **in an "enterprise"**;
(2) **Acquired or maintained an interest in an "enterprise"** through a pattern of racketeering activity;
(3) **Conducted or participated in the affairs of an "enterprise"** through a pattern of racketeering activity; or
(4) Conspire to do any of the above.[383]

The "pattern of racketeering activity" means two or more of the predicate offenses within a ten-year period.[384] The predicate offenses include mail and wire fraud, material support of terrorism, and money laundering.[385] The "enterprise", which is an entity, person, or group of entities or persons associated in some *de jure* way (e.g., partnership) or as a *de facto* association, exists separately from the defendants.[386] In this scheme, the enterprise is the U.S. financial institution involved in SCF. As has been established in the foregoing pages, to the extent that a U.S. financial institution has criminal culpability for the predicate offenses[387], that particular institution would join the list of defendants and operate as part of the enterprise. The evidence of the RICO crime then would include the fraud and ulterior motives of the *Shari'ah* authorities and how they have manipulated the enterprise to achieve their criminal ends. If such an indictment were handed down, it could lead to a pretrial asset freeze[388] and a post-conviction massive forfeiture of the criminal enterprise's assets.[389]

The question for the U.S. financial industry and the legal profession which is charged with watching over its every move as a fiduciary is whether U.S. financiers will take the black box to the bank or send it back from whence it came.

IV. Conclusion

SCF exposes the financial institutions and other businesses which attempt to exploit this new industry to a whole host of disclosure, due diligence, and compliance issues, all of which elevate substantially the civil liability and criminal exposure such companies otherwise factor into their business risk profiles.[390] What is clear from this preliminary legal analysis of what might be called the SCF industry is that very little of this increased civil and criminal exposure has been recognized, analyzed, or guarded against in any meaningful way.[391]

The salient points of this analysis are:

- The *Shari'ah* black box syndrome: U.S. financial institutions and businesses involved in SCF risk grave consequences by willfully ignoring the endogenous elements of *Shari'ah*. Ignoring what *Shari'ah* is -- both in theory and in practice -- and its intimate connection to Islamic terror and holy war against the non-Muslim world amounts to corporate recklessness.

- Putting *Shari'ah* in a black box and treating its prohibitions as if they were benign secular and objective "screens" ignores the duty of disclosure of the most important elements of *Shari'ah*: its purposes and its ultimate methods.

- Undoubtedly, a reasonable post-9/11 investor contemplating an SCF investment would consider (a) the goal of establishing *Shari'ah* as the law of the land and (b) the promulgation of the Law of *Jihad* to establish this goal material to the investment decision.

- To the extent that U.S. *Shari'ah* authorities or foreign *Shari'ah* authorities retained by U.S. businesses advocate the implementation of historical and traditional *Shari'ah*, they risk being charged with a violation of 18 U.S.C. § 2385.

- U.S. financial institutions and businesses have a duty to conduct reasonable due diligence investigations to be certain that their respective *Shari'ah* authorities are neither advocating crimes in the name of *Shari'ah* nor promoting the material support of terror, either through legal rulings or through the funneling of "purification" funds to terrorists. Failure to conduct such due diligence might very well lead to civil liability, if not criminal exposure.

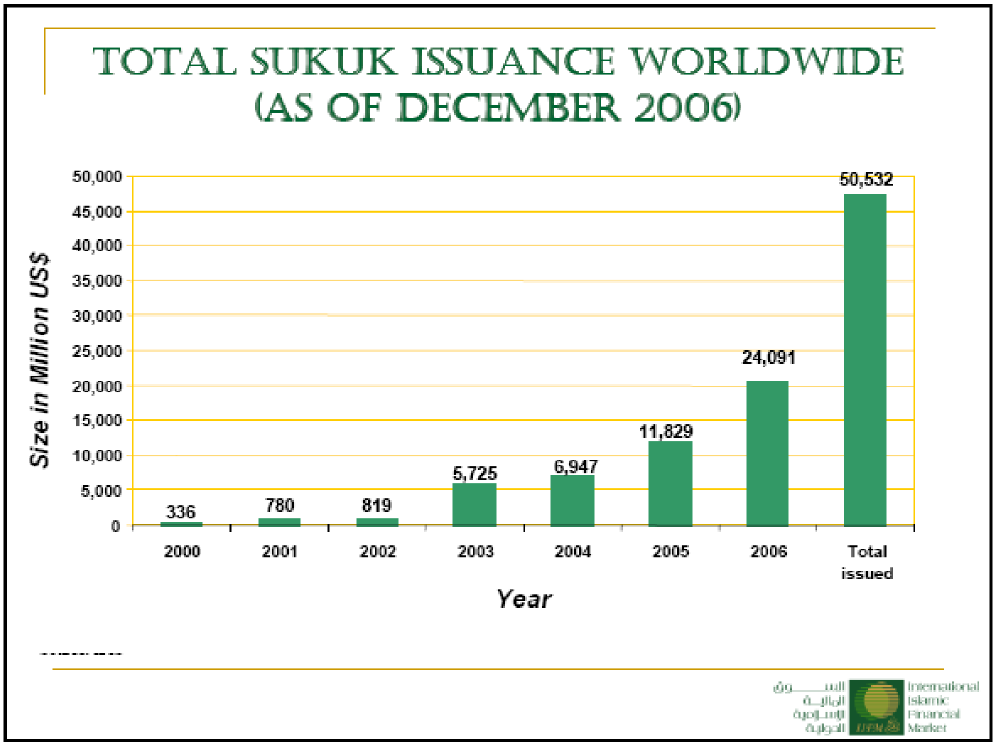
- The *Shari'ah* black box is yet another financial fad like the sub-prime market where transparency is shrouded in opacity in the mad rush to market-share and quick profits. U.S. mutual funds are poised to embrace SCF without a word about the risks associated specifically with *Shari'ah*. U.S. banks are cavalierly promoting *Shari'ah*-compliant loans as "interest-free" when in fact they are merely repackaged loans at standard interest rates. This violates any number of consumer protection statutes. Financial institutions are underwriting *Shari'ah*-compliant loans and bond issuances without really understanding the risks associated with default and bankruptcy treatment.

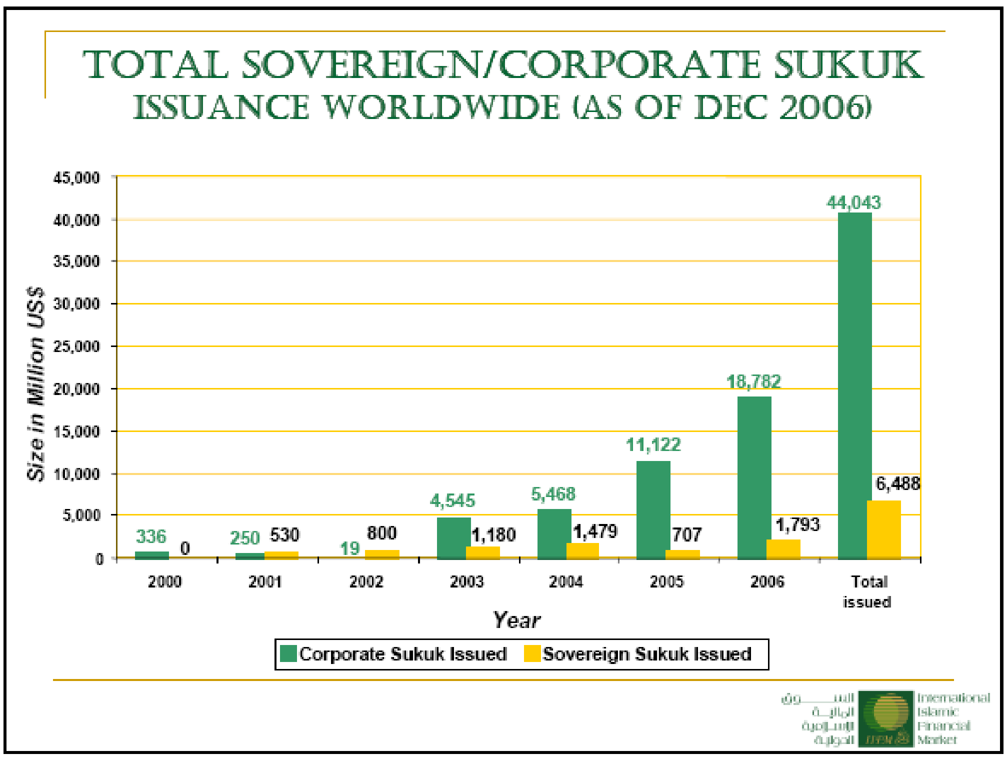
- Insofar as U.S. financial institutions participate in and cooperate with the *Shari'ah* authorities' efforts to establish the rules and regulations for the SCF industry, antitrust issues such as rules collusion are likely to present yet additional issues of exposure for those embracing this new industry.

- The current structure of the SCF industry in which two dozen of the most influential *Shari'ah* authorities control the way funds go in and out of the largest financial enterprises in the world creates the paradigmatic pattern of predicate racketeering activity any aggressive prosecutor or plaintiff's lawyer looks for in a RICO cause of action.

The failure by corporate management and their legal advisors to confront these issues in any serious fashion is not surprising given the wholesale failure of the participants and facilitators in this industry to have undertaken a serious analysis of these risks. The extant legal academic and professional literature reads more like promotional material and not serious legal analysis conducted by men and women trained to protect clients from their own blind enthusiasm. The legal industry has gone down this road too many times in the past. The difference this time is that the risk is not simply financial; it is potentially existential.

Appendix A: Dollar-Growth of *Shari'ah*-Compliant Bonds Issuances





Source: Alvi, Ijlal A., *Increasing the Secondary Markets for Sukuks*, (slide presentation published by International Islamic Financial Market, Bahrain) *available at* http://www.iifm.net/download/Presentations/Increasing%20the%20secondary%20market%20for%20Sukuk.pdf (last visited Dec. 15, 2007).

Endnotes:

[1] The distinction made throughout between a SCF "investment" and "transaction" is intended and important in this context. SCF expresses itself in fundamentally two ways: (a) "the investment" refers to the kind of investment or business *Shari'ah* is understood to permit (i.e., equity versus debt with interest; asset-based versus intangibles such as derivatives or hedging transactions based upon future contingencies; and commerce in permitted versus prohibited industries) and (b) "the transaction" refers to the way in which a permitted investment or business transaction is structured typically through the use of nominate contracts (i.e., an "interest-free" loan may be structured as a cost-plus sale or sale/lease back). *See infra* notes 4-5.

[2] This memorandum uses the term "facilitator" (or in some cases "professional facilitator") to mean the range of legal, accounting, and financial advisor professionals who are intimately involved in the promotion and structuring of SCF investments and transactions. An example of this burgeoning cottage industry can be gleaned by looking at the promotional material for the myriad of professional and business conferences dedicated to SCF. *See*, *e.g.*, *Upcoming Event*, Arab Bankers Ass'n of N. Am., *available at* http://www.arabbankers.org/shared/layouts/section.jsp?_event=view&_id=120130_U127360__132301 (last visited Jan. 24, 2008).

[3] *See*, *e.g.*, ISLAMIC FINANCE: THE REGULATORY CHALLENGE (Simon Archer & Rifaat Ahmed Abdel Karim eds., 2007); Ayman H Abdel-Khaleq, *Offering Islamic funds in the US and Europe*, INTERNATIONAL FINANCIAL LAW REVIEW, *available at* http://www.iflr.com/?Page=17&ISS=16434&SID=515350 (last visited Jan. 24, 2008).

[4] *See*, *e.g.*, THE POLITICS OF ISLAMIC FINANCE (Clement M. Henry & Rodney Wilson eds., 2004); *see also* IBRAHIM WARDE, ISLAMIC FINANCE IN THE GLOBAL ECONOMY (2000).

[5] Michael J.T. McMillen, *Symposium: Islamic Business and Commercial Law: Contractual Enforceability Issues: Sukuk and Capital Markets Development*, 7 CHI. J. INT'L L. 427 (2007).

[6] *See*, *e.g.*, THE POLITICS OF ISLAMIC FINANCE, *supra* note 4; Jane Pollard & Michael Samers, *Islamic Banking And Finance: Postcolonial Political Economy And The Decentring Of Economic Geography*, 32 TRANSACTIONS OF THE INSTITUTE OF BRITISH GEOGRAPHERS 313 (2007), *available at* http://www.blackwell-synergy.com/doi/pdf/10.1111/j.1475-5661.2007.00255.x?cookieSet=1 (last visited Jan. 24, 2008).

[7] This memorandum does not address in any meaningful way SCF insurance. This is due in large part to the complex nature of the business of insurance and its regulation and the relatively untested models for *Shari'ah* compliant insurance schemes from within the SCF industry itself.

[8] The post-Enron "Sarbanes-Oxley" world is the recent result of this failure. *See*, *e.g.*, Harvey J. Goldschmid, Comm'r, Sec. & Exch. Comm'n, Post-Enron America: An SEC Perspective, Address at the Third Annual A.A. Sommer, Jr. Corporate Securities & Financial Law Lecture (Dec. 2, 2002), *available at* http://www.sec.gov/news/speech/spch120202hjg.htm (last visited Jan. 24, 2008).

[9] Beyond the Enron-era, the financial world is in the midst of the "sub-prime mortgage securitization" industry meltdown, *see*, *e.g.*, Ben S. Bernanke, Chairman, Fed. Reserve, The Recent Financial Turmoil and its Economic and Policy Consequences, Address at the Economic Club of New York (Oct. 15, 2007), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20071015a.htm (last visited Jan. 24, 2008), which is already being compared to the debacle of the Savings & Loan crisis, *see*, *e.g.*, Amy Waldman, *Move Over, Charles Keating - Causes Of The Savings And Loan Scandal*, WASHINGTON MONTHLY, May 1995, *available at* http://findarticles.com/p/articles/mi_m1316/is_n5_v27/ai_16947718 (last visited Jan. 24, 2008).

[10] While it is not the purpose of this memorandum to detail the legal risks for the professional facilitators, there is substantial legal exposure for the legal, accounting, and financial professionals who provide the knowledge and expertise to develop the financial and legal instrumentalities of SCF. While "scheme liability" under a Rule 10b-5 private right of action has been put to rest by *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 128 S. Ct. 761 (2008), to the extent that the lawyers get involved in drafting the "representations", liability will still apply. *See* LOUIS LOSS & JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATION 1329-1332 (2004) (for a discussion on "primary liability" for lawyers under Rule 10b-5); *id.* at 1465-1469 (for a discussion of the "duty to report evidence of a material violation" under Part 205 to Title 17 of the Code of Federal Regulations promulgated by the SEC pursuant to Section 307 of the Sarbanes-Oxley Act of 2002).

[11] This conclusion has been reached by a thorough review of the published proprietary and non-proprietary information disseminated by many of the financial institutions and the professional facilitators (i.e., the law

firms, accounting firms, and financial advisors who promote SCF as a business model and marketing niche) and of the published academic and trade journals which have treated SCF in some detail over the past decade. Some of this material will be referenced throughout this memorandum as its relevance to disclosure, due diligence, compliance, industry standards, and best practices are examined.

[12] A good yet basic recitation of SCF by a U.S. Muslim academic who was the "Scholar-in-Residence: U.S. Department of Treasury"on SCF is in Mahmoud Amin El-Gamal, *A Basic Guide to Contemporary Islamic Banking and Finance* (June 2000), *available at* http://www.nubank.com/islamic/primer.pdf (last visited Jan. 24, 2008).

[13] In classical and traditional Islamic law, extant and in use to this day by the recognized *Shari'ah* authorities, there are essentially five categories of normative assessments: obligatory, recommended, permitted, discouraged, and forbidden. ENCYCLOPEDIA OF ISLAMIC LAW: A COMPENDIUM OF THE MAJOR SCHOOLS xxxvii-xxxviii (Laleh Bakhtar ed., 1996).

[14] While *Shari'ah* is often referred to as Islamic law, *Shari'ah* is according to the *Shari'ah* authorities the divine law of Allah which is articulated directly to man through the *Qur'an* and indirectly through the canonical stories of Mohammed's life as told through the *Hadith*. The jurisprudential rules developed by the *Shari'ah* authorities over time to arrive at finite legal rulings are often referred to as *usul al fiqh* or the roots of the law and *al fiqh* or just *fiqh* is the *corpus* of jurisprudential rules and principles. *Furu'* is the term used for the positive law rulings of individual jurists. For a discussion of this in more detail, *see infra* note 32. For purposes of this memorandum, the word *Shari'ah* is used as a collective term to include all of these elements unless otherwise indicated. This is how most Muslims use the word in the vernacular.

[15] There is no universally recognized degree or examination to acquire the status of an SCF authority. Generally, the discipline in *Shari'ah* related in part to commerce is termed *fiqh al muamalat* and while there are jurists who specialize in this area, the qualifications for such positions are quite varied. While the industry itself is undertaking to create standards and structures for uniformity and transparency, it has not been successful to date. An examination of these issues can be found in Wafik Grais & Matteo Pelligrini, *Corporate Governance and* Shariah *Compliance in Institutions Offering Islamic Financial Services* (World Bank Policy Research Working Paper No. 4054, 2006), *available at* http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2006/11/08/000016406_20061108095535/Rendered/PDF/wps4054.pdf (last visited Jan. 24, 2008).

[16] The manner in which a *Shari'ah* advisor is employed or contracted for by the financial institution bears on several of the legal complications and risks discussed herein. *See infra* notes 48-51 and accompanying text (discussing criminal *respondeat superior*); *see also supra* note 14 and accompanying text.

[17] The number of *Shari'ah* scholars sufficiently versed in the disciplines necessary to be gainfully employed by a "blue chip" financial institution engaged in SCF is quite limited. It is generally represented that there are only about 20-25 competent *Shari'ah* scholars who have mastered *Shari'ah*, finance, and English well enough to be considered both an SCF scholar and employable. Richard C. Morais, Don't Call It Interest, Forbes.com, http://www.forbes.com/business/global/2007/0723/104.html (last visited Jan. 24, 2008). For the general problem of the dearth of qualified *Shari'ah* scholars, *see* Grais & Pellgrini, *supra* note 15, at [page number here] & n.18.

