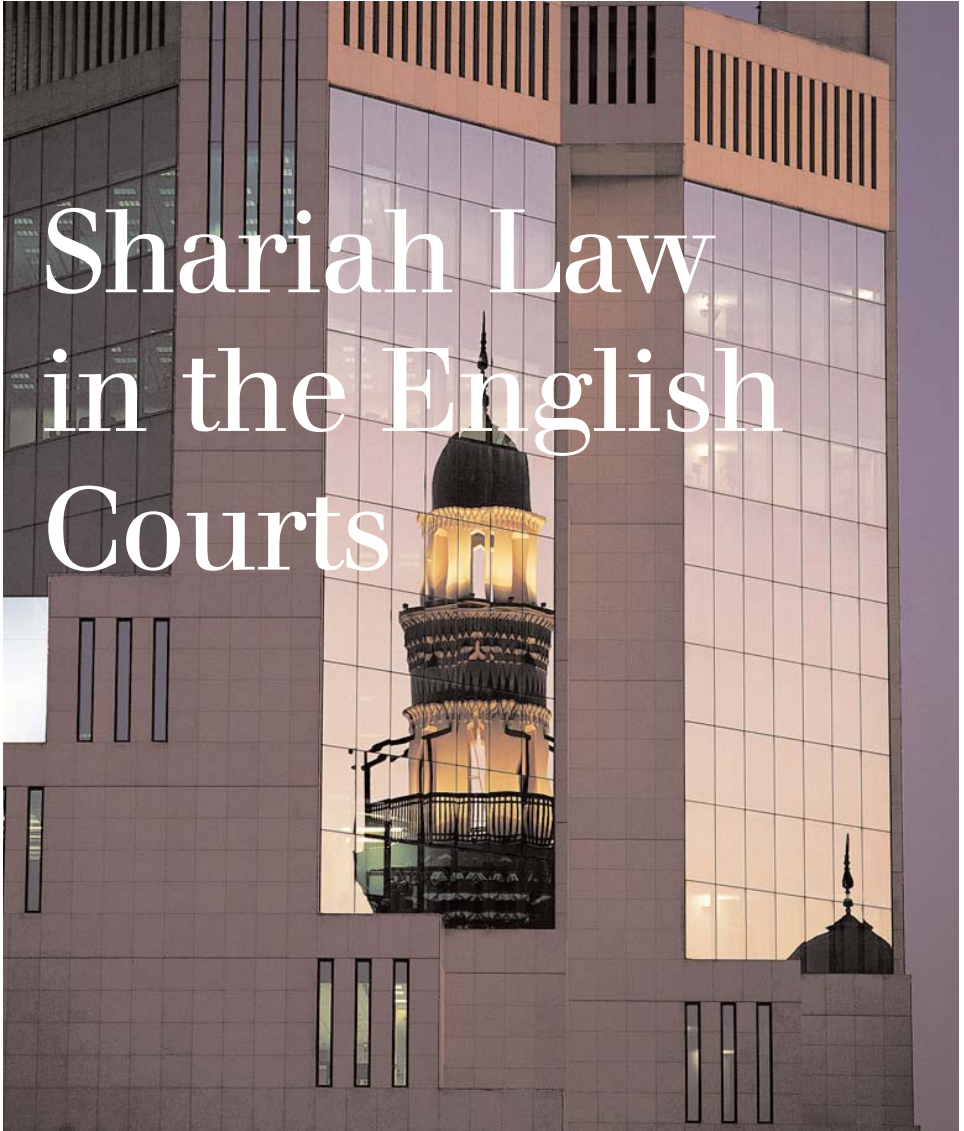


# Lovells

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# Shariah Law in the English Courts

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# Introduction

*This brochure provides a brief outline of our Islamic finance practice, and provides a case synopsis of Shamil Bank of Bahrain v Beximco Pharmaceuticals Ltd and others (2004). This case raised some interesting questions on the interpretation of Shariah in the courts of England and Wales.*

Islamic finance is a key developing international practice area for Lovells. This has led to the development of an experienced and highly specialised team of lawyers throughout our extensive network of international offices. We work on some of the most significant deals in the market.

We have been advising clients since the early days of the Islamic finance market. Our global presence means we are well placed to provide a fully integrated and efficient service irrespective of the jurisdictions involved. This enables our clients to exploit more global opportunities and the more complex Islamic financing solutions which are coming to the market.

With 27 offices in 18 countries throughout the world, Lovells delivers the breadth of experience and depth of expertise you expect from a successful, international law firm.

All our lawyers - more than 1,600 and counting - have an incisive awareness of commercial priorities, ensuring we give you practical solutions that make business sense.

Our particularly strong commitment to collaboration - both internally and with our clients - underpins our ability to work with you in finding the ways forward that best suit your circumstances and objectives.

In addition to London, we provide full service Islamic finance advice from our offices in Frankfurt, New York, Moscow, Singapore and Tokyo. We are able to provide expertise across the Middle East and North African (MENA) region through close ties with leading regional law firms.

# Shariah - conflict with English Law?

*In a recent case (Shamil Bank of Bahrain v Beximco Pharmaceuticals Ltd and others (2004)), the Court of Appeal was asked to consider whether the arrangement fell foul of Islamic Shariah principles such that the borrowers could escape liability under the financing scheme. The Court held that Shariah principles did not apply and that the financing scheme was enforceable. The case has some interesting implications.*

The lender was the Shamil Bank of Bahrain (the "Bank") which holds itself out as applying Islamic principles in the course of its banking business. In common with many Islamic banks, it has a Religious Supervisory Board comprising *Shariah* scholars, who specialise in Islamic jurisprudence. The Religious Supervisory Board reviews all of the Bank's investments and other business activities to determine whether or not these comply with *Shariah*.

