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Citation: Chuah, J. C. T. (2010). Impact of Islamic Law on Commercial Sale Contracts – A Private International Law Dimension in Europe. European Journal of Commercial Contract Law, 2010(4), pp. 191-204.

This is the unspecified version of the paper.

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Impact of Islamic Law on Commercial Sale Contracts – A Private International Law Dimension in Europe

The steady rise in Islamic finance has necessarily entailed a corresponding rise in transnational[1] commerce which is guided by Islamic law and practice. There is much research literature on the content and scope of Islamic law with respect to transnational commerce.[2] The object of this article however is not to engage with the scholarly debate as to what Islamic law says about how transnational commerce is carried on but to question how European transnational sales law copes with the direct and indirect effect of Islamic law. The research question is essentially one that relates to how an established European or Western private international law regime should accommodate both legally and practically the intervention of Islamic law. Although the Vienna Convention on Contracts for the International Sale of Goods (CISG) is not a private international law instrument, it represents a harmonised system of law for its signatories. It is intended thus to be a substitute for private international law where cross-border sale transactions are concerned. It would therefore be a significant lapse not to examine in this study the implications for the CISG and its application in European countries where there is an Islamic element in the sale relationship.

The methodology is largely directed by an appropriate delineation or description of the 'problem' in question. The 'problem' is then examined in the light of the current legal regimes applicable to contracts for the international sale of goods – domestic private international law and the CISG. Specific legal rules are examined in the light of legislative intent, case law and commercial practice. Some discussion on the position of non-country-specific law (such as the *lex mercatoria)* in private international law would also be necessary as Islamic law or Sharia is not a country-specific legal system. In addition, given the limitations of this work, we will necessarily have to make certain assumptions about the scope and nature of this important source of law.

The 'problem'

In reality, the 'problem' in question is simpler than might be imagined. A merchant in a European country enters into a contract with a buyer. The contract may or may not contain a choice of law clause and the buyer may or may not be established in an Islamic jurisdiction.[3] However, issues of a conflict with Islamic law may arise where the contract of sale needs to

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1. The use of the term 'transnational' instead of 'international' is to emphasise the private law perspective of the subject under consideration in this article.
2. The voluminous literature on Islamic finance as opposed to Islamic commercial law is omitted unless there is an immediate relevance to commercial law. On sources on Islamic commercial law, see generally, Berschadsky, 'Innovative Financial Securities in the Middle East: Surmounting the Ban on Interest in Islamic Law', *University of Miami Business Law Review* (2001), 107; Bilal, 'Islamic Finance: Alternatives to the Western Model', *Fletcher F. World Aff.* (1999), 145; Childress, 'Saudi-Arabian Contract Law: A Comparative Perspective', *St. Thomas L. F.* 2 (1990), 69; Coulson, *Commercial Law in the Gulf States* (London: Graham & Trotman, 1984); Dar & Presley, 'Lack of Profit Loss Sharing in Islamic Banking' *Int. J. of Islamic Fin. Services* 2 (2000), 1; Donboli & Kahsefi, 'Doing Business in the Middle East: A Primer for U.S. Companies', *Cornell International LJ* 38 (2005), 413; El-Gamal, '"Interest" and the Paradox of Contemporary Islamic Law and Finance' *Fordham Int'l LJ* 27 (2003), 108; El-Gamal, *Islamic Finance Law, Economics and Practice* (Cambridge, 2006); Foster, 'Encounters between Legal Systems: Recent Cases concerning Islamic Commercial Law in Secular Courts', Amicus Curiae (Nov/Dec 2006) 2; Foster, *Islamic Commercial Law – An Overview* (I) (Barcelona: INDret, 2006); Hafeez, *Islamic Commercial Law and Economic Development* (San Francisco, USA: Heliographica, 2005); Haji Hasan, *Sales and Contracts in Early Islamic Law* (Malaysia, 2007; first published Islamic Research Institute, Islamabad, Pakistan, 1994); Hassan, 'Contracts In Islamic Law: The Principles of Commutative Justice and Liberality', *Journal of Islamic Studies* 13:3 (2002), 257; Ibrahim, 'The Rise of Customary Businesses in International Financial Markets: An Introduction to Islamic Finance and the Challenges of International Integration', *Am. U. Int'l L. Rev.* 23 (2008) 661; Khan, 'Interaction between Shariah and International Law in Arbitration', *Chi. J. Int'l L.* 6 (2005-2006), 791; Kutty, 'The Shari'a Factor in International Commercial Arbitration', *Loy. L.A. Int'l & Comp. L. Rev*. 28 (2006), 565; Mallat, *Introduction to Middle Eastern Law* (esp. ch. 9) (OUP, 2009); Rehman, 'Globalization of Islamic Finance Law', *Wis. Int'l L.J.* 25 (2007-2008), 625; Saleh, *Commercial Arbitration in the Arab Middle East: Shari'a, Syria, Lebanon, and Egypt: Shari'a, Lebanon, Syria, and Egypt* (Hart Publ., 2006); Sloane, 'The Status of Islamic Law in the Modern Commercial World' *International Lawyer* 22 (1988), 743; Suratgar, 'The Impact of Islamic Banking on World Financial and Commercial Relations', *Law & Pol'y Int'l Bus*. 16 (1984), 1089; Usmani, *An Introduction to Islamic Finance* (Kluwer, 2002); also relevant materials at <www.ruf.rice.edu/>, <www.islamic-banking.com> and <islamic-finance.net/journals/>.
3. For a useful source of the commercial laws of certain Islamic countries, please see <www.jus.uio.no/lm/islamic.law/islamic.law.html>.

