Private international law - choice of law - Islamic law

Shamil Bank of Bahrain EC v Beximco and others
[2004] EWCA Civ 19, English Court of Appeal

Jason Chuah

School of Law

This is an electronic version of an article published in the Journal of International Maritime Law, 10 (2). pp. 125-127, 2004, and is reprinted her with the permission of the publisher.

PRIVATE INTERNATIONAL LAW – CHOICE OF LAW – ISLAMIC LAW

Shamil Bank of Bahrain EC v Beximco and others
[2004] EWCA Civ 19, English Court of Appeal

The facts

The claimant bank applied for summary judgment in its action against the defendants on the basis of certain financing agreements made between the bank and the defendants. The underlying agreement was described as a 'Morabaha' agreement, under Sharia law, the essential characteristics of which were that the bank as seller undertook to acquire possession of goods that it agreed to sell to the defendants as purchaser by instalments, with the addition of a pre-fixed profit. The agreement stated that 'subject to principles of Glorious Sharia' the English court shall have jurisdiction to resolve disputes under the contract. The bank (S) claimed amounts outstanding under the agreements when Beximco (B) failed to make payments.

B's defence was that, on the proper construction of the governing law clause, the agreements were only enforceable in so far as they were valid in accordance with Sharia law and in accordance with English law, and that the agreements were in fact contrary to Sharia law. B's case was that (1) the guarantors were discharged if the principal debtors were discharged; alternatively (2) the guarantees had been entered into on the basis of a common mistake as to the validity of the agreements under Sharia law and were therefore of no effect. It was also raised in argument that certain parts of the agreement were contrary to Islamic principles because they were in fact disguised loans with interest.

The trial judge held that English law was the governing law because there could not be two separate systems of law governing the contracts. The parties had not chosen Sharia law as the governing law because it was not the law of a country and they could not have intended the secular English court to resolve matters of religious controversy.

The decision

The Court of Appeal dismissed the appeal.

The court affirmed the view expressed by Morrison J that the commercial purpose of the contracts was that there should be certainty in the applicable law of the contract. A contract cannot have two competing governing laws in general.

The Rome Convention on the law applicable to contractual obligations scheduled to the Contracts (Applicable Law) Act 1990 only contemplated and sanctioned the choice of the law of a country. Sharia law does not refer to any particular country's laws; as such it falls outside the purview of the 1990 Act. The court went on to hold that although it was possible to incorporate provisions of foreign law as terms of a contract, it is important for the reference to principles of Sharia law in the contract to identify specific aspects of Sharia intended to be incorporated into the agreements.

The reference to Sharia law was thus repugnant to the choice of English law and could not sensibly be given effect to. The judge was right that the words were to be read as a reference to the fact that S held itself out as conducting its affairs according to Sharia principles. The Court of Appeal also ruled that a common mistake as to the legal consequences of the agreements (as a matter of fact because of foreign law) would not give rise to a defence to the claims on the guarantees, because B's sole interest was to obtain advances of funds and they were indifferent to the form of the agreements required by the bank or the impact of Sharia law on their validity. There was thus no operative mistake (of fact) that rendered 'the subject-matter of the contract essentially and radically different from the subject-matter which the parties believed to exist' (*per* Lord Steyn in *Associated Japanese Bank (International Ltd) v Crédit du Nord SA* [1989] 1 WLR 255 at 268) or that 'the thing [contracted for] essentially different from the thing [that] it was believed to be' (*per* Lord Atkin in *Bell v Lever Bros Ltd* [1932] AC 161, as adopted and confirmed by the Court of Appeal in *Great Peace Shipping Ltd v Tsavliris Salvage (International) Ltd* [2002] EWCA Civ 1407).

Comment

This case is significant in that the Court of Appeal has affirmed the general thinking of commentators that the applicable law of a contract, as provided for in the 1990 Act, must necessarily be that of a country. Whilst it is possible in arbitration to rely on *lex mercatoria*, general principles of fair trading etc, as far as judicial resolution of disputes is concerned, the applicable or governing law is that of a specific and identifiable country. Indeed, Article 3(3) specifically refers to the law of a 'country' as defined in Article 19(1). There is no provision in the Act for the choice or application of a non-national system of law such as Sharia law. In any event, the principles of Sharia are not simply principles of law but principles which apply to other aspects of life and behaviour. Even treating the principles of Sharia as principles of law, the application of such principles in relation to matters of commerce and banking would be subject to much controversy. In particular there is controversy as to the strictness with which principles of Sharia law will be interpreted or applied. In consequence it was highly improbable that the parties to the agreements could be said to have intended that Sharia was to operate beyond a guide as to conduct and behaviour.

B's argument was that although there was some controversy about the precise application and scope of the rules of Sharia in the present context, there was nothing to prevent an English court adjudicating on the advice of expert witnesses as to those aspects which were sufficiently clear to help resolve the issue of whether the agreements were valid under Sharia law. However, as it was not possible for the contract to adopt general principles of non-national law as the governing law, there was no scope to deal with the argument raised. That is a little regrettable but quite understandable – a little regrettable because the issue as to whether the agreements were disguised loans with interest under Sharia law would make for an interesting analysis.

It was also the position, not only under the common law but the Rome Convention, that a particular contractual provision cannot be governed by two separate legal systems. This is different from severance where different parts of the contract may be subject to different governing laws. Severance is valid but as far as the Giuliano-Lagarde Report (the official explanatory report accompanying the Rome Convention) is concerned, severance should be employed 'as seldom as possible' and only 'for part of a contract which is independent and separable, in terms of the contract and not of the dispute' (OJ 1980 C282/23).

The court was also quick to point out that B's conduct until the time of the claim was such that they did not seem to have any difficulty with the agreements on religious grounds or they intended to challenge them on the basis of Sharia law. That would support the contention that the presumed intention was that the agreements were for all intents and purposes to be legally enforceable under English law.

It is important for parties intending to deal on Islamic principles to incorporate the law of an Islamic country which most closely gives effect to those principles of Sharia that they are concerned with. It is neither enough to choose Sharia law *per se*, nor English law as guided by Sharia principles. It is preferable, although not always offering better certainty, to adopt a clause which subjects certain parts of the contract to, say, Saudi law and other parts to English law.

Another issue of some interest is the fact that many such financing agreements in the Middle East and elsewhere in the Islamic world, tend to require monitoring by an Islamic board (in the present case, it was the bank's own Religious Supervisory Board). It is clearly open to the parties to ensure that the decisions and recommendations made by the Board be taken seriously by contractually providing for appropriate sanctions; where Sharia principles are considered to be fundamental, the parties may provide for a more active involvement of such a Board. In the present case, the system of supervision was of little help because it was not the specific agreements which were subject to religious supervision, only the general activities of the bank. The powers of the Board were set out not in the financing agreements but in the bank's Articles of Association. Although it may not be in some banks' interest to subject their financing and commercial transactions to detailed supervision, that is an available and workable option for traders serious about the incorporation of Islamic principles. The option is not entirely free from difficulties; there is much controversy over what

financing or commercial arrangements are permitted by Sharia and also there is a potential problem of conflict given that some of these Boards, as is the case here, are managed and run by the banks themselves. In some countries (eg Malaysia) the Board is state-regulated, making the decisions, to an appreciable degree, more independent.

JC