Beximco Pharmaceuticals Ltd and the other borrowers (together the "Borrowers") were Bangladeshi companies involved in the manufacture, export and import of pharmaceuticals to and from Bangladesh.

In 1995 the Bank agreed to provide the Borrowers with a working capital facility. So as not to offend against the prohibition under *Shariah* of the charging of interest (*Riba*) the financing took the form of *Murabaha* contracts (for further information on *Murabaha* and other Islamic finance contracts generally refer to Lovells publication -

Shariah, Sukuk and Securitisation) under which interest was not payable but with the Bank utilising other techniques to extract profit.

*Murabaha* agreements are contracts for the sale of goods whereby the seller (here the Bank) agrees to purchase, in its own name, goods specified by the buyer (here the Borrower) and sells them to the buyer on a deferred payment basis, payable in instalments. The difference between the original price and the deferred price is the Bank's profit.

The *Murabaha* agreements contained the following governing law clause:

*"Subject to the principles of the Glorious Shariah, this Agreement shall be governed by and construed in accordance with the laws of England."*

The Borrowers' defaulted under the *Murabaha* agreements. After the occurrence of various termination events under the agreements the Bank issued formal court proceedings and made an application to the Court for summary judgment.

The question before the Court raised by the Borrowers' defence was whether on a true construction of the governing law clause, the finance agreements were enforceable only if they were valid and enforceable both in accordance with the principles of *Shariah* and in accordance with English law. The Borrowers' also argued that the effect of the governing law clause was to select English law as the governing law but at the same time stipulating as a condition precedent that the contract would be enforceable only if consistent with the principles of *Shariah*. While the Borrowers acknowledged that the application of *Shariah* gave rise to disputes between different jurists as to the content of

Shariah itself, they argued that it was uncontroversial that *Shariah* prohibited interest being charged on loans. As a consequence these *Murabaha* agreements were invalid and unenforceable because they were in truth disguised loans charging at interest.

The High Court and Court of Appeal granted summary judgment to the Bank on its claims concluding that the principles of *Shariah* did not apply to the *Murabaha* agreements, principally because that had not been the parties' intention. The Court's reasoning was as follows:

- the reference to the "Glorious Shariah" in the governing law clause was merely intended to reflect the Islamic religious principles according to which the Bank held itself out as doing business. It was not a system of law designed to trump the application of English law as the governing law.
- It is widely accepted that there could not be two separate systems of law governing a contract. The Rome Convention provided that a contract shall be governed by "the law chosen by the parties" and the reference to a choice of law was to the law of a country, not to a non-national system of law such as *Shariah*. Although it was perfectly open to the parties to a contract to incorporate some provisions of a foreign law into an English contract, but only where the parties had sufficiently identified specific provisions of a foreign law or an international code or set of rules. The general reference to principles of *Shariah* in the governing law clause did not identify those aspects of *Shariah* which were intended to be incorporated into the contract. It was insufficient for the Borrowers' to contend that the basic rules of *Shariah* applicable *in this case* were not controversial. Those basic rules were neither identified nor referred to in the contract.

- Both sides accepted that there were areas of considerable controversy and difficulty to applying *Shariah* to matters of finance and banking. Consequently it was "*improbable in the extreme, that the parties were truly asking [the Courts] to get into matters of Islamic religion and orthodoxy.*" The fact that there might be general consensus upon the proscription of Riba and the essentials of a valid *Murabaha* agreement did no more than to indicate that if the governing law clause had sufficiently incorporated the principles of *Shariah* into the agreements, the Borrowers' would have been likely to succeed.
- The Court also noted that there was no suggestion that the Borrowers' had been in any way concerned about the principles of *Shariah* either at the time the agreements were made or at any time before the proceedings were started. In the Court's opinion, the *Shariah* defence was "*a lawyer's construct.*" Therefore the Court leant against a construction which would defeat the commercial purpose of the documents.

## COMMENT

This case involved a consideration by the Courts of a commonly employed method of Islamic financing and in particular the legal basis on which such agreements are founded. Due to the circumstances of the case and the fact that the Borrowers' *Shariah* defence was found to be a lawyer's construct, the Court's scope to consider the applicability of *Shariah* was limited. It would have been manifestly unjust for the Borrowers' to avoid their liability to the Bank by raising the *Shariah* defence having previously been indifferent to the form of the agreements or the impact of *Shariah* on their validity. If the parties had wanted compliance with *Shariah* to be a condition

precedent, they should have said so. Two points arise from the decision.

First, it would have been difficult for the Court to resolve fundamental differences between scholars about *Shariah* principles, but on the other hand the Courts are accustomed to dealing with controversy between experts. Parties looking to enter into agreements incorporating *Shariah* principles should nonetheless consider including a dispute resolution provision referring disputes about *Shariah* and its applicability to a *Shariah* expert chosen by the parties or by a suitable institution. This might help to streamline the resolution of disputes and avoid the need for court proceedings which could be more costly.

Second, this case was decided on the construction of the governing law clause which incorporated English law and the Court did not need to consider and apply *Shariah*. However, the Court said that had the relevant *Shariah* principles been validly incorporated in this case, the borrowers might have succeeded in their application.

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