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be performed in an Islamic country,[4] or where the contract tries to incorporate Islamic practices into the performance of the contract, or where it contains a specific reference to Islamic law as the applicable law. Moreover, even if the contract is expressed to be governed by the CISG (and there are increasingly more Islamic countries adopting the CISG[5]) or a Western applicable law and there is no Islamic dimension to the contractual performance, the application of the CISG or the applicable law may cause specific problems where the enforcement or recognition of the judicial or arbitral award is sought in an Islamic jurisdiction. This is especially the case where the enforcement of the award entails the application of Western legal constructs which are unacceptable in the eyes of Islam. Another interesting issue is whether, and to what extent, the CISG, which should be interpreted in 'good faith',[6] might be applied by a tribunal (whether located in an Islamic jurisdiction or not) to incorporate Islamic principles where there is a strong Islamic cultural complexion (such as the parties are trading on a halal[7] basis) in the contractual relationship.

But, why the focus on sale contracts? It has to be said that the issue is particularly acute in sales because many international sale contracts, whether Islamic in complexion or not, will need some kind of trade financing. As soon as trade financing, whether the documentary credit or discounting of bills of exchange or factoring or forfaiting, the issue of interest will necessarily have to be considered. Islamic businesses and financial institutions will necessarily have an issue with the charging and paying of interest. The imperative on the Islamic participants would be to employ Sharia-compliant sale financing tools.[8] It is therefore especially needful to consider the implications of Islamic legal principles on contracts for the international sale of goods.

The problematic issues of conflict could not easily be ameliorated by the parties' private contract; although it will be argued that private contractual provision will go some distance to reducing the attendant commercial and legal risks. The conflict of laws issue in commercial contractual relationships is becoming more controversial given the huge furore over the perceived interference of Islamic *personal* law into Western societies – in the UK, for example, there was serious disquiet when the Archbishop of Canterbury,[9] Dr Rowan Williams, publicly said[10] that the UK should 'face up to the fact' that some of its citizens do not relate to the British legal system and that adopting parts of Sharia law could help maintain social cohesion. He also added that Muslims should not have to choose between 'the stark alternatives of cultural loyalty or state loyalty'. At a transnational level, these 'stark alternatives' appear to be more and more pronounced; with many more Muslim international traders seeking contracts which do not compromise their cultural and religious loyalty.