[18] In Arabic, the term used is *riba*, which literally means "increase." In the past, there has been debate among *Shari'ah* authorities and Islamic academic scholars over the prohibition against *riba* in financial and commercial transactions. Some scholars point to the fact that the prohibition against interest in the *Qur'an* is not simple interest but usurious interest and specifically a default interest prevalent in pagan pre-Islamic Arabia. Today, the debate is academic because there is broad consensus that interest of all kinds is forbidden by *Shari'ah*. For the consensus view of the prohibition against interest, *see* FRANK E. VOGEL & SAMUEL L. HAYES, III, ISLAMIC LAW AND FINANCE: RELIGION, RISK, AND RETURN 71-87 (1998). For a contrarian position, *see* TIMUR KURAN, ISLAM & MAMMON: THE ECONOMIC PREDICAMENTS OF ISLAMISM 14 (2004); *see also* Alex Alexiev, *Islamic Finance or Financing Islamism?* 6-7 (The Center for Security Policy, Occasional Papers Series No. 29, 2007). For a general discussion of how contemporary SCF has perverted the "intent" of an "authentic" Islamic political economy, *see* Mahmoud Amin El-Gamal, "*Interest" and the Paradox of the Contemporary Islamic Law and Finance*, 27 FORDHAM INT'L L.J. 108 (2003); Chibli Mallat, *The Debate on Riba and Interest in Twentieth Century Jurisprudence*, *in* ISLAMIC LAW AND FINANCE (Chibli Mallat ed., 1988).

[19] The *Qur'an* forbids gambling or *maysir*; the *Sunna* includes *gharar* or risk in the prohibition. Since all business includes an element of risk, the jurisprudential task for the *Shari'ah* authorities is to take the

specific examples found in the canonical literature, such as "Do not buy fish in the sea, for it is *gharar*," and to translate that into principles, then rules and finally into finite rulings and contract forms which are considered *halal* or permitted. *See generally* VOGEL & HAYES, *supra* note 18, at 87-95.

[20] While there is general agreement about most of these industries as absolutely forbidden, some such as the tobacco business and military and defense industries are typically forbidden in SCF in Western countries but not considered an absolute *Shari'ah* prohibition. For an exploration into the *Shari'ah* motives for forbidding defense industry investments in the West, *see infra* notes 50, 78-81362 and accompanying text.

[21] *Zakah* (sometimes referred to as *zakat*), which literally means purification, is a form of religious tax for assisting the less fortunate and those that "struggle for Allah." The amount is between 2.5% and 20%, depending upon the source of the wealth, but it is typically on the lower end (2.5%) of the scale. The amounts also vary based upon which of the four Sunni schools of jurisprudence one follows. Shi'a Muslims also follow their own jurisprudence which also accounts for some of the variation. For a fuller discussion of this religious tax and its use to support those who "struggle for Allah" or fight against non-Muslims in holy war (i.e., *Jihad*), *see* John D.G. Waszak, *The Obstacles to Suppressing Radical Islamic Terrorist Financing*, 37 CASE W. RES. J. INT'L L. 673 (2005).

[22] See the extended discussion on purification by a well-known American *Shari'ah* authority, in Yusuf Talal DeLorenzo, *Shari'ah Supervision of Islamic Mutual Funds*, *available at* http://www.djindexes.com/mdsidx/downloads/delorenzo.pdf (last visited Jan. 24, 2008).

[23] Yusuf Talal DeLorenzo, *Dow Jones Universtiy Questions and Answers*, Question 32, *available at* http://www.central-mosque.com/fiqh/dow.htm (last visited Jan. 24, 2008).

[24] For a thorough discussion from a "moderate" *Shari'ah* authority on the full theological and jurisprudential analysis of *Shari'ah*, *see* MOHAMMAD HASHIM KAMALI, PRINCIPLES OF ISLAMIC JURISPRUDENCE (2003). For the specific discussion of "abrogration", which is the juridical view of latter *Qur'an*ic verses which contradict earlier ones, *see id.* at 202-227. For an analytical and objective analysis of Islamic jurisprudence and its implications for Muslim-non-Muslim relations, *see* Stephen Collins Coughlin, "To Our Great Detriment": Ignoring What Extremists Say About Jihad (with appendices) 83-133 (July 2007) (unpublished thesis, National Defense Intelligence College).

[25] Because the original Arabic *Qur'an* is not formally numbered and there are no periods in classical Arabic setting off one verse from another, Islamic canon typically breaks the 114 *suras* or chapters into 6,236 *ayat* or verses, but other counts are also used.

[26] There is also a healthy debate over which verses in the *Qur'an* are actually legal sources (*ayat al-ahkam*) such that laws are directly or indirectly derived from them. According to most scholars, the debate centers on the context of the appearance of a verse which has within it a connection to normative or instructional language. Some include all such verses while others only count those verses which are clearly "legal" in that they address authorized or prohibited behavior. *See, e.g.*, KAMALI, *supra* note 24, at 25-27.

[27] *Hadith* is singular for 'tradition'. *Ahadith* is the plural. This memorandum uses *Hadith* as the collective body of traditions.

[28] The *Hadith* were not formally collected between 100 to 200 years after the death of Mohammed. *See generally* THE ISLAMIC SCHOOL OF LAW: EVOLUTION, DEVOLUTION, AND PROGRESS viii-xii (Peri Bearman, Rudolph Peters & Frank E. Vogel eds., 2005) ; *see also* Coughlin, *supra* note 24, at [page number here] n.90:

> Individuals associated with Muhammad in his lifetime were called "companions." Among the numerous companions, the seven most prolific commentators on his life were Abu Hurrairah 'Abdur Rahman bin Sakhar Dasi (5,374 Hadith), Abdullah bin Umar bin Khattab (2,630), Anas bin Malik (2,286), Aisha (2,210), Abdullah bin Abbas (1,660), Jabir bin Abdullah Ahsan (1,540), and Sa'ad bin Malik Abu Saeed Khudhri (1,540). The compiled Hadith of these companions did not survive in their original creations but were passed down and collected by numerous Hadith collectors of varying quality and repute. Six scholars stand out among Hadith collectors for the reputed accuracy and authenticity in the selection of Hadith they chose to include as a part of their collections. In precedent order, the six "correct" collections of the Sunni, also called the "Six Canonical Collections" (the Sahih Sittah), are the works of Bukhari, Muslim, Abu Dawud, Tirmidhi, Ibn Maja and Nasa'i. Hence, if a story concerning Muhammad is related through one of the six "correct" collections and it reliably cites one of the seven companions, a presumption emerges, verging on irrebuttable, that the texts cited are accurate for the points being made - as matters of both Islamic theology and law. Because those accounts are presumed reliable, the

Sunna arising from them cannot be construed to contradict the Qur'an but rather are to be understood as doctrinally authoritative explanations of the Quranic verses they support: "Whatever the Messenger gives you, then take it and whatever he prohibits you, then stay away from it." (Qur'an 59:7)

[29] The debate over the role the *Hadith* should play as the secondary basis for *Shari'ah* is in fact the debate between the traditionalists who follow the millennium-old doctrine of the Islamic legal schools versus the progressives, typically in academia. The former account for the "*Shari'ah* authorities" and the latter for university professors who wish to distance themselves and Islam from the quite bellicose legal-military doctrines derived from the *Hadith*. The subject is fascinating and rich with drama but not one this memorandum can take up. The interested reader should begin with Coughlin, *supra* note 24, at 83 et seq., and then turn to one of the founders of the academic study of *Shari'ah* and Islamic jurisprudence, Joseph Schacht. Must reading would be JOSEPH SCHACHT, AN INTRODUCTION TO ISLAMIC LAW (1982), and JOSEPH SCHACHT, MUHAMMADAN JURISPRUDENCE (1950). Revisionists abound and two interesting versions are WAEL B. HALLAQ, A HISTORY OF ISLAMIC LEGAL THEORIES (1997) and WAEL B. HALLAQ, THE ORIGINS AND EVOLUTION OF ISLAMIC LAW (2005) on the one hand; and M. MUSTAFA AL-AZAMI, ON SCHACHT'S ORIGINS OF MUHAMMADAN JURISPRUDENCE (1996) on the other hand. Useful also would be KAMALI, *supra* note 24.

[30] Shi'a Islam differs from Sunni Islam theologically on who they consider to be legitimate successors to Mohammad's reign as leader of the Muslim *Umma* or nation. This has jurisprudential consequences because Shi'a Muslims, who await the return of the Fourth Imam or Caliph following Mohammed, consider their Imams who have followed in the Fourth Imam's footsteps to be his stand-in until his return and as such they share his infallibility. Thus, the leading contemporary Shi'a Imams are considered by their followers as inerrant and their legal rulings take on the perfection one would expect from inerrant beings. *See* Coughlin, *supra* note 24, at [page number here] n.52 and accompanying text.

[31] As noted, the *Shari'ah* authorities developed different schools of legal interpretation. These schools are called *maddhahib* (or *maddhab* in the singular form). Early in their development, there were many schisms and new schools but over time, the main body of legal scholarship and almost all *Shari'ah* authorities have long come to recognize only four extant schools among Sunni Muslims and one dominant school (some cite two) among Shi'a Muslims. While there are important jurisprudential and theological differences between the Sunni and Shi'a, *see supra* note 29, and indeed between the schools themselves within the respective Sunni and Sh'ia traditions, the specific rulings among all schools on the fundamental issues regarding the purposes of *Shari'ah*, the point of the individual Muslim's life, and the integrity and unity of the Muslim nation as a whole and the methodologies to achieve those ends are remarkably consistent, *see generally* Coughlin, *supra* note 24.

[32] *Furu'* is the Arabic word most often associated with positive law or the particular rulings in any given case. *See* VOGEL & HAYES, *supra* note 18, at 23-24; *see also* M. Cherif Bassiouni & Gamal M. Badr, *The Shari'ah: Sources, Interpretation, and Rule-Making*, 1 UCLA J. ISLAMIC & NEAR E.L. 135 (2002). For a discussion of *furu'* and *usul al-fiqh*, *see* Wael B. Hallaq, Usul Al-Fiqh*: Beyond Tradition*, 3:2 J. ISLAMIC STUD. 172-202 (1992), *reprinted in* [needs to be more specific here] Law and Legal Theory.

[33] *See Qur'an* 45:18. *But see Qur'an* 5:48, where a variation of the word appears and has the meaning of the 'proper way'; while some might argue that the word appears in yet other variations, the first of these two are the typical verses cited where the word is used in the sense of a legally proper path.

[34] The legal verses of the Qur'an are typically broken down into those verses dealing with religious rites and worship (*ibadat*) and those dealing with civil relations including commerce, political life, and the Law of *Jihad* (*mu'amalat*). KAMALI, *supra* note 24, at 26. What is confusing to many is that most academics writing on the subject of SCF define *mu'amalat* as civil or commercial relations giving the impression that there is in fact some sub-code of strictly commercial matters devoid of broader implications. *See*, *e.g.*, Yusuf Talal DeLorenzo & Michael J.T. McMillen, *Law and Islamic Finance: An Interactive Analysis*, *in* ISLAMIC FINANCE, *supra* note 3, at 142. *But cf.* VOGEL & HAYES, *supra* note 18, at 301, where the "Glossary" defines *mu'amalat* as "dealings or transactions among human beings; compare *'ibādāt*." Thus, while the "glossary" definition is technically correct and properly juxtaposes *mu'amalat* against *ibadat*, the reader who would need such a glossary is not likely to understand that *mu'amalat* is as much the Law of *Jihad* as it is commercial dealings.

[35] *See generally supra* note 18. For the "socio-economic" impetus for SCF, *see* Walid S. Hegazy, *Symposium: Islamic Business And Commercial Law: Contemporary Islamic Finance: From Socioeconomic Idealism To Pure Legalism*, 7 CHI. J. INT'L L. 581 (2007).
[36] *See generally* DeLorenzo & McMillen, *supra* note 34, at 132-197.
[37] *See* Muslim-Investor.com, Resources -- Education/Curricula in Islamic Finance, Education and Banking, *available at* http://muslim-investor.com/mi/education.phtml (last visited Jan. 25, 2008) (listing university departments).
[38] *See generally* WARDE, *supra* note 4, who theorizes of a "First and Second Aggiornamento" to suggest a first movement driven by a centralization of power and influence flowing from Arab oil wealth and a second movement driven by decentralized social, political, and financial constituencies. For a media rendition of the oil wealth-driven industry, *see* Wayne Arnold, Islamic Banking Rises on Oil Wealth, Drawing Non-Muslims, INT'L HERALD TRIB., Nov. 22, 2007, *available at* http://www.iht.com/articles/2007/11/22/business/islamic.php (last visited Jan. 25, 2008).
[39] The first order of business for determining whether a business is *Shari'ah* compliant is to make certain that it is not involved in a "vice" industry such as interest-based financing, the pork industry, various forms of the entertainment industry, and gambling. The question for *Shari'ah* authorities is how much "involvement" in a prohibited business amounts to a violation of *Shari'ah* such that an investor must not invest in that company. The same question applies to a permitted business that might earn interest on deposits or accounts payable and pay interest on debt: How much interest is too much interest? For a discussion of the *Shari'ah* authority opinions on this matter by one of the leading *Shari'ah* authorities, *see* Nizam Yaquby, Participation and Trading In Equities of Companies Which Main Business Is Primarily Lawful but Fraught with Some Prohibited Transactions, Address at the Fourth Harvard Islamic Finance Forum, Harvard University (Sept. 30-Oct 1, 2000), *available at* http://www.djindexes.com/mdsidx/downloads/yaquby.pdf (last visited Jan. 25, 2008).
[40] *See* DeLorenzo, *supra* note 22.
[41] *See* DeLorenzo & McMillen, *supra* note 34, at 143-150. Since the development of SCF, the debate among Islamic, economic, and *Shari'ah* scholars continues over the propriety of this new field of *Shari'ah* scholarship. Some argue that the industry is nothing more than form over substance and an abuse of *Shari'ah*. Others contend that SCF is a convoluted way for *Shari'ah* to effect its purposes in modern Western financial institutions. For the former, the debate is over the perversion of *Shari'ah* and its pre-modern ethic and economic principles. This group of critics would prefer that *Shari'ah* be used to modify the existing political economies to move away from interest-based debt and highly speculative and leveraged derivative transactions. For the latter group of critics, SCF is more than just an attempt to mollify the *Shari'ah* authorities; it is a "Trojan Horse" to legitimatize and to institutionalize *Shari'ah*, the purpose of which is the destruction of Western societies as such. For an example of the former group, *see* Haider Ala Hamoudi, Muhammad's Social Justice or Muslim Cant?: Langdellianism and the Failures of Islamic Finance, 40 CORNELL INT'L L.J. 89; El-Gamal, *supra* note 18. For the latter group, *see* KURAN, *supra* note 18; Alexiev, *supra* note 18.
[42] Drake Bennett, *The Zero Percent Solution*, BOSTON GLOBE, Nov. 4, 2007, *available at* http://www.boston.com/news/education/higher/articles/2007/11/04/the_zero_percent_solution/ (last visited Jan. 25, 2008).
[43] Alexiev, *supra* note 18, at [page number here] & n.1.
[44] Islamic Banking---Status of Islamic Banking, Institute of Islamic Banking and Insurance, *available at* http://www.islamic-banking.com/ibanking/statusib.php (last visited Jan. 25, 2008).
[45] *See* Mohammed El Qorchi, *Islamic Finance Gears Up*, 42 Fin. & Dev., Dec. 2005, *available at* http://www.imf.org/external/pubs/ft/fandd/2005/12/qorchi.htm (last visited Jan. 25, 2008). Growth is reported to have reached 30% annually. *See* Karina Robinson, *Islamic Finance Is Seeing Spectacular Growth*, INT'L HERALD TRIB., Nov. 5, 2007, *available at* http://www.iht.com/articles/2007/11/05/business/bankcol06.php (last visited Jan. 25, 2008).
[46] Gayle Young, Fast Growing Islam Winning Converts in Western World, CNN Interactive News, http://www.cnn.com/WORLD/9704/14/egypt.islam/ (last visited Jan. 25, 2008). The Executive Vice President and General Counsel of the Federal Reserve Board of New York cited a White House report that Islam is the "fastest growing faith in the United States." Thomas C. Baxter, Jr., Executive Vice President & Gen. Counsel, Fed. Reserve Bank of N.Y. Welcome Speech to the Seminar on Legal Issues in the Islamic

Financial Services Industry (March 1, 2005), *available at* http://www.newyorkfed.org/newsevents/speeches/2005/bax050301.html (last visited Jan. 25, 2008).

[47] *Sukuk* in Arabic is plural for bonds; *sak* is the singular form.

[48] Mark Bendeich, Islamic Finance: Safe Haven or Irrational Exuberance? REUTERS, Dec. 10, 2007, http://www.reuters.com/article/bankingfinancial-SP-A/idUSKLR27708220071210 (last visited Jan. 25, 2007). Growth in this industry is best illustrated graphically. For growth data on *Shari'ah* compliant bonds, *see* Appendix A. To put the *Shari'ah* compliant bond issuance in context, the total net issuances of all international bonds and notes for the third quarter of 2007 was $396 billion, which represents a significant downturn in worldwide demand for such debt instruments. *See* BANK FOR INTERNATIONAL SETTLEMENTS, BIS QUARTERLY REVIEW 19-21, Dec. 2007,,*available at* http://www.bis.org/publ/qtrpdf/r_qt0712.pdf (last visited Jan. 25, 2008). That *Shari'ah* compliant bonds were showing spectacular growth in the same quarter and representing approximately 10% of worldwide demand speaks volumes for the popularity and the liquidity of this particular market segment.

[49] The principal oil-producing Muslim states are located in and around the Persian Gulf: Bahrain, Kuwait, Quatar, Oman, Saudi Arabia, the United Arab Emirates, Iraq, and Iran. These countries, sans Iraq and Iran, formed the Gulf Cooperation Council in February 1981. *See* Council Charter of the Secretariat General of the Cooperation Council for the Arab States of the Gulf, *available at* http://www.gcc-sg.org/eng/index.php?action=Sec-Show&ID=1 (last visited Jan. 25, 2007).

[50] For some of the promotional literature naming several of the "facilitators," *see*, *e.g.*, John Butcher, *Shariah Funds Inc Introduces the First Islamic Hedge Fund Aided by Scholars*, HEDGE FUNDS REV., *available at* http://www.shariahfunds.com/news/images/Hedge_Funds-Rev.pdf. For specifically offices of such international law firms as Patton Boggs in Qatar, see the firm's Internet site, http://www.pattonboggs.com/Locations/Office.aspx?office=4 (last visited [date]). For Patton Boggs promotional material indicating the law firm is also a registered agent for lobbying on behalf of the Saudi Arabian government, *see* Patton Boggs LLP, Attorneys at Law, http://www.pattonboggs.com/middleeast/ (last visited [date]). The law firm of King and Spaulding also highlights its activities in the area on its Internet site. *See* King & Spaulding, http://www.kslaw.com/portal/server.pt?space=KSPublicRedirect&control=KSPublicRedirect&PracticeAreaId=141&us_more=0 (last visited [date]); *see also* Brian O'Connell, *Wealth Management: Gulf's Super Rich Return Home*, Meed, Dec. 21, 2007 (updated Jan. 9, 2008), *available at* http://www.meed.com/bankingandfinance/specialreport/2007/12/gulfs_superrich_return_home.html.