Few readers of the *European Journal of Commercial Contract Law* will have missed the recent controversial Oklahoma Legislative Referendum. Oklahoma Referendum State Question No. 755 is now infamous despite the vote having only been counted and confirmed on 2 November 2010. The State Question asks the population of Oklahoma to consider whether to approve a change to Article 7(1) of the State Constitution which will make it imperative for courts to rely only on federal and state law when deciding cases. The legislative change will also forbid all courts from 'considering or using international law ... [and] Sharia Law.' It then defines for the voter international law as the law of nations which deals with the conduct of international organisations and independent nations as being contained in customary law, treaties and international agreements. The referendum question then describes Sharia law as Islamic law, a law based on two principal sources – the Koran and the teaching of Mohammed. A staggering 70% of the population approved of the proposal. The Oklahoma State Board of Elections then scheduled a meeting on 9 November 2010 to certify the referendum results. That meeting has now been stayed by an application to the District Court[11] from one Mr Awad, the Executive Director of the Council on American Islamic Relations. Awad argued that State Question No. 755 was not constitutional and the Board of Elections should therefore be restrained from certifying the vote. In particular, Awad asserted that the ban on the state courts' use and consideration of Sharia law violated the US Constitution First Amendment's religion clauses – the Establishment and Free Exercise Clauses.[12] In US law, for a governmental action to be in breach of the Establishment Clause it '(1) must have a secular legislative purpose, (2) its principal or primary effect must be

4. The term 'Islamic country' is used loosely to describe a country which applies to a substantial extent the legal principles of Sharia. Sharia might be defined as those legal and moral principles laid down in the Koran and the teachings of Mohammed.
5. Countries with a significant Islamic tradition which have adopted the CISG include Turkey, Uzbekistan, Mauritania, Lebanon, Kyrgystan, Iraq, Egypt and Syria.
6. Art. 7(1) CISG states that 'in that interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade'.
7. Lawful or compliant with Sharia.
8. See below.
9. The Archbishop of Canterbury is the Head of the Church of England. For more information about the Archbishop's office, see <www.archbishopofcanterbury.org/>.
10. See news report by the BBC at <news.bbc.co.uk/1/hi/uk/7232661.stm>.
11. *Awad v. Ziriax*, Case No. CIV-10-1186-M, United States District Court for the Western District of Oklahoma, 2010 U.S. Dist. LEXIS 119660 (9 November 2010).
12. The freedom of religion clauses in the First Amendment provide that Congress shall make no law respecting an establishment of religion (the so-called Establishment Clause) or prohibiting the free exercise thereof (the Free Exercise Clause).

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one that neither advances nor inhibits religion, and (3) it must not foster an excessive government entanglement with religion.'[13] The court found that the plaintiff had shown there was substantial likelihood of success[14] that the proposed amendment was secular because it necessitated excessive religious entanglement. Awad was especially concerned that the State Question was motivated by a malicious intention to disapprove or stigmatise his faith. The court also agreed with Awad that the proposed amendment would violate the First Amendment's Free Exercise Clause because the law discriminated against some or all religious beliefs or prohibited conduct on the basis that it was undertaken for religious reasons.[15] Lastly, the temporary restraining order was given because the court found that alleged injury to the plaintiff would outweigh any injury to the Board of Elections. Therefore although the court recognised 'the importance of the importance of the will of the voters being carried out', it considered that 'any harm that would result from a slight delay in certifying the election results is minimal in comparison to the irreparable injury that occurs when an individual suffers the loss of his constitutional rights'.[16]

It is not the object of this article to go into the intricacies of US constitutional law but the Oklahoma case clearly demonstrates the tussle between the 'stark alternatives' that the Archbishop of Canterbury was referring to. It should also necessarily be noted that the Oklahoma proposal makes no distinction between personal and commercial matters. It relates to all matters falling under state jurisdiction.

The Choice of Law Framework and Sharia

Until recently, on matters of choice of law, the Member States of the EU were governed by the Rome Convention.[17] That Convention provided in Article 3 that:

'(1) A contract shall be governed by the law chosen by the parties. The choice must be express or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or a part of the contract.'

A question thus is whether the contracting parties may agree to subject their contract to the governance of Islamic law. In an English case, *Bank Shamil of Bahrain v. Beximco*[18] the parties had inserted the following clause into their contract:

'Subject to the principles of the Glorious Sharia, this Agreement shall be governed by and construed in accordance with the laws of England.'[19]

It is immediately obvious that the clause referred to *two* legal systems as being the applicable laws of the contract. The Court of Appeal was asked to overrule the lower court's decision which refused to recognise and give effect to the reference to 'Sharia'.

It should not be assumed that such clauses are a rare occurrence. Many Islamic financial institutions, through their Religious Supervisory Boards,[20] will insist on the use of either explicit or tacit references to Islamic law. It is also not inconceivable for commercial contracts with an Islamic law clause to be litigated or arbitrated in a Western jurisdiction. The jurisdiction

13. *Weinbaum v. City of Las Cruces, N.M.*, 541 F.3d 1017, 1030 (10th Cir. 2008).
14. Which is the standard required for the application for a temporary injunction and restraining order. See *Dominion Video Satellite, Inc. v. Echostar Satellite Corp.*, 269 F.3d 1149, 1154 (10th Cir. 2001) where it was held that a party seeking a temporary restraining order must demonstrate: (1) there is a substantial likelihood of success on the merits; (2) he will suffer irreparable injury in the absence of injunctive relief; (3) the alleged injury to the movant outweighs the injury to the party opposing the motion; and (4) the injunctive relief would not be adverse to the public interest.
15. *Church of the Lukumi Babalu Aye, Inc. v. City of Hialeah*, 508 U.S. 520, 532, 113 S. Ct. 2217, 124 L. Ed. 2d 472 (1993).
16. See section IV(C) of the *lexisnexis* judgment.
17. The Convention on the law applicable to contractual obligations negotiated and drawn up by the EU which was opened for signature in Rome on 19 June 1980. Although the Convention is by and large a measure of EU law (see section 2 of the Convention) and does indeed require Contracting States to refer any questions of law to the European Court of Justice and to decide any such question in accordance with the principles laid down by the European Court (s. 3 of the Act), Art. 2 makes it plain that any law specified by the Convention (namely the applicable law as ascertained) shall be applied whether or not it is the law of a Contracting State. Since December 2009, Regulation 593/2008 on the law applicable to contractual obligations has come into force replacing the Rome Convention.
18. [2004] 4 All ER 1072 (Court of Appeal); for a detailed analysis of the Islamic financing aspects of the case see Chuah, 'International Trade Financing Instruments expressed to be governed by Islamic principles – A Study of the Morabaha in English Law', *Northwestern Journal of International Law and Business* 27 (2006), 137.
19. See para. 1 of the judgment.
20. There is some controversy as to the importance Western courts have paid to these religious boards. These boards essentially set the moral and religious direction for the Islamic institution however in law, it is not clear how and to what extent their decisions are legally binding. In *Bank Shamil of Bahrain v. Beximco* (*supra* n. 18), it was held that 'so far as the position of the bank's religious supervisory board was concerned, Khan J stated that certification by the board that the operations of the bank were according to the Sharia'a would not be a decision binding on any court dealing with the dispute under the law of Sharia'a. The dispute would fall to be resolved by the court in the light of its own view of the position under Sharia'a law. In any event there was no evidence that the board had had knowledge of, nor was it required to approve, the particular transaction in this case, its function being one of overall supervision and approval of the methods and procedures adopted by the bank in the course of its business' (at para. 34). (See also *Financial Times* 21 April 2010; also the English case of *The Investment Dar Company KSCC v. Blom Developments Bank SAL* [2009] EWHC 3545 (Ch)).

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question is seen rightly to be quite distinct from the question of applicable law. Traders are keen to ensure that whilst the substance of the contract is regulated by Islamic principles, matters of practicality such as process and enforcement are best dealt with in jurisdictions with convenient, cost-effective and prompt procedures.