[51] For GCC sovereign wealth funds purchasing U.S. assets, *see* David Enrich, *Oil-Rich Persian Gulf Countries Show Growing Financial Clout,* DOW JONES NEWSWIRES, Oct. 22, 2007, *available at* http://www.zawya.com/story.cfm/sidDN20070920015851 (last visited Feb. 4, 2008). For the push to establish SCF in the U.S., *see generally* Wayne Arnold, *Adapting Finance to Islam*, N.Y. TIMES, Nov. 22, 2007, *available at* http://www.nytimes.com/2007/11/22/business/worldbusiness/22islamic.html?ei=5087&em=&en=d6f0821c05a1d02f&ex=1195880400&pagewanted=all (last visited Jan. 25, 2008).

[52] Karen Lane, *Islamic-Bond Market Becomes Global By Attracting Non-Muslim Borrowers*, WALL ST. J., Nov. 16, 2006, *available at* http://online.wsj.com/article/SB116361223362324035.html (last visited Jan. 25, 2008); *see also* Press Release, Dow Jones, *Dow Jones Indexes and Citigroup To Launch First Islamic Bond Index* (Mar. 6, 2006), *available at* http://www.dj.com/Pressroom/PressReleases/Other/US/2006/0306_US_DowJonesIndexes_1095.htm (last visited Jan. 25, 2008).

[53] *See* Dow Jones Islamic Market Indexes, Dow Jones Indexes*, available at* http://www.djindexes.com/mdsidx/?event=showIslamic (last visited Jan. 25, 2008).

[54] *See* STANDARD & POOR'S, S & P SHARIAH INDICES, *available at* http://www2.standardandpoors.com/spf/pdf/index/SP_Shariah_Indices_Methodology_Web.pdf (last visited Jan. 25, 2008).

[55] *See* Index Comparisons, Dow Jones Islamic Fund, http://www.investaaa.com/cgi-bin/client_product.cgi?member=55&product_id=527 (last visited Jan. 25, 2008).

[56] *See* Joanna Slater, *Growing Interest: When Hedge Funds Meet Islamic Finance*, WALL ST. J., Aug. 9, 2007, *available at* http://online.wsj.com/article/SB118661926443492441.html?mod=todays_us_page_one (last visited Jan. 25, 2008).

[57] *See, e.g.*, Islamic Finance, Devon Bank, http://www.devonbank.com/Islamic/ (last visited Jan. 25, 2008) (Chicago-based Devon Bank internet site promoting its Islamic finance products).
[58] *See*, *e.g.*, Shirley Chieu, *Islamic Finance in the United States: A Small But Growing Industry*, Chicago Fed Letter No. 214, May 2005, *available at* http://www.chicagofed.org/publications/fedletter/cflmay2005_214.pdf (last visited Jan. 25, 2008); Office of the Comptroller of the Currency, Interpretive Letter No. 806, Oct. 17, 1997, *available at* http://www.occ.treas.gov/interp/dec97/int806.pdf; Office of the Comptroller of the Currency, Interpretive Letter No.867, June 1, 1999, *available at* http://www.occ.treas.gov/interp/nov99/int867.pdf; *see also* State of New York Commissioner of Taxation and Finance Advisory Opinion Petition No. M010821A, Jul. 26, 2002, *available at* http://www.tax.state.ny.us/pdf/advisory_opinions/real_estate/a02_4r.pdf (last visited Jan. 25, 2008).
[59] *See generally* VOGEL & HAYES, *supra* note 18. SCF is "legal" in the sense it includes aspects of binding law, especially in Muslim countries where *Shari'ah* is considered both constitutional and statutory, such as Saudi Arabia, Iran, and Sudan; "normative" in the sense that *Shari'ah* is considered an all-encompassing way of life; and "communal" in the sense that communities of Muslims have in fact embraced *Shari'ah* as authoritative at some level.
[60] Bassiouni & Badr, *supra* note 32, at 135.
[61] WARDE, *supra* at note 4, at 33.
[62] JOSEPH SCHACHT, AN INTRODUCTION TO ISLAMIC LAW 1 (1982).
[63] VOGEL & HAYES, *supra* note 18, at 23.
[64] MERVYN K. LEWIS & LATIFA M. ALGAOUD, ISLAMIC BANKING 24 (Edward Elgar ed., 2001). While the authors attempt to "tone down" this absolute statement of *Shari'ah* by suggesting that as a practical matter *Shari'ah* has in fact lived side-by-side with secular law and in some cases even incorporated it into *Shari'ah*, they honestly but almost unnoticeably add the following to their effort to soften *Shari'ah*: "The continuation of a custom of a particular place or community is allowable under Islamic law, and may in fact be assimilated into the law, as were many of the customs of the Arabs. **To be permissible a custom must not be contrary to revealed injunctions**, and this point remains highly controversial in some areas, for example the treatment of women." *Id*. at 25. What the authors mean by "revealed injunctions" means any legal ruling of *Shari'ah* authorities where there is consensus among the authorities that the ruling is based on an explicit verse in the Qur'an or Sunna. *See infra* note 75 and accompanying text (discussing jurisprudential force of "consensus"). What is intriguing is that of all of the fixed unalterable laws of *Shari'ah*, the authors are concerned about the treatment of women. While many certainly argue that *Shari'ah* demeans and subordinates the Muslim woman, one might have thought that the fixed death penalty for an apostate – a Muslim who wishes to leave Islam – would have captured their concern sufficient for articulation. Apparently, it is not, in the authors' views, "highly controversial" among the *Shari'ah* faithful.
[65] The literal meaning of *Shari'ah* is "the way" -- especially to the source of water (i.e., life).
[66] *See*, *e.g.*, DeLorenzo & McMillen, *supra* note 34, at 136-137.
[67] Coughlin, *supra* note 24.
[68] *See supra* note 31. For a detailed discussion of the schools of jurisprudence, *see id.*
[69] *See generally* DeLorenzo, *supra* note 22.
[70] A typical ruling reads: "If the lease of real estate is for purely prohibited purposes, like a bar, or a church, or a nightclub, then the lease contract is prohibited and legally void because the benefit, or subject of the contract, is prohibited." A COMPENDIUM OF LEGAL OPINIONS ON THE OPERATIONS OF ISLAMIC BANKS 13-29 (Yusul Talal DeLorenzo ed. & trans., 2000).
[71] In a detailed legal ruling relating to interest earned in a bank in non-Muslim lands, a leading *Shari'ah* authority explains that the strictures of *Shari'ah* on certain business transactions such as deposits in a non-Muslim bank are relaxed when a Muslim enters the Abode of War (*dar al-harb*), which is the land of non-Muslims. The point of this ruling is to give a concrete example of how even the Law of *Jihad* in the context of the doctrines relative to the Abode of War versus the Abode of Islam are integral to the law of commerce. Thus, in the legal ruling, the *Shari'ah* authority began his analysis as follows:

> . . . In the terminology of Islamic Law, "people of the abode of wara" are not only those who are actually at war with Muslims, **but all those who are not formally allied with Muslims by a covenant of protection, such that war could conceivably be declared between them and Muslims at any time.**

Id. at 214-245, 224 (emphasis added). For a ruling on whether a Muslim can lease a building in the Abode of Islam to a foreign school for foreign, non-Muslim students and what must be done to separate the male students from the female students, *see id*. at 27-28.

[72] There is no shortage of academic literature on the political and religious turmoil that existed in the Muslim empires from soon after the death of Mohammed and the battles between the "traditionalists" who sought a *Shari'ah*-centered political world and those who opposed it for one reason or another. A good, deep history of Islam may be found in MARSHALL G. S. HODGSON, THE VENTURE OF ISLAM: CONSCIENCE AND HISTORY IN A WORLD CIVILIZATION, 3 vols. (1974). And, of course, the required reference to BERNARD LEWIS, THE MIDDLE EAST: A BRIEF HISTORY OF THE LAST 2,000 YEARS (1995). For the narrative of the failures in Islamic history for the political leaders to abide by *Shari'ah* from the "traditionalist" vantage, *see* SAYYID QUTB, SOCIAL JUSTICE IN ISLAM (2000). For the classic statement on this "theory" versus "practice" and the dominant role of *Shari'ah* authorities to determine the theory and even the practice when *Shari'ah* is put into practice, *see* Joseph Schacht, *supra* note 62. For the lament of a "moderate" *Shari'ah* academic scholar who would like to see *Shari'ah* and *usul al-fiqh* modernized so that it might be used to govern modern societies, he suggests that the failure of *Shari'ah* to keep pace with modernity was precisely because it often was not fully integrated into Islamic society but rather developed as a private affair among *Shari'ah* authorities. KAMALI, *supra* note 24, at 500-521.

[73] This is evident in SCF itself. The sole authorities for determining *Shari'ah* compliance or even what is "Islamic" regarding finance and commerce are the traditional *Shari'ah* scholars. Whatever criticism some critics might have of the "Islamist" bent of SCF, there is no serious challenge to the absolute authority of the traditionalists in this discipline. *See*, *e.g.*, *infra* note 74.

[74] *See*, *e.g.*, VOGEL & HAYES, *supra* note 18, at 9-10, 23. Although Professors Vogel and Hayes do not come right out and say that the traditional *Shari'ah* authorities are the exclusive authorities on SCF, their entire book is dedicated to convincing *Shari'ah* authorities to move toward greater liberality in order to embrace more of modern day finance. Thus, in the conclusion of their highly acclaimed book on SCF, the authors ask: "Does Islamic law (*fiqh*), as elaborated by the scholars and institutions devoted to it, have the potential to meet all the needs of modern Muslims in the commercial and financial sector, in the traditional sense of offering normative guidance for various aspects of daily life?" *Id.* at 294. And, in concluding they hold out optimism but recognize the future is in the hands of the *Shari'ah* authorities, not the academics:

> No doubt many of the legal challenges now facing Islamic finance are disquieting and difficult – such as creating derivatives or other risk-hedging devices or encouraging trade in financial instruments. If *fiqh* scholars take too cautious and literalist an approach, backing away from the deeper comparative and functional analysis and bolder legal reasoning or *ijtihad* which is now needed, Islamic finance could languish. Given the record to now, we are optimistic about the future.

Id. at 295.

[75] For the classic statement on the role of consensus, see SCHACHT, *supra* note 62, at 30. For a more general discussion, *see id*. at 29-75. For a scholarly work on consensus by the revisionist school of new academics, see Wael B. Hallaq, *On the Authoritativeness of Sunni Consensus*, 18 INT'L J. MIDDLE E. STUD. 427-454 (1986), *reprinted in* WAEL B. HALLAQ, LAW AND LEGAL THEORY IN CLASSICAL AND MEDIEVAL ISLAM VIII (1994) [hereafter LAW AND LEGAL THEORY]; see also Coughlin, *supra* note 24, at 91-109.

[76] For a discussion of the DJII in greater detail, *see infra* Part III.B.

[77] The fundamental standard regarding disclosure of risks and other pertinent information is whether the risks are material and whether any other information would be material to a reasonable investor. For a more thorough discussion of materiality and other disclosure issues, *see infra* Part II.E.a.

[78] This fund was begun in 1999 and liquidated in 2002. For access to its SEC filings, *see* http://www.sec.gov/cgi-bin/browse-edgar?action=getcompany&CIK=0001088654&owner=include&count=40 (last visited Feb. 4, 2008).

[79] Thus, even if it promoted itself as ethical equity-based investing, if it was based upon *Shari'ah*, the disclosure issue would remain. Further, it is different than the so-called Catholic indexes. Even in the case of the "Catholic Values" funds, there is no representation that there is an underlying legal code requiring certain investment behavior by adherent Catholics. Instead, the funds follow "Catholic values" as they and their advisors determine them to be based upon the doctrine of the Catholic Church but they are just as clear that even if their "Catholic advisors" were to determine a company was not suited to these values, there is no requirement either by the rules of the fund or by the Catholic Church that such companies not be

included in the fund. In other words, the Catholic funds are like other truly "values-based" funds where like-minded individuals agree on certain standards.

[80] Investment Company Act of 1940, Pub. L. No. 76-768, 54 Stat. 789.

[81] The lawyers' imputed knowledge is "rudimentary" because very few of the lawyers acting as facilitators in the SCF industry fully understand or acknowledge what *Shari'ah* is beyond thinking of it as just another "value-based screen."

[82] For the Dow Jones Islamic Market Index Portfolio's Registration Statement filed pursuant to the Investment Company Act of 1940, Part B, Item 12, *see* Dow Jones Islamic Market Index Portfolio, Registration Statement (Form N-1A), *available at* http://www.sec.gov/Archives/edgar/data/1088654/0000935489-99-000014.txt (last visited Jan. 25, 2008). In addition, in Part A of the of the registration statement, there are warranty disclaimers relative to the DJII, the most important of which is:

> Although Dow Jones uses reasonable efforts to comply with its guidelines regarding the selection of components in the Dow Jones Islamic Market Index, Dow Jones disclaims any warranty of compliance with Shariah law or other Islamic principles . . . .

While this might insulate Dow Jones from a claim of breach of warranty, it does not address the failure to disclose material risks relative to the very real problem of competing *Shari'ah* authorities.

[83] This example is not academic. One of the leading *Shari'ah* authorities on SCF has recently shaken the *Shari'ah*-compliant bond industry by stating that he does not believe the current structures approved by most *Shari'ah* advisory boards are in fact *Shari'ah*-compliant. *See* Sebastian Abbot, *Muslims Debate Bonds*, MORNING CALL, (Jan. 12, 2008), *available at* http://www.mcall.com/business/local/all-islamicbonds.6224369jan12,0,6766410.story (last visited Jan. 25, 2008).

[84] The exposure for this now defunct fund in such a lawsuit would arguably be "relatively high" due, in large part, to the failure of the registration statement to detail the fact that *Shari'ah* by its own terms rejects the notion that a given *Shari'ah* expert or legal authority, or even a single *Shari'ah* advisory board, can rule definitively on what is or is not proper compliance with a *Shari'ah* principle. Even an individual ruling soundly rooted in consensus among other scholars might be challenged on the grounds that it violates a particular canonical precept. *See*, *e.g.*, VOGEL & HAYES, *supra* note 18, at 32-34. This fact and the likelihood of such disputes arising among *Shari'ah* authorities given the current *Shari'ah* landscape, which already shows a fair amount of discordance based, in large part, along geographical contours, suggests that the fund managers had a duty to investigate these rather material facts and to disclose them to their investors. *See generally id.* at 28-52. For a series of good articles on SCF as it appears in different geographical locations and the role of geo-political factors in its development, *see* THE POLITICS OF ISLAMIC FINANCE, *supra* note 4.

[85] The following represent just a few of the queries one might expect to be addressed, all of which force the issue of what does the *Shari'ah* in *Shari'ah* compliant finance really mean: Is a company dedicated to atheism or polytheism *Shari'ah* compliant even if it passes the "objective" screens discussed in the text above? What about abortion clinics? Is a company that otherwise passes the publicly-disclosed filters remain *Shari'ah* compliant even if it is owned by or domiciled in the territory of the enemies of the Muslim nation (i.e., an Israeli-owned or domiciled company)? When the Dow Jones Islamic Index publicizes that weapons manufacturers are forbidden, does *Shari'ah* in fact forbid weapons manufacturing by Muslims for Muslim nations? Would it be material to a reasonable U.S. investor to know if the answers to any of these questions is "no"? What would happen if the U.S. went to war against a major *Shari'ah*-compliant Muslim nation and, as a result, the GCC states together with most of the authoritative *Shari'ah* scholars in the world declare the war an act of war against the entire Muslim nation? Will this declaration of war affect the Dow Jones' Islamic Index filters? Would any company owned by non-Muslim U.S. citizens be *Shari'ah*-compliant under those circumstances? For a related discussion, *see infra* notes 362-366 and accompanying text.

[86] *See supra* note 59 and accompanying text.

[87] *See* VOGEL & HAYES, *supra* note 18, at 24-28. Vogel and Hayes note especially the minority view that interest is not prohibited: "But such Muslims, though numerous, appear to be in the minority. A much larger number, **supported by a near-unanimity of traditional scholars**, seem certain that modern bank-interest falls within the revealed prohibitions and entails a major sin, tolerable only in the throes of necessity." *Id*. at 25 (emphasis added).

[88] In some complicated cases, both judicial and arbitration venues are chosen depending upon the specific issue litigated or the type of enforcement sought. *See*, *e.g.*, Michael J.T. McMillen, *Symposium: Islamic Business and Commercial Law: Contractual Enforceability Issues: Sukuk and Capital Markets Development*, 7 CHI. J. INT'L L. 427 (2007).

[89] *See generally* David S. Ruder, *Lessons From Enron: Director and Lawyer Monitoring Responsibilities*, (Oct. 10, 2002) (paper presented to the 41st Annual Corporate Counsel Institute, Chicago, Illinois), *available at* http://www.law.northwestern.edu/professionaled/documents/Ruder_Lessons_Enron.pdf (last visited Jan. 28, 2008); *see also* MODEL RULES OF PROF'L CONDUCT R. 1.2(d) (2002); AM. BAR ASS'N, ANNOTATED MODEL RULES OF PROFESSIONAL CONDUCT 39-40 (5th ed. 2003).

[90] While the terms "certainty, consistency, predictability, and transparency" are oft-used in the law in this context, this memorandum borrows these precise terms and their meanings from one of SCF's biggest advocates and one of the most influential of the legal practitioners making a career of SCF in Michael J.T. McMillen, *Islamic Shari'ah-compliant Project Finance: Collateral Security and Financing Structure Case Studies*, 24 FORDHAM INT'L L.J. 1184 (2001).

[91] As discussed *supra* at notes 60-62 and accompanying text, there is no universal standard of authority or hierarchy for *Shari'ah* authorities. This fact alone and the development of authoritativeness is part of the black box of *Shari'ah*.

[92] *See*, *e.g.*, McMillen, *supra* note 88, at 1196, n.14.

[93] According to *Shari'ah* doctrine rooted directly and firmly in the Qur'an, and agreed upon by all legal schools, no secular law can take precedence over Allah's divine law: "Whoever does not follow the revealed law and does not judge according to it is counted an unbeliever." *See*, *e.g.*, AL-AZAMI, *supra* note 29, at 12; *see also* Coughlin, *supra* note 24, at 90:

> Known among Islamic jurists to take a more "liberal" view toward Islamic law, Mohammad Hashim Kamali, in his Principles of Islamic Jurisprudence, nonetheless comes down four-square on the notion of the absolute sovereignty of Allah that necessarily pre-empts all other forms of sovereignty – including the democratic concept of sovereignty of the people.

The blending of secular law and *Shari'ah* as it has unfolded in many Muslim countries would appear to be *ipso facto* evidence of the failure to tame *Shari'ah* since there are no Muslim dominated countries that one might call "mostly free" with real representative government except possibly Turkey and Indonesia. Most observers recognize Turkey's success has come at the expense of "religious freedom" since the Kemalists and their use of the army to suppress the public expression of Islam and *Shari'ah* is well documented. Indonesia is changing for the worse due in large part to the growing violence against non-Muslims which in turn is due in large part to the increasing influence of *Shari'ah*. *See*, *e.g.*, Freedom House, Country Reports, *available at* http://www.freedomhouse.org/template.cfm?page=21&year=2007 (last visited Jan. 28, 2008) [hereinafter Freedom Survey 2007]. For a careful analysis of the extent to which *Shari'ah* is codified as the law of the land in Muslim countries, *see* TAD STAHNKE & ROBERT C. BLITT, U.S. COMM. ON INT'L RELIGIOUS FREEDOM, THE RELIGION-STATE RELATIONSHIP AND THE RIGHT TO FREEDOM OF RELIGION OR BELIEF: A COMPARATIVE TEXTUAL ANALYSIS OF THE CONSTITUTIONS OF PREDOMINANTLY MUSLIM COUNTRIES (Mar. 2005) [hereinafter STAHNKE & BLITT, RELIGIOUS FREEDOM *SHARI'AH* REPORT], *available at* http://www.uscirf.gov/countries/global/comparative_constitutions/03082005/Study0305.pdf (last visited Jan. 28, 2008). For an examination of "religious freedom" in such Muslim countries as Indonesia, Egypt, Iran, Saudi Arabia, *see* U.S. COMM. ON INT'L RELIGIOUS FREEDOM, ANNUAL REPORT (May 2005), *available at* http://www.uscirf.gov/countries/publications/currentreport/2005annualRpt.pdf#page=71 (last visited Jan. 28, 2008). For the growing influence of *Shari'ah* in Indonesia, *see* Tom A. Peter, *At Massive Rally, Hizb Ut-Tahrir Calls For A Global Muslim State*, CHRISTIAN SCIENCE MONITOR, Aug. 14, 2007, *available at* http://www.csmonitor.com/2007/0813/p99s01-duts.html (last visited Jan. 28, 2008). For a good discussion of "modernist legislation" vis-à-vis *Shari'ah* in Muslim countries, albeit somewhat dated, *see* SCHACHT, *supra* note 62, at 100-111.

[94] Certainty, consistency, predictability, and transparency in transactional law are never perfect but operate within a range of comfort for investors. The market tends to step in and price deals inversely to their approximation of these goals. As transparency goes down, price goes up until the deal or product just is no longer in reach of the demand's willingness to pay.

[95] For a SCF-friendly practitioner's view of these problems, *see* McMillen, *supra* note 88.

[96] The existence of the "corporate veil" to protect the individual from liability is a good example of this "form" over "substance." Even though an individual might "maintain the corporate formalities," in

substance he is acting as the sole entrepreneur but the law and the policy behind the law shield him from personal liability to promote the risk taking inherent in commercial endeavors. For a discussion of this "legal fiction," *see* Sanford A. Schane, *The Corporation Is A Person: The Language Of A Legal Fiction*, 61 TUL. L. REV. 563 (1987).

[97] Even this is not exactly true. According to some scholars, interest was once not divinely prohibited *per se*. But the debate about the divinity of this prohibition as it exists today is not open to a societal or political discussion and conclusion. Rather, it is confined to the *Shari'ah* black box entrusted to the *Shari'ah* authorities. *See generally* KURAN, *supra* note 18; El-Gamal, *supra* note 18.

[98] *See*, *e.g.*, Text of the Historic Judgment on Interest Given by the Supreme Court of Pakistan, ALBALAGH, http://www.albalagh.net/Islamic_economics/riba_judgement.shtml (last visited Jan. 28, 2008).

[99] Islamic scholars in academia have given this issue much attention. *See*, *e.g.*, Mahmoud A. El-Gamal, *An Economic Explication of the Prohibitions of Riba in Classical Islamic Jurisprudence*, *in* THE PROCEEDINGS OF THE THIRD HARVARD UNIVERSITY FORUM ON ISLAMIC FINANCE: LOCAL CHALLENGES, GLOBAL OPPORTUNITIES 29-40 *available at* http://www.ruf.rice.edu/~elgamal/files/riba.pdf (last visited Jan. 28, 2008); *see also* KURAN, *supra* note 18; McMillen, *supra* note 87, at [page number] n.2; Timur Kuran, *The Genesis Of Islamic Economics; A Chapter In The Politics Of Muslim Identity*, Social Research (Summer 1997), *available at* http://findarticles.com/p/articles/mi_m2267/is_n2_v64/ai_19652892/pg_1 (last visited Feb. 1, 2008).

[100] This would be the case as a matter of theory, prudence, and actual practice. Theory: the lawyer is not an expert; prudence: the lawyer's involvement would expose him to accusations of tampering with divine law, extending beyond his area of expertise, and for disturbing the lines of authority and discipline in a team effort; actual practice: lawyers are not *Shari'ah* authorities and use good judgment in not pretending to be such. *See supra* note 71; DeLorenzo & McMillen, *supra* note 34.

[101] This might not be the case if the company is a publicly-owned company or even a company with other shareholders where the law articulates a duty to minority shareholders. *See* Mary Siegel, *Fiduciary Duty Myths In Close Corporate Law*, 29 DEL. J. CORP. L. 377 (2004) (discussing fiduciary duties in context of close corporation).

[102] Such nominate contracts include cost-plus agreements where a purchase money lender purchases and immediately resells the collateral to the borrower at an agreed upon stepped-up price with a deferred payment schedule, or sale-lease back agreements where the lease payments cover the interest for the loan. VOGEL & HAYES, *supra* note 18, at 181-200. Recently, certain *Shari'ah* authorities have even developed what are represented as *Shari'ah* compliant structures to allow investment in highly speculative derivates, something most *Shari'ah* authorities have forbidden altogether. For a theoretical discussion of "legal" derivatives, *see id*. at 219-232. For an example in practice, *see* Slater, *supra* note 56.

[103] *See supra* note 93.

[104] *See* McMillen, *supra* note 88, at 1259-1260.

[105] Tax matter agreements are most properly and conservatively used in inter-company tax allocations for related entities. *See*, *e.g.*, Interagency Policy Statement on Income Tax Allocation in a Holding Company Structure, 63 Fed. Reg. 64,757 (Nov. 23, 1998).

[106] *Id.*

[107] For a discussion of defining and classifying "financial intangibles" and the complexities in the post-Enron world, *see* Olufunmilayo B. Arewa, *Measuring and Representing the Knowledge Economy: Accounting for Economic Reality under the Intangibles Paradigm*, 54 BUFFALO L. REV. 1 (2006); Anthony J. Luppino, *Stopping The Enron End-Runs And Other Trick Plays: The Book-Tax Accounting Conformity Defense*, 2003 COLUM. BUS. L. REV. 35.

[108] *See, e.g.,* Interagency Policy Statement on Income Tax Allocation in a Holding Company Structure, 63 Fed. Reg. 225 (Nov. 23, 1998) *available at* http://www.fdic.gov/regulations/laws/federal/98soptx.pdf (last visited Feb. 14, 2008). *See also* Arewa, *supra* note 107, and Luppina, *supra* note 107 (discussing the complexities of structuring transactions with conflicting purposes).

[109] *See*, *e.g.*, Pahl v. Commissioner, 150 F.3d 1124, 1128 (9th Cir. 1998).

[110] Throughout the legal literature on SCF, there is a recognition that defaults and bankruptcies will pose real challenges because it is not clear how the transactions will be characterized. *See, e.g.,* McMillen, *supra* note 90 (much of the deal structures were addressing the uncertainty of default under *Shari'a* legal systems) and McMillen, *supra* note 88 (enforceability and rating issues for securitization of bond issuances).

[111] It is not enough to refute this proposition by stating that the intent of *Shari'ah* is known: the avoidance of interest, speculation, and vice. If the refutation were both true and meaningful, it would suggest that the speaker knows what *Shari'ah* means by interest, speculation, and vice. And, if that were true, the speaker could devise his own legal structures without reference to or assistance from *Shari'ah* scholars and authorities. But this is not the case.

[112] A good example is to look at the published works of the legal practitioners making a living providing expert legal services to the SCF industry. The articles by McMillen cited herein generally are examples but notably *see* McMillen, *supra* note 88, at [page number] n.18 and accompanying text where the author waxes on about the utilization of *Shari'ah* in Saudi Arabia and various other Muslim countries and does not raise even a word of caution regarding the abuses well documented under the *Shari'ah* legal system.

[113] *Id.*; *see also* William L. Rutledge, Executive Vice President, [institution], Regulation and Supervision of Islamic Banking in the United States, Address Before the 2005 Arab Bankers Ass'n of N. Am. Conference on Islamic Fin.: Players, Products & Innovations in New York City (Apr. 19, 2005), *available at* http://www.nubank.com/islamic/regulation.pdf (last visited Jan. 28, 2008). For a discussion of *Shari'ah* as "Medieval obscurantism," *see* Alexiev, *supra* note 18.

[114] Even the scholarly literature produced by academic "Islamicists" and economists produces only rarely an objective critique that begins by asking whether *Shari'ah* is at all compatible with Western life. *See*, *e.g.*, KURAN, *supra* note 18.

[115] *See* McMillen, *supra* note 88.

[116] Borrowed term from ENCYCLOPEDIA OF SOCIAL SCIENCE RESEARCH 308-309 (Michael Lewis-Beck, Alan Bryman & Tim Futing Liao eds., 2003), *available at* http://www-personal.umd.umich.edu/~delittle/Encyclopedia%20entries/endogeneous%20variable.pdf (last visited Jan. 28, 2008). The endogenous/exogenous taxonomy for analyzing disclosure has an ancient pedigree. In standard common law fraud, commentators such as Judge Story distinguished between the heightened duty to disclose for intrinsic elements of a deal versus the extrinsic:

> Intrinsic circumstances are properly those which belong to the nature, character, condition, title, safety, use, or enjoyment, &c., of the subject-matter of the contract, such as natural or artificial defects in the subject-matter. Extrinsic circumstances are properly those which are accidentally connected with it, or rather bear upon it at the time of the contract, and may enhance or diminish its value or price, or operate as a motive to make or decline the contract; such as facts respecting the occurrence of peace or war, the rise or fall of markets, the character of the neighborhood, the increase or diminution of duties, or the like circumstances.

1 JOSEPH STORY, COMMENTARIES ON EQUITY JURISPRUDENCE 300, at 301-02 (W. H. Lyon, Jr. ed., Little, Brown & Co. 14th ed. 1918) (1834).

[117] One such *Shari'ah*-based nominate lease contract is called *Ijara*. VOGEL & HAYES, *supra* note 18, at 143-145.

[118] Typically, a sale-lease back financing transaction is a way for a company to gain liquidity and to move a capital asset off the balance sheet to avoid the burdens to the company's debt ratios if standard capital asset financing is used. For a short discussion of the accounting aspects, *see* Richard J. Strotman, *Sale/leaseback: Financing Tool for the '90s*, CPA J. ONLINE (Apr. 1991), *available at* http://www.nysscpa.org/cpajournal/old/10691657.htm (last visited Jan. 28, 2008). The motivation for a *Shari'ah* sale-lease back, however, is to avoid interest and to accommodate *Shari'ah* fixed rules relative to the actual transfer of ownership of the property, who is responsible for repairs (lessor), who can cancel the contract under changed circumstances (lessee), and how the parties will treat future sale and option terms. In other words, the purposes of a secular sale-lease back are purely for accounting purposes or "form"; for the *Shari'ah* contract, however, the purpose is to effect the actual form required by *Shari'ah* as "substance".

[119] *See* Yaquby, *supra* note 38 (various *Shari'ah* authorities prohibit investment in companies that earn more than 5-15% of total earnings from interest income). The DJII achieves this prohibitory goal by screening out companies with a debt to market capitalization equal to or greater than 33%. For this and other ratios intended to screen for interest income, *see* M. H. Khatkhatay & Shariq Nisar, Investment in Stocks: A Critical Review of Dow Jones *Shari'ah* Screening Norms, Paper Presented at the Int'l Conference on Islamic Capital Markets (Aug. 27-29, 2007), *available at* http://www.djindexes.com/mdsidx/downloads/Islamic/articles/DowJonesShariahScreeningNorms.pdf (last visited Jan. 28, 2008).

[120] This is not to say that financial institutions will not in time become endogenous elements of *Shari'ah* if SCF were to be wholly institutionalized within the Western financial system. The point being that *Shari'ah* is not viewed as stagnant or inert vis-à-vis what is today understood as endogenous and all else being exogenous. In fact, the literature suggests *Shari'ah* is an organic system which, over time, has developed new endogenies and expelled others. *See* SCHACHT, *supra* note 51, at 199-211. What might be said is that the most static of the endogenous elements of *Shari'ah* are what are called the Five Pillars and *Jihad*, which is sometimes referred to as the Sixth Pillar. *See* Coughlin, *supra* note 24, at 83 et seq.

[121] *See*, *e.g.*, Munshtak Parker, *UK Government Serious About Sukuk*, ARAB NEWS (2007).

[122] J. Quinn Martin, *City Tries to Increase Share of Sharia Finances*, N.Y.SUN (Oct. 9, 2007) *available at* http://www.nysun.com/article/64175?page_no=1 (last visited Jan. 28, 2008).

[123] *See* Elliot Blair Smith, *Dream Fulfilled Helps Muslims Realize Theirs*, USA TODAY (Feb. 24, 2005), *available at* http://www.usatoday.com/money/perfi/general/2005-02-24-islamic-finance-usat_x.htm (last visited Jan. 28, 2008); *see also* Rutledge, *supra* note 110; Press Release, Freddie Mac, Devon Bank, Freddie Mac Announce Expanded Financing Opportunities for Muslim Homebuyers (Jan. 10, 2005), *available at* http://www.freddiemac.com/news/archives/afford_housing/2005/20050110_devonbank.html (last visited Jan. 28, 2008).

[124] For example, in the regulation of securities, SEC has enormous oversight responsibility for and authority over public disclosures of information relative to the particular offering, investment, or business represented by a particular security. Much of this authority is administered through stop order proceedings. The SEC also has the authority to go to court and seek injunctive relief and other forms of equity-like ancillary relief. Criminal prosecutions under the federal securities laws, however, are brought by the Department of Justice. See generally LOSS & SELIGMAN, *supra* note 10, at 143-144, 598-603, 653-655, 1411-1532.

[125] Formally the **U**niting and **S**trengthening **A**merica by **P**roviding **A**ppropriate **T**ools **R**equired to **I**ntercept and **O**bstruct **T**errorism Act of 2001, Pub. L. No. 107-56, 115 Stat. 272.

[126] *See* Nike, Inc. v. Kasky, 539 U.S. 654 (2003) (per curiam) (Stevens, J., concurring) (discussing commercial versus non-commercial speech and suggesting that case was disposed of summarily on procedural grounds).

[127] LOSS & SELIGMAN, *supra* note 10, at 910.

[128] *Id.* at 911.

[129] *Id.* at 1187-1192.

[130] Securities Act of 1933 (Truth in Securities Act), 15 U.S.C. §§ 77a to 77aa (2006) (focuses on initial distribution of securities); Securities Exchange Act of 1934, 15 U.S.C. §§ 78a to 78mm (focuses on ongoing post-distribution trading of trading); Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa to 77bbbb (supplements the 1933 Act and focuses on distribution of debt securities); Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to 80a-64 (governs activity of publicly owned companies that invest in and trade securities); Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1 to 80b-21 (requires regulation and registration of those in business of advising others on securities investments); Securities Investor Protection Act of 1970, 15 U.S.C. §§ 78aaa to 78lll (creates nonprofit membership corporation designed to cover customer losses when broker-dealer firms cannot cover their customer accounts); Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 11, 15, 18, 28, and 29 U.S.C.) (adds several additional lawyers of corporate reporting and ethics oversight). The Public Utility Holding Company Act of 1935, 15 U.S.C. §§ 79 to 79z-6, which governed public utilities, was repealed by the Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594.

[131] No analysis of the current SCF industry in the U.S. would be complete without an examination of the Investment Company Act of 1940 and the Investment Advisors Act of 1940. This is because much of the SCF investments are being propelled by mutual funds tracking the DJII and the S&P's version of the same thing. In addition, with the huge sovereign wealth in the GCC looking for sophisticated investment strategies, *Shari'ah* compliant hedge funds are right around the corner. The analysis which follows will examine these two acts to the extent they implicate these types of SCF investments and require a different analysis of the liability exposure for securities fraud.

[132] H.R. REP. NO. 73-85, at 3 (1933); *see* 1934 Act, 15 U.S.C. § 78b (stating that one purpose of securities law is "to insure the maintenance of fair and honest markets").

[133] *See generally* LOSS & SELIGMAN, *supra* note 10 at Chapter 9-B-6.

[134] 17 C.F.R. § 240.10b-5 (1997); *see Herman & Maclean v. Huddleston*, 459 U.S. 375, 380 (1983) ("The existence of this implied remedy is simply beyond peradventure.").
[135] 15 U.S.C. § 78j.
[136] *See generally* LOSS & SELIGMAN, *supra* note 10, at 910, 1273-1301 (implied right of action under Rule 10(b)-5).
[137] 15. U.S.C. § 78ff(a) (criminal penalties); see LOSS & SELIGMAN, *supra* note 10, at 1418-1425. For a general survey of criminal liability under the securities acts, *see* Nic Heuer, Les Reese & Winston Sale, *Securities Fraud*, 44 AM. CRIM. L. REV. 956 (2007).
[138] *See* Jeffrey T. Cook, *Recrafting The Jurisdictional Framework For Private Rights Of Action Under The Federal Securities Laws,* 55 AM. U.L. REV. 621 (2006).
[139] *Supra* note 126.
[140] 15 U.S.C. §§ 41-58.
[141] For a discussion of the broad sweep of state consumer fraud statutes, *see* Victor E. Schwartz & Cary Silverman, *Common-Sense Construction of Consumer Protection Acts,* 54 KAN. L. REV. 1 (2005).
[142] The law, known as the Unfair Competition Law ("UCL"), is codified at CAL. BUS. & PROF. CODE §§ 17200-17210 (Deering 2007).
[143] *Supra* note 126. The UCL recently was amended by Proposition 64 to eliminate the right of private plaintiffs to sue as "private attorneys general" without a showing of injury. *See* Schwartz & Silverman, *supra* note 141, at 34-37.
[144] David Monsma & John Buckley, *Eighteenth Annual Corporate Law Symposium: Corporate Social Responsibility In The International Context: Is There An Emerging Fiduciary Duty To Consider Human Rights?*, 74 U. CIN. L. REV. 75 (2005).
[145] For Pennsylvania, *see* Denison v. Kelly, 759 F. Supp. 199, 202 (D. Pa. 1991) (referencing 73 PA. CONS. STAT. §§ 201-1-202-9.3 (2007)). For Illinois, *see* Onesti v. Thomson McKinnon Secur., Inc., 619 F. Supp. 1262, 1267 (D. Ill. 1985) (referencing ILL. REV. STAT. ch. 121 1/2, § 262, et seq. (1985), now 815 ILL. COMP. STAT. 505/2 (2007)). For Arizona, *see* State ex rel. Corbin v. Pickrell, 136 Ariz. 589, 592 (Ariz. 1983) (referencing ARIZ. REV. STAT. ANN. §§ 44-1522 – 1531 (2007)).
[146] 15 U.S.C § 1125 (2006).
[147] 15 U.S.C. §§ 1601-1693r.
[148] 15 U.S.C. app. 12 CFR § 226.
[149] Pub. L. No. 103-325, 108 Stat. 2190 (codified as amended in scattered sections of 15 U.S.C.).
[150] LOSS & SELIGMAN, *supra* note 10, at 1205 (defense of reasonable care under Section 12(a)(2) of the 1933 Act); *id*. at 1227-1239 (reasonable care and "expertizing" defenses under Section 11 of the 1933 Act).
[151] 31 U.S.C. §§ 5311-5332 (2006).
[152] *See infra* Part II.F.3.i.
[153] *See infra* Part II.F.3.ii.
[154] "*Shari'ah* rules and principles" is a term of art among *Shari'ah* authorities. Various standards publications are available to the public through the Islamic Financial Services Board ("IFSB"), one of the premier standards institutes of SCF. *See* IFSB Published Standards, Islamic Financial Services Board,, http://www.ifsb.org/index.php?ch=4&pg=140 (last visited Jan. 28, 2008) [hereinafter IFSB Standards].
[155] Excepting of course the non-Muslim facilitators and financial institutions who desire to exploit it for purely pecuniary gain.
[156] As the literature makes clear, consensus among *Shari'ah* authorities is an important part of the tradition and integrity of *Shari'ah*. In some Muslim countries, however, there is actual government oversight and regulation. *See*, *e.g.*, THE POLITICS OF ISLAMIC FINANCE, *supra* note 4; *see also* Islamic Financial Services Board, *Guidance on Key Elements of the Supervisory Review Process of Institutions Offering Islamic Financial Services (Excluding Islamic Insurance (*Takaful*) Institutions and Islamic Mutual Funds)*, at ¶¶ 110-118 at 24-25 (Dec. 2007), *available at* http://www.ifsb.org/view.php?ch=4&pg=257&ac=36&fname=file&dbIndex=0&ex=1201533270&md=%C1h%D5%BB%AA%B9zc%C3%9E%7CV%29%0A%BA%3C (last visited Jan. 28, 2008) [hereinafter IFSB Standard].
[157] *Supra* note 58 and accompanying text.
[158] *Supra* note 59 and accompanying text.
[159] *See*, *e.g.*, STAHNKE & BLITT, RELIGIOUS FREEDOM *SHARI'AH* REPORT, *supra* note 93. Recently, northern Nigeria has been added to this list. *See Nigeria Turns From Harsher Side of Islamic Law*, N.Y. TIMES, Dec.

1, 2007, *available at* http://www.nytimes.com/2007/12/01/world/africa/01shariah.html?_r=1&oref=login (last visited Jan. 28, 2008).

[160] *Supra* note 156; *see* Freedom Survey 2007, *supra* note 93.

[161] An integral part of this inquiry is a study of the extant rulings of the classical *Shari'ah* authorities considered to be authoritative by contemporary *Shari'ah* authorities.

[162] *See*, *e.g.*, MARY HABECK, KNOWING THE ENEMY: JIHADIST IDEOLOGY AND THE WAR ON TERROR (2006). For a critique of this work essentially making the case that the author properly documents the connection between doctrines underpinning the holy war by contemporary Islamic terrorists and the classical Law of *Jihad* but overlays this factual connection with wishful policies based upon her argument that most Muslims are not *Shari'ah*-adherent, *see* David Yerushalmi, Book Review, Townhall.com, *Knowing the Enemy: Jihadist Ideology and the War on Terror*, http://www.townhall.com/columnists/DavidYerushalmi/2006/09/06/knowing_the_enemy_jihadist_ideology_and_the_war_on_terror (last visited Jan. 28, 2008).

[163] Two examples of the government's unwillingness to examine the doctrines of Islamic terrorists seriously. Example One. In the 9-11 Commission Report, the most substantial public government effort to date to understand what Islamic terrorism is and what drives it, the authors mention "Islamic law" only four times. While the report concedes that al Qaeda's doctrine of worldwide *Jihad* is based on Islamic law, immediately thereafter the report attempts to distance anything but "radical" or "extremist" Islamic law from the narrative. But the report makes no effort at analysis or comparison to see if the "al Qaeda" version of *Shari'ah* is somehow different in kind or degree from historical, traditional, and authoritative *Shari'ah*. NAT'L COMM'N ON TERRORIST ATTACKS UPON THE U.S., THE 9/11 COMMISSION REPORT 48-53 (2004), *available at* http://www.9-11commission.gov/report/911Report.pdf (last visited Jan. 28, 2008) [hereinafter THE 9/11 COMMISSION REPORT]. At one point the report notes that "fundamentalists" blame the decline of the Islamic Empire on the failure of its religious leaders to abide by the tenets of Islamic law and the need to return to the literal understandings of the Qur'an and Hadith. The report then suggests bin Laden bases much of his doctrine on artificially selecting from the legal works of Ibn Taymiyyah. This is an effort to buttress the Report's narrative that there is no legitimate connection between traditional *Shari'ah* and the terrorists' doctrine of *Jihad*. *Id.* at 50-51.The problem with this "analysis" is that ibn Taymiyyah is a very important *Shari'ah* authority today among Hanbali jurists and even many non-Hanbali jurists (especially in matters relating to SCF) and his doctrine on *Jihad* is no less extreme than bin Laden's. For ibn Taymiyyah's complete work on *Jihad* translated, *see* RUDOPH PETERS, JIHAD IN CLASSICAL AND MODERN ISLAM 43-54 (2005). *But see* Coughlin, supra note 24, at 46 (describing criticism of ibn Taymiyyah by *Shari'ah* authorities from the other schools.)

Example Two. The New York Police Department produced a 90-page report on the logistics and processes on the domestic recruitment of Muslims living in Western countries by Islamic terrorist groups. Islamic law or *Shari'ah* is mentioned only six times and while the report concedes that the goal of the terrorists is the establishment of a worldwide Caliphate subject to *Shari'ah*, all factual indices of *Shari'ah* adherence by budding terrorists is characterized as an act identified as "Salafist" or "Wahhabi." Again, this is an effort to marginalize the connection to *Shari'ah* proper and to label it as a Saudi Arabian-based cult. The New York City Police Department report made no effort to understand the relationship between Salafism and *Shari'ah* or to see what traditional and authoritative *Shari'ah* mandated in the Law of *Jihad*. Had the researchers done so, they would have found that Salafism is nothing more than what the classical *Shari'ah* authorities have held for a millennium. MITCHELL D. SILVER & ARVIN BHATT, SENIOR INTELLIGENCE ANALYSTS, N.Y. CITY POLICE DEP'T RADICALIZATION IN THE WEST: THE HOMEGROWN THREAT (2007), *available at* http://sethgodin.typepad.com/seths_blog/files/NYPD_Report-Radicalization_in_the_West.pdf (last visited Jan. 28, 2008).

[164] Coughlin, *supra* note 24.

[165] YAHIYA EMERICK, WHAT ISLAM IS ALL ABOUT: A STUDENT TEXTBOOK (GRADES 7 TO 12) (5th rev. ed. 2004).

[166] Coughlin, *supra* note 24, at 97-108, 134 et seq.

[167] One poignant example is Coughlin's use of Averroes (aka Abu al-Walid Muhammad Ibn Muhammad Ibn Rusd), one of the leading *Shari'ah* authorities of the so-called Golden Era in Islamic history often touted as an age of Muslim enlightenment, pluralism, and peace. What Coughlin points out, based upon available English translations of Averroes' major work on *Jihad*, is that even in their best light, *Shari'ah*

authorities consistently maintain that infidels and polytheists "must be fought." *See*, *e.g.*, Coughlin, supra note 24, at 184. For the entire work on *Jihad* translated, *see* Peters, supra note 163, at 27-42.
[168] *See*, *e.g.*, 15 U.S.C. 77g (2006) (disclosures required in registration statements); § 77j (disclosures required in prospectuses); § 77aa (schedules of information required in registration statements).
[169] *Id*. § 77k.
[170] Respectively (1) § 77f; (2) § 77k(a)(2); (3) § 77k(a)(3); (4) § 77k(a)(4); and (5) § 77k(a)(5).
[171] *Id*. § 77l.
[172] *See generally* LOSS & SELIGMAN, *supra* note 10, at 1217-1239.
[173] *Supra* notes 134-137 and accompanying text.
[174] LOSS & SELIGMAN, *supra* note 10, at 1273-1301; *see also* Heuer,, Reese & Sale, *supra* note 137.
[175] 15 U.S.C. § 78ff(a); *see also* Heuer, Reese & Sale, *supra* note 137, at [page number] & nn.53-54.
[176] A thoroughgoing analysis would require a determination of the following: whether the matter was a criminal indictment, SEC enforcement proceeding, or a private civil lawsuit and who was the defendant such as an issuer, investment advisor, or expert signatory to a registration statement and under which particular anti-fraud provision the matter was pursued. *See generally* LOSS & SELIGMAN, *supra* note 10.
[177] VOGEL & HAYES, *supra* note 18, at 38.
[178] *See* Coughlin, *supra* note 24, at 147-150; *supra* note 162.
[179] 426 U.S. 438 (1976).
[180] The materiality issues under the proxy rules are transferable to many other provisions, including Rule 10(b)-5. *See*, *e.g.*, Basic Inc. v. Levinson, 485 U.S. 224, 232 (1988); LOSS & SELIGMAN, *supra* note 10, at 580 & n.148.
The relevant language of the proxy rules states:

> No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

[181] 485 U.S. 224, 445 (1988) (emphasis in the original).
[182] *Id*. at 449 (quoting from 478 F. 2d at 1302).
[183] *Id*. at 445-449 (footnotes and citations omitted).
[184] *Id.*
[185] *Id.* at 238-239.
[186] A related question would be who decides and how does one decide what *Shari'ah* is? This is not specific to the query of materiality. As noted supra, if a financial institution relies upon specific *Shari'ah* authorities, the question might be as simple as determining what these specific *Shari'ah* authorities consider to be authentic and authoritative *Shari'ah* rulings on *Jihad*, terrorism, and violence against non-Muslims and non-*Shari'ah*-compliant Muslims. Aside from a careful examination of the rulings on these subjects issued by the relevant *Shari'ah* authorities, a problem in any event if they have not published rulings in these areas, one would be well-advised to look to the classical *Shari'ah* authorities upon which these contemporary *Shari'ah* authorities rely as authoritative in their SCF rulings. While such a reliance might not be dispositive (i.e., a *Shari'ah* authority might rely on Ibn Taymiyyah for purposes of determining what kind of nominate contract *Shari'ah* allows for any given transaction, but in fact reject Ibn Taymiyyah's rulings on *Jihad* and war against the infidels). But at the very least, it raises an important fact question for the reasonable investor that might very well rise to the level of materiality: Do the *Shari'ah* authorities of the particular financial institution consider Ibn Taymiyyah's *Shari'ah*-based rulings on war against non-Muslims and non-*Shari'ah* compliant Muslims authoritative? If not Ibn Taymiyyah's, whose?
[187] This is procedurally akin to a defendant's position on a motion to dismiss or for summary judgment. Assuming all the allegations are true, as a matter of law, there is no actual evidence that *Shari'ah* is the cause of violence rather than its excuse.
[188] 426 U.S. 438, 450 (1976).
[189] *See supra* note 93; *supra* notes 290-291 and accompanying text..

[190] *See generally* LOSS & SELIGMAN, *supra* note 10, at 171-174. For a thorough discussion of the quantitative-qualitative distinction in disclosure, *see* John M. Fedders, *Qualitative Materiality: The Birth, Struggles, And Demise Of An Unworkable Standard,* 48 CATH. U.L. REV. 41 (1998).
[191] Common law fraud did not originally impose a duty to disclose; rather, once a statement represented something as fact, it had to be truthful. Materiality gets at "truthfulness" in that "half-truths" can be as misleading as false statements. The development of the law on the disclosure of omitted facts has always lagged behind the duty to disclose the whole of a truth partially told. For a discussion in this development relative to securities fraud cases, *see* LOSS & SELIGMAN, *supra* note 10, at 910-918.
[192] This would be the case whether a company made no disclosure at all or represented itself as focused on "socially responsible" or "ethical" investing without any mention of *Shari'ah*. If the business model was in fact based upon *Shari'ah*, this would remain a material fact. *See infra* notes 380-381 and accompanying text (discussing Azzad Asset Management).
[193] Recent media stories about the *Shari'ah* criminal law include only recently a Muslim convert to Christianity sentenced to death, a rape victim sentenced to lashes, and thieves having their hands amputated. *See*, *e.g.*, Josh Gersten, *Widespread Outrage At Afghan Facing Death For Abandoning Islam*, N.Y. SUN, Mar. 21, 2006. For a scholarly look at the *Shari'ah* criminal law from the time of the Ottoman Empire until today, *see* RUDOLPH PETERS, CRIME AND PUNISHMENT IN ISLAMIC LAW: THEORY AND PRACTICE FROM THE SIXTEENTH TO THE TWENTY-FIRST CENTURY (2005).
[194] *See supra* note 162.
[195] For *Shari'ah* as expressed by *Shari'ah* authorities over the past millennium, *see* DAVID COOK, UNDERSTANDING JIHAD; PETERS, *supra* note 163; Coughlin, supra note 24, at 83-223. *See generally*, THE LEGACY OF JIHAD 141-367 (2005).
[196] The SEC documents from which this narration is drawn can be found through a Lexis search: for the Halliburton "No Action Letter" file, *see* 2003 SEC No-Act. LEXIS 433 [hereinafter Halliburton No-Action File]. For General Electric, *see* 2005 SEC No-Act. LEXIS 137 [hereinafter GE No-Action File]. For a broader article discussing these cases in some detail in the context of compliance by foreign subsidiaries of U.S. corporations, *see* Terence J. Lau, *Triggering Parent Company Liability Under United States Sanctions Regimes: The Troubling Implications Of Prohibiting Approval And Facilitation*, 41 AM. BUS. L.J. 413 (2004).
[197] 17 CFR 240.14a-8.
[198] The rule sets the floor at less than 5% of assets at the end of the current fiscal year; and less than 5% of gross earnings and net income. *Id.*
[199] *See* Halliburton No-Action File, *supra* note 196. Halliburton raised other objections such as the requested proxy statement included factual errors.
[200] The Global Security Risk Database was a first of its kind approach to ferreting out companies doing business in "terror sponsoring states." The work was carried out and published by the Center For Security Policy, a Washington, D.C.-based policy think tank headed by former Reagan administration official Frank Gaffney. For the Global Security Risk Database, *see* THE CTR. FOR SEC. POLICY, THE TERRORISM INVESTMENTS OF THE 50 STATES (Aug. 12, 2004), *available at* http://www.centerforsecuritypolicy.org/modules/newsmanager/center%20publication%20pdfs/divestterror_report.pdf (last visited Jan. 30, 2008). For an overall review of the "Divest Terror" program spearheaded by the Center for Security Policy, *see* Center for Security Policy, Divest Terror Initiative, http://www.centerforsecuritypolicy.org/home.aspx?sid=56&categoryid=56&subcategoryid=57&newsid=11567 (last visited Jan. 30, 2008).
[201] Letter from Janice Silberstein, Assoc. Gen. Counsel, City of N.Y., Office of the Comptroller, to Sec. and Exch. Comm'n, Div. of Corporate Fin., Office of the Chief Counsel (Feb. 7, 2003), *in* Halliburton No-Action File, *supra* note 196.
[202] *See* GE No-Action File, *supra* note 196.
[203] Letter from Richard S. Simon, Deputy Gen. Counsel, The City of N.Y., Office of the Comptroller, to Sec. and Exch. Comm'n, Div. of Corporate Fin., Office of the Chief Counsel (Dec. 10, 2004), *in* GE No-Action File, *supra* note 196.
[204] *Id.*
[205] U.S. Securities and Exchange Commission, Office of Global Security Risk, http://www.sec.gov/divisions/corpfin/globalsecrisk.htm (last visited Jan. 30, 2008). In this context, the SEC proposed the following:

II. Disclosure of Business Activities in or With Countries Designated as State Sponsors of Terrorism

The federal securities laws do not impose a specific disclosure requirement that addresses business activities in or with a country based upon its designation as a State Sponsor of Terrorism. However, the federal securities laws do require disclosure of business activities in or with a State Sponsor of Terrorism if this constitutes material information that is necessary to make a company's statements, in the light of the circumstances under which they are made, not misleading. [Note 6 citation appears here in the text. See below.] The term "material" is not defined in the federal securities laws. Rather, the Supreme Court has determined information to be material if there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision or if the information would significantly alter the total mix of available information. [Note 7 citation appears here in the text. See below.]

The materiality standard applicable to a company's activities in or with State Sponsors of Terrorism is the same materiality standard applicable to all other corporate activities. Any such material information not covered by a specific rule or regulation must be disclosed if necessary to make the required statements, in the light of the circumstances under which they are made, not misleading. The materiality standard's extensive regulatory and judicial history helps companies and their counsel to interpret and apply it consistently, and we remain committed to employing this standard to company disclosure regarding business activities in or with State Sponsors of Terrorism.

Although the Commission is well positioned to review disclosure relating to business activities regardless of the country in which they are conducted, we do not have the expertise or information necessary to identify the particular countries whose governments have funded, sponsored, provided a safe haven for, or otherwise supported terrorism. Nor is it the Commission's role to determine the degree to which a public company's business activities may support terrorism or may be inconsistent with U.S. foreign policy or U.S. national interests.

Note 6: Rule 408 of Regulation C, [17 CFR 230.408] and Rule 12b-20 under the Securities Exchange Act of 1934 [17 CFR 240.12b-20].

Note 7: *TSC Industries v. Northway, Inc.*, 426 U.S. 438 (1976). It has also held that materiality of contingent or speculative events or information depends on balancing the probability that the event will occur and the expected magnitude of the event. *Basic v. Levinson*, 485 U.S. 224, 238 (1988).

Concept Release on Mechanisms to Access Disclosures Relating to Business Activities in or With Countries Designated as State Sponsors of Terrorism, 72 Fed. Reg. 65862, 65863 (proposed Nov. 23, 2007) (to be codified at 17 C.F.R. pts. 228, 229, 230, 239, 240 & 249) (footnotes omitted).

[206] *See generally* Coughlin, *supra* note 24.

[207] This is a term of art used by many commentators, both of the punditry variety and of the scholarly. It should be distinguished from 'Islamicist', which tends to describe an academic whose discipline is the study of things Islamic.

[208] *Supra* note 191.

[209] *See generally* LOSS & SELIGMAN, *supra* note 10, at 910-11, 1018-31.

[210] *Supra* note 191.

[211] This is especially true after the passage of the Private Securities Litigation Reform Act of 1995 (PSLRA), which ratcheted up the *scienter* pleadings requirements and froze discovery during a defendant's motion to dismiss to eliminate frivolous suits and to eliminate the "leverage" plaintiffs use by propounding reams of discovery requests early on to tie-up company management and extort a settlement. For a good discussion of the pleadings requirements post-PSLRA, *see* Ray J. Grzebielski & Brian O. O'Mara, *Whether Alleging "Motive and Opportunity" Can Satisfy the Heightened Pleading Standards of the Private Securities Litigation Reform Act of 1995:Much Ado About Nothing*, 1 DEPAUL BUS. & COM. L.J. 313 (2003).

[212] Certainly this is true in the Second Circuit Court of Appeals, given the ruling in *Press v. Chemical Investment Services Corp.*, 166 F.3d 529, 538 (2d Cir. 1999) ("'Whether or not a given intent existed is, of course, a question of fact.'" (quoting *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996))); *see also id.* ("'Whether a given intent existed is generally a question of fact.'" (quoting *In re Time Warner*, 9 F.3d 259, 270-71 (2d Cir. 1993))). For an argument in favor of the Second Circuit's approach to *scienter*, *see* Daniela Nanau, *Analyzing Post-Market Boom Jurisprudence in the Second and Ninth Circuits: Has the*

Pendulum Really Swung Too Far in Favor of Plaintiffs?, 3 CARDOZO PUB. L. POL'Y & ETHICS J. 943 (2006).
[213] RESTATEMENT (SECOND) OF TORTS §552(1) (1977).
[214] *See supra* notes 211-212; *see also* Cook, *supra* note 138 (providing an overall examination of the jurisdictional issues raised by the recent federal legislation affecting class actions alleging securities fraud).
[215] *See generally* LOSS & SELIGMAN, *supra* note 10, at 1019 & n.345.
[216] *See generally id.* at 1227-39 (except the discussion on "expertizing" at 1232-33).
[217] Per its terms, Section 12(2) creates civil liability for misrepresentations when someone "offers or sells a security" and does so "by means of a prospectus or oral communication." 15 U.S.C.S. § 77l(a)(2); *see also Gustafson v. Alloyd Co.*, 513 U.S. 561, 569 (1995) (stating that a "prospectus" is a specific kind of document under the 1933 act and misrepresentations of the written kind must be in the prospectus to be the basis for an action under Section 12(2)).
[218] 15 U.S.C. § 77l(a)(2) (2006).
[219] 17 C.F.R. § 275.206(4)-1 (2008).
[220] For the SEC Final Rule, *see* 72 Fed. Reg. 44,756, 44,761 (Sep. 10, 2007) (codified at 17 C.F.R. pt. 275).
[221] 375 U.S. 180, 195 (1963). For a discussion of whether there is a private right of action to void contracts under Section 215 of the Investment Advisors Act, *see Transamerica Mortg. Advisors (tama) v. Lewis*, 444 U.S. 11, 18-19 (1979); *see also* LOSS & SELIGMAN, *supra* note 10, at 1241-47.
[222] *See supra* note 211; *see also* Jeffrey W. Stempel, *Class Actions and Limited Vision: Opportunities for Improvement Through a More Functional Approach to Class Treatment of Disputes*, 83 WASH. U. L. REV. 1127 (2005) (discussing the Class Action Fairness Act of 2005 (CAFA)).
[223] 425 U.S. 185 (1976); *see also Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033 (7th Cir. 1977) (stating the classic "recklessness" standard as follows: "[H]ighly unreasonable [conduct], involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it").
[224] *See supra* note 191; *see also City of Monroe Employees Ret. Sys. v. Bridgestone*, 399 F.3d 651, 687 (6th Cir. 2005). In the *Bridgestone* case, the court quoted *Rubin v. Schottenstein*, 143 F.3d 263, 267 (6th Cir. 1998) (en banc), as follows:

> The question thus is not whether a [defendant's] silence can give rise to liability, but whether liability may flow from his decision to speak . . . concerning material details . . ., without revealing certain additional known facts necessary to make his statements not misleading. This question is answered by the text of [SEC] Rule 10b-5(b) itself: it is unlawful for any person to "omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . . ."

Bridgestone, 399 F.3d at 687.
[225] *See Bridgestone,* 399 F.3d at 669 (quoting *Helwig v. Vencor, Inc.,* 251 F.3d 540, 555 (6th Cir. 2001)), wherein the court explained that "[a]s for materiality, whether or not a statement is material turns on 'a fact-intensive test.'" The court also stated that "'[m]ateriality depends on the significance the reasonable investor would place on the withheld or misrepresented information.'" *Id.* (quoting *Basic Inc. v. Levinson,* 485 U.S. 224, 240 (1988)). That is, would the information, had it been presented accurately, have "'significantly altered the 'total mix' of information made available?'" 251 F.3d at 563 (quoting *Basic*, 485 U.S. at 231-32).
[226] *See Bridgestone,* 399 F.3d at 669 (citing *PR Diamonds, Inc. v. Chandler*, 364 F.3d 671, 680 (6th Cir. 2004)).
[227] These "rubrics" are derived from the nine illustrative factors in *Helwig*, which are often cited by other courts.
[228] Ariz ARIZ. REV. STAT. ANN. § 44-1991 (1999); *see also* Richard G. Himelrick, *Arizona Securities Fraud Liability: Charting a Non-Federal Path*, 32 ARIZ. ST. L.J. 203 (2000).
[229] *See id.* at 230 & n. 186.
[230] *See supra* note 145.
[231] For case law regarding Illinois' private right of action, *see In re CLDC Management Corp.*, 18 B.R. 797, 799-800 (Bankr. D. Ill. 1982) (implied private right of action allowed); *Martin v. Heinold Commodities*, 163 Ill. 2d 33, 67 (1994) (punitive damages allowed). For case law regarding Arizona's private right of

action, *see Holeman v. Neils*, 803 F. Supp. 237 (D. Ariz. 1992) (implied private right of action allowed); *Dunlap v. Jimmy GMC of Tucson, Inc.*, 666 P.2d 83 (Ariz. Ct. App. 1983) (punitive damages allowed).

[232] *Strigliabotti v. Franklin Res., Inc.*, No. C 04-00883 SI, 2005 U.S. Dist. LEXIS 9625 (N.D. Cal. March 7, 2005).

[233] *Brown v. Bd. of Educ.*, 345 U.S. 972 (1953).

[234] 367 U.S. at 207-210. The intervening statute purportedly overruling the Smith Act membership clause, the Internal Security Act of 1950, 64 Stat. 987 (codified at 50 U.S.C. § 781), was repealed by Act of Dec. 17, 1993, Pub. L. No. 103-199, Title VIII, § 803(1), 107 Stat. 2329.

[235] The petitioner also raised "as applied" claims but these boiled down to an evidentiary analysis.

[236] 367 U.S. at 225.

[237] 367 U.S. at 297.

[238] *Id*. In *Brandenburg v. Ohio*, 395 U.S. 444 (1969), in a *per curiam* decision, the Court held in striking down a state law criminalizing speech advocating violence that such speech is constitutionally protected unless it is intended and likely to cause imminent illegal conduct. The *Brandenburg* Court understood its decision as concordant with the Smith Act cases cited. The question of "imminence" will no doubt plague future cases and remain a fact-based inquiry. Imminence will likely involve not simply the timing of the threat of violence, but also its seriousness and its likelihood.

[239] Olivier Guitta, *The Cartoon Jihad: The Muslim Brotherhood's project for dominating the West,* WEEKLY STANDARD 22, Feb. 20, 2006, *available at* http://www.weeklystandard.com/Content/Public/Articles/000/000/006/704xewyj.asp (last visited Jan. 31, 2008).

[240] 212 U.S. at 498. The Elkins Act made it an offense to "give or receive a rebate whereby goods are transported in interstate commerce at less than the published rate." Preet Bharara, *Corporations Cry Uncle and Their Employees Cry Foul: Rethinking Prosecutorial Pressure on Corporate Defendants*, 44 AM. CRIM. L. REV. 53, 61 n.42 (2007) (quoting *New York Central*, 212 U.S. at 498).

[241] 212 U.S. at 494.

[242] Bharara, *supra* note 240, at 62-63.

[243] W. PAGE KEETON, PROSSER AND KEETON ON TORTS 499-508 (5th ed. 1984). For a general discussion on corporate liability, *see* Note, *Corporate Crime: Regulating Corporate Behavior through Criminal Sanctions*, 92 HARV. L. REV. 1227, 1247-51 (1979).

[244] *See infra* notes 359-361 and accompanying text.

[245] *See infra* notes 362-364 and accompanying text.

[246] In his essay on the proper role of a *Shari'ah* authority for a mutual fund, DeLorenzo argues that beyond the "quantitative" rules, there are "socially responsible" screens that must be applied over the purely objective ones. DeLorenzo, *supra* note 22, at 6. For a discussion of the purpose of the DJII *Shari'ah* advisory board, *see infra* Part III.B.1.

[247] *See infra* notes 286-291 and accompanying text.

[248] *See* Patricia S. Abril & Ann Morales Olazabal, *The Locus of Corporate Scienter*, 2006 COLUM. BUS. L. REV. 81 (2006) (discussing "collective knowledge").

[249] It seems *Shari'ah* authorities themselves understand the reputational and even financial risks of not imposing some broad standards for entry into the elite group of *Shari'ah* authorities and for not standardizing what is *Shari'ah*-compliant and what is not. *See, e.g.,* IFSB Standards, *supra* note 154.

[250] *See infra* notes 358-363 and accompanying text.

[251] *Nike, Inc. v. Kasky*, 539 U.S. 654 (2003); *see also supra* notes 140-142 and accompanying text.

[252] *Kasky v. Nike, Inc.*, 27 Cal. 4th 939, 946 (2002).

[253] This is assisted by the burgeoning use of Internet sites which provide legal rulings (*fatawa*) to the *Shari'ah* faithful anywhere in the world. *See, e.g.,* IslamOnLine.net, http://www.islamonline.net/english/index.shtml (last visited Jan. 31, 2008).

[254] Alexiev, *supra* note 18, at n.43. The number 20-25 was derived by developing a list of names of *Shari'ah* authorities which appear in SEC filings and the major SCF Internet sites. If one includes *Shari'ah* authorities who deal almost exclusively in Pakistan, Malaysia, or the GCC states, the number is probably closer to 60. *See generally* Islamic Banking and Finance Issue #3 Summary, http://islamicbankingandfinance.com/summary3.html (last visited Jan. 31, 2008) (summarizing an issue of the London-based journal *Islamic Banking and Finance*, which discusses this "bottleneck").

[255] *See supra* notes 216-218 and accompanying text.

[256] 50 U.S.C. app. § 1 (2007).
[257] 50 U.S.C.S. §§ 1701-1706 (2007).
[258] *See*, *e.g.*, Notice of March 8, 2007--Continuation of the National Emergency With Respect to Iran, 72 Fed. Reg. 47 (March 12, 2007).
[259] *See* HALLIBURTON COMPANY, FORM 10K FOR THE FISCAL YEAR ENDED DEC. 31, 2006, at 58, *available at* http://www.sec.gov/Archives/edgar/data/45012/000004501207000072/ed10k2006_final.htm (last visited Jan. 31, 2008):

> **Operations in Iran**
>
> We received and responded to an inquiry in mid-2001 from the Office of Foreign Assets Control (OFAC) of the United States Treasury Department with respect to operations in Iran by a Halliburton subsidiary incorporated in the Cayman Islands. The OFAC inquiry requested information with respect to compliance with the Iranian Transaction Regulations. These regulations prohibit United States citizens, including United States corporations and other United States business organizations, from engaging in commercial, financial, or trade transactions with Iran, unless authorized by OFAC or exempted by statute. Our 2001 written response to OFAC stated that we believed that we were in compliance with applicable sanction regulations. In the first quarter of 2004, we responded to a follow-up letter from OFAC requesting additional information. We understand this matter has now been referred by OFAC to the DOJ. In July 2004, we received a grand jury subpoena from an Assistant United States District Attorney requesting the production of documents. We are cooperating with the government's investigation and responded to the subpoena by producing documents in September 2004.
>
> Separate from the OFAC inquiry, we completed a study in 2003 of our activities in Iran during 2002 and 2003 and concluded that these activities were in compliance with applicable sanction regulations. These sanction regulations require isolation of entities that conduct activities in Iran from contact with United States citizens or managers of United States companies. Notwithstanding our conclusions that our activities in Iran were not in violation of United States laws and regulations, we announced that, after fulfilling our current contractual obligations within Iran, we intend to cease operations within that country and withdraw from further activities there.

[260] *See* Lau, *supra* note 196, at 418-19.
[261] 31 U.S.C. §§ 5318 et seq. (2006).
[262] *See generally* Eric J. Gouvin, *Bringing Out the Big Guns: The USA Patriot Act, Money Laundering, and the War on Terrorism*, 55 BAYLOR L. REV. 955 (2003).
[263] *See, e.g.*, CairChicago.org, Action Alert (Dec. 1, 2005), *available at* http://www.cairchicago.org/actionalerts.php?file=aa_blog12012005 (last visited Jan. 31, 2008) (announcing a special Internet web log site opposing the Patriot Act on "civil rights" grounds, published by the Council on American-Islamic Relations (CAIR)).
[264] *See* Gouvin, *supra* note 262, at 976-77.
[265] FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNSEL, BANK SECRECY ACT/ ANTI-MONEY LAUNDERING EXAMINATION MANUAL 8 (2006), *available at* http://www.ffiec.gov/pdf/bsa_aml_examination_manual2006.pdf (last visited Jan. 31, 2008).
[266] *See* Gouvin, *supra* note 262, at 967-69.
[267] *Id.* at 976-77.
[268] "FISA" is the Foreign Intelligence Surveillance Act of 1978, Pub. L. No. 95- 511, 92 Stat. 1783 (codified as amended at 50 U.S.C. §§ 1801-1862), which was amended materially by the Patriot Act. *See* USA Patriot Act, § 218, 115 Stat. 291 (amending 50 U.S.C. §§ 1804(a)(7)(B) & 1823(a)(7)(B)). A Fifth Amendment "criminal" warrant typically requires a showing of probable cause before a judge. The FISA requirements for a warrant, which are directed at foreign threats, even if on domestic soil, has relaxed standards. For a thorough explanation of these standards, *see* Richard Henry Seamon & William Dylan Gardner, *The Patriot Act and the Wall Between Foreign Intelligence and Law Enforcement*, 28 HARV. J.L. & PUB. POL'Y 319 (2005).
[269] *See* David Hardin, *The Fuss Over Two Small Words: The Unconstitutionality of the USA PATRIOT Act Amendments to FISA Under the Fourth Amendment*, 71 GEO. WASH. L. REV. 291, 291 & n.395 (2003).
[270] *See generally* Montgomery E. Engel, *Donating "Blood Money": Fundraising For International Terrorism By United States Charities and the Government's Efforts to Constrict the Flow*, 12 CARDOZO J. INT'L & COMP. L. 251 (2004). Specifically, Engel writes that:

> The authority of the President to issue both Executive Orders 12,947 and 13,224 originates in the International Emergency Economic Powers Act ("IEEPA"). Upon declaration of a national emergency in response to an "unusual and extraordinary threat," IEEPA grants the President broad authority to govern the disposition and block the assets of "any person, or with respect to any property, subject to the jurisdiction of the United States." The Supreme Court has upheld IEEPA's broad grant of authority to the President in its form as amended in 1977. The Court refused to limit the President's authority to continued blocking or freezing but ensured that it extended to the permanent disposition of assets suggested by IEEPA's congressional grant of the power to "transfer," "compel," and even "nullify" assets. Underlying this deferential grant, the Court recognized a legitimate and discretionary exercise of the President's power to govern foreign policy by using frozen assets as a "bargaining chip" in dealing with a hostile country.

Id. at 258-59 (footnotes omitted). The role of Muslim charities in financing terror has been discussed in Congressional testimony as well. *See Role of Charities and NGOs in the Financing of Terrorist Activities: Hearing Before the Subcomm. on International Trade and Finance of the S. Comm. on Banking, Housing, and Urban Affairs,* 107th Cong. (2002) (statement of Matthew Levitt, Senior Fellow, Washington Institute for Near East Policy), *available at* http://banking.senate.gov/02_08hrg/080102/levitt.htm (last visited Feb. 1, 2008). Military strategists have also looked at this modality for furthering the terrorist war aims. *See* Major Wesley J. L. Anderson, *Disrupting Threat Finances: Utilization of Financial Information to Disrupt Terrorist Organizations in the Twenty-First Century* (November 4, 2007) (unpublished thesis, School of Advanced Military Studies, U.S. Army Command and General Staff College), *available at* http://stinet.dtic.mil/cgi-bin/GetTRDoc?AD=A470454&Location=U2&doc=GetTRDoc.pdf (last visited Feb. 1, 2008).

[271] Prosecutions for the "material support of terrorism" are notoriously difficult cases to try before a jury because they often require reams of financial data evidence, circumstantial evidence of associational links, and the defense often raised by defendants that they had no specific knowledge that the money they contributed was going to support illegal activities. A recent case with these dynamics, the largest federal terror-financing case to date, ended in mistrial on the bulk of the charges. See the court filings (organized and with commentary) in the criminal prosecution *U.S. v. Holy Land Foundation for Relief and Development,* Criminal Action No. 3:04-CR-240-G, 2007 U.S. Dist. LEXIS 50239 (N.D. Tex. July 11, 2007), *available at* http://www.nefafoundation.org/hlfdocs.html (last visited Jan. 31, 2008).

[272] One of the leading *Shari'ah* authorities recommends that *Shari'ah*-compliant mutual funds calculate the *Shari'ah*-based religious tax called *zakat* for the investors and withhold it at source as a value added. *See generally supra* note 22 and accompanying text. The assumption for this memorandum has been that if a reporting mutual fund does not disclose that it has the authority to gift *zakat* contributions on behalf of the individual investors, then the mutual fund has left that for the individual investors.

[273] *Id.*; *see also* Yaquby, *supra* note 39; ISLAMIC FINANCIAL SERVICES BOARD, EXPOSURE DRAFT: GUIDING PRINCIPLES ON GOVERNANCE FOR ISLAMIC COLLECTIVE INVESTMENT SCHEMES 14-17 (Dec. 2007), *available at* http://www.ifsb.org/view.php?ch=4&pg=140&ac=31&fname=file&dbIndex=0&ex=1201805784&md=%EB%FA%AF%F7%DD%E3%80%1F%9C%DC%ED%9F%07%EE%E7%23 (last visited Jan. 31, 2008).

[274] *See supra* note 270.

[275] *Id.*

[276] While it does not appear that the DJII calculates the "purification" requirement for its index of funds with a concomitant reduction in the stated values and returns for its universe of stocks, one index actually promotes this feature:

> **Incorporates Dividend Purification:** In addition, the application of a dividend adjustment factor in the creation of the MSCI Islamic Index Series results in more relevant benchmarks, as they reflect the total return to an Islamic portfolio net of dividend purification.

MSCI Global Islamic Indices, http://www.mscibarra.com/products/indices/islamic/ (last visited Jan. 31, 2008).

[277] 18 U.S.C. §1956(a)(2)(A) (2006).

[278] As one commentator began an analysis into the problem of Muslim charities being used to funnel funds to Islamic terrorists:

> On December 4, 2001, nearly three months after the terrorist attacks of September 11th and barely three days after a pair of terrorist suicide bombings killed 25 and injured 200 in Israel,

> President Bush declared the Holy Land Foundation for Relief and Development ("HLF") of Richardson, Texas, a terrorist organization, its assets frozen, and announced that its offices had been raided by the FBI. Purportedly the largest Muslim charity in the United States, HLF had been under investigation by the FBI for its alleged financing of the Islamic Resistance movement, or Hamas, for nine years. Ten days later, the Bush Administration acted again, freezing the assets and raiding the offices of two more Muslim charities, the Benevolence International Foundation ("BIF") and the Global Relief Foundation ("GRF"), both located in the Chicago, Illinois area.

Engel, *supra* note 270, at 251 (footnotes omitted).

[279] For a case study of Caribou Coffee, *see infra* notes 323-338 and accompanying text.

[280] Or, as set out *supra* note 223 and accompanying text, was this fact willfully or recklessly avoided?

[281] *See supra* note 278.

[282] *See* U.S. Department of the Treasury, Key Issues: Protecting Charitable Organizations, http://www.ustreas.gov/offices/enforcement/key-issues/protecting/charities_execorder_13224-a.shtml#a (last visited Jan. 31, 2008).

[283] Typically, good legal counsel, when developing a due diligence plan, will construct it such that it accounts for the threshold *prima facie* requirements of an indictment or other criminal charging process rather than an acquittal at trial.

[284] 108 Pub. L. No. 458, 118 Stat. 3638 (2004).

[285] 18 U.S.C. § 2339(A)(b) (2006).

[286] 395 F. Supp. 2d 79 (S.D.N.Y. 2005).

[287] *Id.* at 99.

[288] For the discussion of this point in an earlier appeal arising out of the same trial, *see U.S. v. Sattar*, 314 F. Supp. 2d 279, 301-02 (S.D.N.Y. 2004).

[289] *See, e.g., Boim v. Quranic Literacy Inst.*, 291 F.3d 1000 (7th Cir. 2002).

[290] 28 U.S.C. § 1350 (2006).

[291] The ATS is a jurisdictional statute. *See Sosa v. Alvarez-Machain,* 542 U.S. 692 (2004). It gives an alien plaintiff access to federal courts if there is an allegation that the alien suffered some harm that is in "violation of the law of nations or a treaty of the United States." *Id.* In the Court's opinion, it held that the norm of law violated must be "specific, universal, and obligatory." *Id.* at 732. The U.S. laws against terrorism and the "material support of terrorism" are in accord with the Law of Nations and at the very least are "specific, universal, and obligatory." *See, e.g., Filartiga v. Pena-Irala*, 630 F.2d 876, 885 (2d Cir. 1980) (stating that torture is a violation of the Law of Nations); *see also* Torture Victim Protection Act of 1991, § 2(b), Pub. L. No. 102-256, 106 Stat 73 (codified at 28 U.S.C. § 1350).

[292] *See supra* note 15 and accompanying text; *see also* Islamic Financial Services Board, http://www.ifsb.org/index.php (last visited Jan. 31, 2008); Accounting and Auditing Organization for Islamic Financial Institutions, http://www.aaoifi.com/index.shtml (last visited Jan. 31, 2008).

[293] IFSB Standards, *supra* note 154 (footnotes omitted).

[294] *See generally Northwest Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.,* 472 U.S. 284 (1985); *see also* Robert Pitofsky, Chairman, Fed. Trade Comm'n, Self Regulation and Antitrust (Feb. 18, 1998), *available at* http://www.ftc.gov/speeches/pitofsky/self4.shtm (last visited Jan. 31, 2008); Debra A. Valentine, Gen. Counsel, Fed. Trade Comm'n, Industry Self-Regulation and Antitrust Enforcement: An Evolving Relationship (May 24, 1998), *available at* http://www.ftc.gov/speeches/other/dvisraelspeech.shtm (last visited Jan. 31, 2008).

[295] *Id.*

[296] *See generally* McMillen, *supra* note 5, at 458-67 (attempting to cure the lack of transparency, certainty, consistency, and predictability of SCF by arguing for the IFSB to propose Model Acts like the Model Acts propounded by the National Conference of Commissioners on Uniform State Laws).

[297] *See Am. Soc'y of Mech. Eng'rs v. Hydrolevel Corp.*, 456 U.S. 556 (1982). In fact, the SCF financial institutions participate at various levels in setting the standards for the industry. *See, e.g.,* AAOIFI Members, http://www.aaoifi.com/members.html (last visited Jan. 31, 2008). The private banks do not appear to play as significant a role in setting standards for the IFSB. *See, e.g.,* IFSB Members, http://www.ifsb.org/index.php?ch=3&pg=7&ac=10 (last visited Jan. 31, 2008).

[298] For an interesting discussion of "rules collusion" as "Type III," *see* Robert H. Lande & Howard P. Marvel, *The Three Types of Collusion: Fixing Prices, Rivals, And Rules*, 2000 WIS. L. REV. 941, 949-84 (2000).

[299] *Id.* The anti-competitive effects of the rule-making monopoly currently enjoyed by the *Shari'ah* authorities go in some measure to the endogenous aspects of what *Shari'ah* itself says about who is qualified to be part of the *Ulema* or scholarly elite with any real authority. Historically and institutionally, because the *Shari'ah* authorities have used "consensus" and the limitation of new interpretations via the doctrine of the "closing of the gate of *itjima*" as a self-regulator, they have been extraordinarily successful in keeping the group over time true to the early doctrines developed after the formal schools had articulated them. *See, e.g.,* Coughlin, *supra* note 24, *passim*.

[300] *See* Rutledge, *supra* note 113.

[301] *Id.*; *see also* Callum McCarthy, Chairman, FSA Muslim Council of Britain Islamic Fin. and Trade Conference, Regulation and Islamic Finance (June 13, 2006), *available at* http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2006/0613_cm.shtml (last visited Jan. 31, 2008).

[302] *See* Rutledge, *supra* note 113.

[303] 12 U.S.C. § 29 (2006). For a senior officer at the Federal Reserve Bank of New York remarking favorably on Islamic banking in the United States, *see* Michael Silva, *Islamic Banking Remarks*, 12 AM. LAW & BUS. REV. 201, 201 & n.4 (2006).

[304] *See* supra note 58.

[305] *Id.*

[306] *Supra* note 147.

[307] *Supra* note 148.

[308] For a thorough discussion of the strengths and weaknesses of TILA in regulating misleading advertising, *see* Patricia A. McCoy, *The Middle-Class Crunch: Rethinking Disclosure in a World of Risk-Based Pricing*, 44 HARV. J. ON LEGIS. 123 (2007).

[309] 15 U.S.C. § 1664(c) (2006), 12 C.F.R. § 226.24(b) (2005).

[310] 15 U.S.C. § 1665(a).

[311] *Id.* § 1664(d); Supp. I to Part 226 – Official Staff Interpretations, 12 C.F.R. pt. 226 (construing § 226.24(c)), *available at* http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=52c796f4a8897e30772fa9be6632dfd5&rgn=div9&view=text&node=12:3.0.1.1.7.5.8.6.27&idno=12.

[312] *See, e.g.*, University Bank, Opening Doors to Islamic Financing, http://www.university-bank.com/IslamicBanking/homefinance.html (last visited Feb. 1, 2008) (declaring Islamic Financial Corporation's loans "free of interest"). While deep in University Bank's "Frequently Asked Questions," http://www.university-bank.com/IslamicBanking/faq.html (last visited Feb. 1, 2008), the bank attempts to explain that "[a]n accountant may argue that rent in the latter two and profit in the former is interest, but in none of these cases is it *riba*. Some accountants argue that anything that may be perceived as generating a benefit from the passage of time has interest in it. The *Sharia'a* scholars have not defined *riba* in this way, rather *riba* necessarily relates to loans of money or exchanges of money like commodities when they are used as money."

Interestingly, in contrast to what one might expect of, an argument aimed at the IRS or OCC -- which would downplay the "form" and argue that the "substance" of the transaction is a loan -- University Bank represents to its customers that its *Shari'ah*-compliant transactions are in fact substantively not loans and that their form is their substance. For example, again buried in its Frequently Asked Questions:

> **Query: Isn't the Islamic system of purchasing houses the same thing, the same mechanics, as the traditional mortgage system only with different labeling?**
>
> SHAPE™: This too is inaccurate. The process of qualifying a consumer and disclosing costs and risks to a consumer is the same as the mortgage system. This process is regulated by federal and state statutes in the United States. Hence, the paperwork is the same or very similar prior to and after making the acquisition, but not the acquisition itself.
>
> The acquisition mechanics are fundamentally different without creating all of the same rights and obligations as in a traditional mortgage. **Hence, it is not a question of labeling, but of actual structure.**

Id. (emphasis added).

[313] *See supra* note 58.

[314] *See supra* note 312.
[315] Bankruptcy and loan defaults open up an entire Pandora's box of issues that this memorandum will not and cannot address. Legal commentators have discussed this in passing; however, only in the most cursory of terms. *See*, *e.g.*, McMillen, *supra* note 88.
[316] *See, e.g.*, Devon Bank, Frequently Asked Questions, http://www.devonbank.com/Islamic/faq.html (last visited Feb. 1, 2008):

> **Why are your costs higher than conventional loans?**
> To be Shariah-compliant, our costs must be related to our actual expenses. Our products have a higher documentation fee due to the extra work in product design and assembling documents for a closing—it is not an automated process as it is for a conventional loan. Our profit rate is otherwise the same as an equivalent traditional mortgage. There are a few transaction costs that are higher because of the dictates of the specific deal structure needed to satisfy the requirements of an Islamic financing transaction, such as two deeds to record instead of one. Otherwise, all our costs are the same as a traditional mortgage. We do not charge a premium for religious accommodation.

[317] Pub. L. No. 103-325, 108 Stat. 2190 (1994) (codified as amended in scattered sections of TILA, 15 U.S.C. §§ 1601-1667).
[318] *See generally* C. Lincoln Combs, *Banking Law and Regulation: Predatory Lending in Arizona*, 38 ARIZ. ST. L.J. 617 (2006).
[319] *See* Elina Chamis, *A New Cup O' Joe: Minneapolis Coffee Retailer Plans Expansion into D.C. Market*, WASH. BUS. J., Mar. 31, 2000, *available at* http://www.bizjournals.com/washington/stories/2000/04/03/story7.html?page=1 (last visited Feb. 1, 2008).
[320] *See* Neal St. Anthony, *Venture Firm Buys Caribou; Its Investors Tapped Out, Caribou Coffee's Founders Will Sell the Chain and Step Aside from Management Roles,* STAR TRIBUNE (Minneapolis, MN), Dec. 9, 2000, at 1D.
[321] *See Milestone Year for First Islamic Investment Ban,* MIDDLE EAST NEWSFILE, Jan. 24, 2001.
[322] *Crescent Capital Soon to be Arcapita*, ATLANTA BUS. CHRON., Feb. 28, 2005, *available at* http://atlanta.bizjournals.com/atlanta/stories/2005/02/28/daily1.html (last visited Feb. 1, 2008); *see also* Arcapita.com, http://www.arcapita.com/about/invest/team-strategy.html (last visited Feb. 1, 2008).
[323] CARIBOU COFFEE COMPANY, INC., FORM S-1 REGISTRATION STATEMENT (2005) [hereinafter CARIBOU COFFEE S-1], *available at* http://www.sec.gov/Archives/edgar/data/1332602/000095014405007474/g96252sv1.htm.
[324] Arcapita Inc. and Arcapita Bank B.S.C.(c) in fact own Caribou through a very complex off-shore ownership structure. As reported in Caribou Coffee Prospectus for its initial public offering:

> (1) As of August 15, 2005, Caribou Holding Company Limited ("CHCL") has 150,600 shares of voting stock and 6,815,038 shares of non-voting stock outstanding. 5,971,218 of the shares of non-voting stock are held by five companies (the "Five Non-Voting Holding Companies"), which are Cayman Island entities owned by approximately 160 international investors. Arcapita Bank B.S.C.(c) ("Arcapita Bank") holds a minority interest in three of the Five Non-Voting Holding Companies, which each own 1,587,180 shares of the non-voting stock of CHCL. 572,820 of the remaining shares of non-voting stock are held by Premium Coffee Holdings Limited, an indirect subsidiary of Arcapita Bank. The remaining 271,000 shares of non-voting stock are held by Arcapita Incentive Plan Limited ("AIPL"), a Cayman Islands entity owned by management of Arcapita Bank (including Messrs. Ogburn and Griffith). 10,040 shares of voting stock are held by each of 15 separate Cayman Islands entities formed by Arcapita Bank (the "Voting Cayman Entities"). The Voting Cayman Entities are owned by approximately 50 international investors (the "International Investors").
>
> Each of the Voting Cayman Entities owns 62/3% percent of the voting stock of CHCL. Each International Investor has granted Arcapita Investment Management Limited ("AIML"), a direct subsidiary of Arcapita Bank, a revocable proxy to vote its shares of voting stock in the Voting Cayman Entities on all matters. In addition, each Voting Cayman Entity has entered into an administration agreement with AIML pursuant to which AIML is authorized to vote the voting stock of CHCL held by such Voting

Cayman Entity. Each administration agreement is terminable by a Voting Cayman Entity upon 60 days' prior written notice to AIML by a vote of two-thirds of its shareholders.

> (2) Arcapita Bank does not directly own any stock of CHCL, Caribou Coffee Company, Inc., AIPL or the Voting Cayman Entities. The number of shares of stock shown as owned by Arcapita Bank includes all of the shares of CHCL subject to the revocable proxies granted to AIML as described in note (1)above. Arcapita Bank is a Bahrain joint stock company.

CARIBOU COFFEE COMPANY, INC., PROSPECTUS 71 nn.1-2 (2005) [hereinafter CARIBOU COFFEE PROSPECTUS], *available at* http://www.sec.gov/Archives/edgar/data/1332602/000095014405009927/g96252b4e424b4.htm#112 (last visited Feb. 1, 2008).

[325] While most of this "firestorm" was local and contained to the media in Minnesota, Ohio, and Illinois, there was at least one international mainstream media outlet that picked it up. *See* Jon Tevlin, *Caribou Severs Ties with Islamic Advisor*, STAR TRIBUNE (Minneapolis, MN), July 4, 2002, at 1B; *see also* Christopher Dickey, *Tempest in a Coffee Cup*, NEWSWEEK, June 26, 2002.

[326] For the profile on Qaradawi, *see* Investigative Project on Terrorism, Apologists or Extremists: Yusuf al-Qaradawi, http://www.investigativeproject.org/profile/167 (last visited Feb. 1, 2008); *see also* Anti-Defamation League, Sheik Yusuf al-Qaradawi: Theologian of Terror (Nov. 9, 2007) [hereinafter ADL Report], http://www.adl.org/main_Arab_World/al_Qaradawi_report_20041110.htm?Multi_page_sections=sHeading_1 (last visited Feb. 1, 2008).

[327] OFFICE OF THE COORDINATOR FOR COUNTERTERRORISM, U.S. DEPT. OF STATE, 2001 REPORT ON FOREIGN TERRORIST ORGANIZATIONS (2001), *available at* http://www.state.gov/s/ct/rls/rpt/fto/2001/5258.htm (last visited Feb. 1, 2008). Both organizations had been so designated in the previous report issued two years earlier. *See* OFFICE OF THE COORDINATOR FOR COUNTERTERRORISM, U.S. DEPT. OF STATE, 1999 REPORT ON FOREIGN TERRORIST ORGANIZATIONS (1999), *available at* http://www.state.gov/s/ct/rls/rpt/fto/2682.htm (last visited Feb. 1, 2008). The FTO designation is made pursuant to the Immigration and Nationality Act, as amended by the Antiterrorism and Effective Death Penalty Act of 1996, 18 U.S.C. §1189, based upon the terrorist activities described in 18 U.S.C. §1182(a)(3)(B), which in turn bring the designated terrorist organization within the scope of 18 U.S.C. §§2339 (B), the material support of terrorism statute.

[328] *Coffeehouse Chain Steamed by Terror Allegations*, CLEVELAND JEWISH NEWS, June 21, 2002, at 22.

[329] *See supra* note 324.

[330] Tevlin, *supra* note 325.

[331] Of special note is the fact that the lawyers for the offering were King and Spaulding, LLP, one of the major law firm facilitators for SCF. *See supra* note 50.

[332] CARIBOU COFFEE S-1, *supra* note 323, at 16-17.

[333] *Id*. at 35-36 & F-21.

[334] Letter from Thomas Jones, Senior Attorney, Securities and Exchange Commission, to George E. Mileusnic, Chief Financial Officer, Caribou Coffee Company, Inc. (Aug. 15, 2005) (commenting on Caribou Coffee Company, Inc.'s Form S-1 Registration Statement), *available at* SEC http://www.sec.gov/Archives/edgar/data/1332602/000000000005042186/filename1.txt (last visited Feb. 1, 2008).

[335] CARIBOU COFFEE COMPANY INC., AMENDMENT NO. 1 TO FORM S-1 REGISTRATION STATEMENT 37 (2005) [hereinafter CARIBOU COFFEE FIRST AMENDED REGISTRATION STATEMENT]. Additional repetitive remarks were made on the inability to hedge. *Id.* at 41.

[336] Letter from Thomas Jones, Senior Attorney, Securities and Exchange Commission, to George E. Mileusnic, Chief Financial Officer, Caribou Coffee Company, Inc. (Sep. 2, 2005) (commenting on Caribou Coffee Company, Inc.'s First Amended Registration Statement), *available at* http://www.sec.gov/Archives/edgar/data/1332602/000000000005046177/filename1.txt. The SEC also asked for an additional clarification on the difficulty to obtain financing due to the adherence to *Shari'ah*.

[337] *See* CARIBOU COFFEE PROSPECTUS, *supra* note 324. The failure to make the suggested changes and revisions requested by the SEC might have been due to any number of reasons: (1) the matter was resolved by telephone or letter after counsel for Caribou argued that there were sufficient disclosures of the matters

raised by the SEC; or (2) the Caribou lawyers resubmitted the amended registration statement and the SEC examiners failed to notice the changes had not been made. The former is more likely.

[338] CARIBOU COFFEE COMPANY, INC., FORM 10-K ANNUAL REPORT FOR THE FISCAL YEAR ENDED DEC. 31, 2006 (2007), *available at* http://www.sec.gov/Archives/edgar/data/1332602/000095013707004971/c13623e10vk.htm.

[339] The citation to legal rulings by Qaradawi opposing terrorist actions outside of Israel is only reassuring if one takes the view that murdering innocent Israelis is not an act of terror criminalized by U.S. law. *See* Dickey, *supra* note 325 (suggesting the Qaradawi affair was overblown insofar as he signed a *fatwa* against "innocent civilians"). Qaradawi considers no Jew in Israel an "innocent civilian." ADL Report, *supra* note 326.

[340] *See* AAOIFI Sharia Board, http://www.aaoifi.com/sharia-board.html (last visited Feb. 1, 2008) (providing short biography of Usmani); *see also* Alex Alexiev, Usmani Dossier (on file with the author) [hereinafter Usmani Dossier] (providing information on Usmani based upon open sources).

[341] The Center for Security Policy is a Washington, D.C.-based non-profit policy think tank. *See* Center for Security Policy, http://www.centerforsecuritypolicy.org/.

[342] Usmani Dossier, *supra* note 340.

[343] MUFTI M. TAQI USMANI, ISLAM AND MODERNISM 123-39 (2006).

[344] This work is an English translation and contains some grammatical, spelling, diction, and punctuation errors. Most of these errors have been left as they appear in the original. Only some quotation marks used in indented quotes have been removed.

[345] In the original, this verse was in Arabic. It is the infamous "Sword Verse" found at *Qur'an*, 9:5

[346] *Jizyah* is a special tax imposed on non-Muslims to establish their subjugation to their Muslim rulers. *See generally* BAT YE'OR, THE DHIMMI: JEWS AND CHRISTIANS UNDER ISLAM (1985).

[347] PBUH is an acronym for "peace be unto him" typically said following Mohammed's name by *Shari'ah* adherent Muslims.

[348] The threat to Arcapita and therefore also to Caribou is that even commingled funds are subject to forfeiture under the anti-money laundering statutes which include the material support of terrorism as a predicate offense. *See United States v. Tencer,* 107 F.3d 1120, 1134-35 (5th Cir. 1997) (stating that all commingled funds in account were subject to forfeiture under § 982(a)(1), as "property involved" includes any property used to facilitate the money laundering offense).

[349] ARCAPITA, ARCAPITA ANNUAL REPORT 2007, at 95, *available at* http://www.arcapita.com/about/financial/pdfs/Arcapita_ar2007_English_Final.pdf (last visited Feb. 1, 2008).

[350] *Id.* at 100.

[351] Press Release, News Corp., News Corp. Completes Dow Jones & Co. Acquisition (Dec. 13, 2007), *available at* http://www.newscorp.com/news/news_359.html (last visited Feb. 1, 2008).

[352] Dow Jones Indexes About Us Overview, http://www.djindexes.com/mdsidx/?event=showAboutUsOverview (last visited Feb. 1, 2008).

[353] *Id.*

[354] Dow Jones Islamic Market Indexes Key Attributes, http://www.djindexes.com/mdsidx/index.cfm?event=showIslamicBenefit (last visited Feb. 1, 2008).

[355] Dow Jones Islamic Market Indexes Methodology Overview, http://www.djindexes.com/mdsidx/index.cfm?event=showIslamicMethod (last visited Feb. 1, 2008).

[356] Dow Jones Islamic Market Indexes Shari'ah Supervisory Board, http://www.djindexes.com/mdsidx/index.cfm?event=showIslamicOverView#board (last visited Feb. 1, 2008).

[357] In an article posted at the DJII Internet site, an important American *Shari'ah* authority and one of the DJII *Shari'ah* authorities, discusses the need for a *Shari'ah* advisory board for a fund that licenses the DJII index. The point of the entire article is to discuss all of the non-quantitative duties of a *Shari'ah* advisor in the selection and control of equities for investment. While one might accept his rationale for such supervision over the actual funds, if the DJII in fact utilizes a strictly quantitative protocol for selecting its "universe" of acceptable stocks, the question remains what useful purpose the DJII *Shari'ah* advisory board plays -- other than window dressing for reputation. *See* DeLorenzo, *supra* note 22.

[358] *See supra* note 356.

[359] *Id.*

[360] *Id.*
[361] DOW JONES INDEXES, GUIDE TO THE DOW JONES ISLAMIC MARKET INDEXES (2007), *available at* http://www.djindexes.com/mdsidx/downloads/imi_rulebook.pdf. This guide is described at the Dow Jones Internet site as a "Rule Book." *See* Dow Jones Islamic Market Indexes Links and Downloads, http://www.djindexes.com/mdsidx/index.cfm?event=showIslamicLinks.
[362] Wikipedia Entry for Iranian Military Industry, http://en.wikipedia.org/wiki/Iranian_defense_industry#External_links (last visited Feb. 1, 2008) (linking to a variety of sources implicating Iran's military industry).
[363] USMANI, *supra* note 343, at 36-38.
[364] ALLIED ASSET ADVISORS, INC., STATEMENT OF ADDITIONAL INFORMATION 10 (2007), *available at* http://www.investaaa.com/pdfs/SAI10.06.pdf (last visited Feb. 1, 2008) [hereinafter STATEMENT OF ADDITIONAL INFORMATION] (providing information on Allied Asset Advisors, Inc., the Dow Jones Islamic Fund's Investment Advisor).
[365] *Id*; *see also* ALLIED ASSET ADVISORS, INC., DOW JONES ISLAMIC FUND PROSPECTUS 11 (2007), *available at* http://www.investaaa.com/pdfs/Prospectus10.06.pdf (last visited Feb. 1, 2008) [hereinafter DJIF PROSPECTUS].
[366] North American Islamic Trust, http://www.nait.net/NAIT_about_%20us.htm (last visited Feb. 2, 2008). NAIT's principle role as a *waqf* or religious trust is to acquire title to Islamic mosques and to preserve their *Shari'ah* compliance so that Muslim communities who become less *Shari'ah*-adherent will not later convert these mosques into something less than *Shari'ah*-compliant. As NAIT itself explains:

> The fundamental motivation for entrusting the title of a center to NAIT is that the founders who establish Islamic centers, and the committed successors who perpetuate them, want to keep these centers true to the Islamic purpose for which they were established. Many Islamic centers founded in the U.S., Europe, and Australia in the 19th and early 20th century became social clubs, or were lost through demographic changes, disrepair and property taxes. Placing a center in trust with NAIT ensures that a third party of national scope and stature is responsible for the preservation of the center for the Islamic aims for which it was founded. The trust document between the Islamic center and NAIT leaves the administration of the center to the local community, but requires NAIT to preserve it to serve the Muslim community in the cause of Islam.

NAIT Islamic Centers Waqf, http://www.nait.net/icw.htm (last visited Feb. 2, 2008). NAIT apparently takes its *Shari'ah* obligations seriously even to the extent that it is prepared to deceive Muslim communities into acquiring their properties and then refusing to deed them back. *See*, *e.g.*, *North Am. Islamic Trust, Inc. v. Muslim Ctr. of Miami, Inc.*, 771 So. 2d 1227, 1227 n.2 (Fla. Dist. Ct. App. 2000) (determining that trial court's finding that NAIT took title to the Miami mosque property in trust for the community would not be overturned, and stating that "NAIT presented evidence that it holds property in trust for many Muslim organizations as 'protector' of the property. It contends that it is in a better position than MCM to ensure that the land will be used for the benefit of the Muslim community. We decline to engage in any such inquiry").
[367] *See supra* note 271.
[368] The trial ended in a mistrial, but the govenment is preparing a retrial. For the government's trial brief, *see* http://nefafoundation.org/miscellaneous/HLF/U.S._v_HLF_TrialBrief.pdf (last visited Feb. 15, 2008).
[369] *See* List of Unindicted Co-conspirators, *U.S. v. Holy Land Found. for Relief and Dev.*, CR NO. 3:04-CR-240-G (N.D. Tex. 2007), *available at* http://www.nefafoundation.org/miscellaneous/HLF/US_v_HLF_Unindicted_Coconspirators.pdf (last visited Feb. 15, 2008).
[370] *Supra* note 368, at 8.
[371] One piece of evidence was a strategy memorandum which sets out the goal of the *Shari'ah* faithful in the U.S.:

> **4- Understanding the role of the Muslim Brother in North America:**
> The process of settlement is a "Civilization-Jihadist Process" with all the word means. The Ikhwan must understand that their work in America is a kind of grand Jihad in eliminating and destroying the Western civilization from within and "sabotaging" its miserable house by their hands and the hands of the believers so that it is eliminated and God's religion is made victorious over all other religions. Without this level of understanding, we are not up to this challenge and have not prepared ourselves for Jihad yet. It is a Muslim's destiny to perform Jihad and work wherever he is

> and wherever he lands until the final hour comes, and there is no escape from that destiny except for those who chose to slack. But, would the slackers and the Mujahedeen be equal.

Government Exhibit 003-0085, *U.S. v. Holy Land Found. for Relief and Dev.*, CR NO. 3:04-CR-240-G (N.D. Tex. 2007) (Arabic), *available at* http://www.nefafoundation.org/miscellaneous/HLF/Akram_GeneralStrategicGoal.pdf (last visited Feb. 2, 2008).

[372] Editorial, *Motion for Retrial*, INVESTOR'S BUSINESS DAILY, Oct. 23, 2007, *available at* http://www.ibdeditorials.com/IBDArticles.aspx?id=278031924272951 (last visited Feb. 2, 2008).

[373] INVESTIGATIVE PROJECT ON TERRORISM, MUSLIM STUDENTS ASSOCIATION DOSSIER, *available at* http://www.investigativeproject.org/documents/misc/84.pdf (last visited Feb. 2, 2008).

[374] DJIF PROSPECTUS, *supra* note 365, at 12.

[375] *Terrorism: Growing Wahhabi Influence in the United States: Hearing Before the Subcomm. on Terrorism, Technology and Homeland Security of the S. Comm. on the Judiciary*, 108th Cong. (2003). The Qur'anic Literary Institute affair appeared in a Wall Street Journal story and was recounted in an article in The Tax Lawyer, the American Bar Association's tax journal:

> [I]n 1991, a Mr. Qadi, an investor in BMI [a company connected to Hamas and tied to funding of terror], transferred $820,000 through one of his companies from a Swiss bank account to the *Qur'an*ic Literacy Institute, a Chicago-based organization. The U.S. government has alleged that the *Qur'an*ic Institute "lent substantial assistance, through means of repeated and possibly illegal subterfuge and misrepresentation, to a man who is an admitted operative of Hamas." Mohammad Salah, an employee of the *Qur'an*ic Literary Institute, was arrested in Israel in 1993 "with a large sum of cash and a cache of notes describing meetings with various Hamas cells," and later pled guilty in an Israeli court "to being a top Hamas operative involved in raising money for the terror group." n58 A 1995 confession by Mr. Salah stated that while in Chicago "in the early 1990s, he trained recruits to work with 'basic chemical materials for the preparation of bombs and explosives,' as well as various toxins."

Mindy Herzfeld, *Restricting the Flow of Funds from U.S. Charities to International Terrorist Organizations--A Proposal*, 56 TAX LAW. 875, 875 n.57 (2003). The story, as told by the media at the time, was that the *Qur'an*ic Literacy Institute was operated out of a residential apartment building in Chicago and was funneling hundreds of thousands of dollars to Hamas. *See, e.g.,* Darlene Gavron Stevens & Matt O'Connor, *Friends Defend Bridgeview Man Linked to Terror*, CHI. TRIB., June 11, 1998.

[376] Eric Lichtblau & James C. Mckinley, *2 Albany Men Are Arrested in Plot to Import a Missile and Kill a Diplomat*, N.Y. TIMES, Aug. 6, 2004, at B-1.

[377] Brian Nearing, *Trust Owns Mosque Location; Group Spent $40,000 For Central Avenue Site; Others Linked To Terror Activities, Reports Reveal*, TIMES UNION (Albany, NY), Aug. 6, 2004.

[378] STATEMENT OF ADDITIONAL INFORMATION, *supra* note 364, at 13.

[379] *See*, *e.g.*, 31 C.F.R. § 103.131 (2003) (emphasis added):

> (b) Customer identification program: minimum requirements.
>
> (1) In general. A mutual fund must implement a written Customer Identification Program ("CIP") appropriate for its size and type of business that, at a minimum, includes each of the requirements of paragraphs (b)(1) through (5) of this section. The CIP must be a part of the mutual fund's anti-money laundering program required under the regulations implementing 31 U.S.C. 5318(h).
>
> (2) Identity verification procedures. The CIP must include risk-based procedures for verifying the identity of each customer to the extent reasonable and practicable. **The procedures must enable the mutual fund to form a reasonable belief that it knows the true identity of each customer**. The procedures must be **based on the mutual fund's assessment of the relevant risks**, including those presented by the manner in which accounts are opened, fund shares are distributed, and purchases, sales and exchanges are effected, the various types of accounts maintained by the mutual fund, the various types of identifying information available, and the mutual fund's customer base. At a minimum, these procedures must contain the elements described in this paragraph (b)(2)

. . .

(C) Additional verification for certain customers. **The CIP must address situations where, based on the mutual fund's risk assessment of a new account opened by a customer that is not an individual, the mutual fund will obtain information about individuals with authority or control over such account**, including persons authorized to effect transactions in the shareholder of record's account, in order to verify the customer's identity. This verification method applies only when the mutual fund cannot verify the customer's true identity using the verification methods described in paragraphs (b)(2)(ii)(A) and (B) of this section. (Emphasis added.)

[380] Azzad Asset Management, http://azzad.net/new/default.aspx (last visited Feb. 2, 2008)

[381] Azzad Asset Management, Social and Financial Screens, http://azzad.net/new/ethical_screens.aspx (last visited Feb. 2, 2008).

[382] CHARLES DOYLE, CRS REPORT FOR CONGRESS, CRIMINAL MONEY LAUNDERING LEGISLATION IN THE 109TH CONGRESS (2006), *available at* http://www.house.gov/gallegly/issues/crime/crimedocs/RS22400.pdf (last visited Feb. 2, 2008).

[383] 18 U.S.C. § 1962(a)-(d) (2006); *see also* NIELS B. SCHAUMANN, GILBERT LAW SUMMARIES: SECURITIES REGULATION 394 (6th ed. 2002).

[384] § 1961(5); *see also H.J. Inc. v. Nw. Bell Tel. Co.,* 492 U.S. 229 (1989) (stating that must show the predicate acts are related to one another and that they amount to, or constitute a threat of, continuing racketeering activity).

[385] *See*, *e.g.*, § 1961(1)B & G; *see also supra* note 382.

[386] § 1961(4).

[387] *See Schofield v. First Commodity Corp.,* 793 F.2d 28 (1st Cir. 1986) (discussing criminal *respondeat superior* under RICO).

[388] § 1963(d); *see also* § 1956(b)(3)-(4).

[389] § 1963(a)-(c).

[390] While it has not been the purpose of this memorandum to detail the legal risks for the professional facilitators, there is substantial legal exposure for the legal, accounting, and financial professionals who provide the knowledge and expertise to develop the financial and legal instrumentalities of SCF. While "scheme liability" under a Rule 10b-5 private right of action has been put to rest by *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 2008 U.S. LEXIS 1091 (U.S. 2008), to the extent that the lawyers get involved in drafting the "representations", liability will still apply. *See* LOSS & SELIGMAN, *supra* note 10, at 1329-1332 (discussing "primary liability" for lawyers under Rule 10b-5); *id.* at 1465-1469 (discussing the "duty to report evidence of a material violation" under Part 205 to Title 17 of the Code of Federal Regulations promulgated by the SEC pursuant to Section 307 of the Sarbanes-Oxley Act of 2002).

[391] This conclusion has been reached by a thorough review of the published proprietary and non-proprietary information disseminated by many of the financial institutions and the professional facilitators (i.e., the law firms, accounting firms, and financial advisors who promote SCF as a business model and marketing niche) and of the published academic and trade journals which have treated SCF in some detail over the past decade. Some of this material will be referenced throughout this memorandum as its relevance to disclosure, due diligence, compliance, industry standards, and best practices are examined.