Although the issue was one which very much impinged on the now defunct Rome Convention, an examination of the English decision is important to show how and the extent to which the law within the EU has moved on. Another reason why a study of the decision is relevant is to demonstrate some of the intrinsic issues for transnational contracts with an Islamic context.

At first instance, the judge ruled that English law was the governing law because there could not be two separate systems of law governing the same contract. The Court of Appeal agreed with this, stating with some degree of force:

'Thus the reference to the 'principles of … Sharia'a' stand unqualified as a reference to the body of Sharia'a law generally. As such, they are inevitably repugnant to the choice of English law as the law of the contract and render the clause self-contradictory and therefore meaningless.'[21]

The court was concerned to note that for the purposes of the Rome Convention, only the law of a country can be made the applicable law. Sharia law could not properly be defined as the law of a particular country. This argument is not without force. Article 3(1) of the Rome Convention clearly contemplates that a contract 'shall be governed by *the law* chosen by the parties'.[22] Article 1(1) in turn seems to emphasise that that reference to the applicable law is a reference to the law of a country.[23] There is no provision for the choice or application of a non-national system of law such as Sharia law. In any event, Sharia is more than a legal code. It also contains religious and moral principles. Not only are these plainly matters of controversy, but a secular court, such as the English court, is not best placed to apply it to resolve commercial disputes. This is exacerbated by the fact that there is uncertainty as how strictly certain principles are to be interpreted or applied. Thus, as a matter of construction of the applicable law clause, it 'was highly improbable that the parties to the agreements intended an English court to determine any dispute as to the nature or application of such controversial religious principles which would involve it in the task of deciding between opposing points of view which themselves might be based on geopolitical and particular religious beliefs'.[24]

The Court of Appeal, in endorsing the lower court's decision, went on to state that the reference in the clause to the Glorious Sharia was not an applicable law clause but merely a declaration that the parties would attempt to do business in a manner consistent with Islamic religious principles. The court said that 'the words are intended simply to reflect the Islamic religious principles according to which the bank holds itself out as doing business rather than a system of law'.[25] Nothing more, it would seem, than the sort of ubiquitous corporate social responsibility clauses found in modern business and corporate documentation.

Recent analyses of the issues thrown up in English case by commentators dealing with other jurisdictions seem to confirm that a Western judicial approach would be *largely* similar to that taken by the Court of Appeal in *Beximco.*[26] It should however be said that these commentaries relate to the position under the Rome Convention; the Rome Convention as alluded to above has been superseded by the Rome I Regulation. The issue of construction or interpretation of the applicable law clause in English law considered the presumed intention of the parties within their commercial relationship. A German approach, for example, would equally consider how workable a particular construction would be.[27] Similarly the issue as to whether the law of a non-state might be chosen might be examined in the context of the Rome Convention as applied in the German international private law (*Internationales Privatrecht* as codified in the second chapter of the *Einfuhrungsgesetz zum Burgerlichen Gesetzbuch* ('EGBGB')). Most German legal scholars consider that the applicable law should mean the law of a state.[28] It is also an inescapable fact that where other statutes are concerned, there is frequently a distinction made

21. Para. 40 of the judgment.
22. Emphasis added.
23. Art. 1(1) provides, 'The rules of this Convention shall apply to contractual obligations in any situation involving a choice between the laws of different *countries*' (emphasis added).
24. See para. 40 of the judgment.
25. See para. 54 of the judgment.
26. See Balz, 'Islamic Law as Governing Law under the Rome Convention – Universalist Lex Mercatoria v. Regional Unification of Laws', *Unif. L. Rev*. n.s. 6 (2001), 37; Junius, 'Islamic Finance: Issues Surrounding Islamic Law as a Choice of Law under German Conflict of Laws Principles', *Chi. J. Int'l L*. 7 (2007), 537; El-Gamal, Mahmoud A, 'Incoherence of Contract-Based Islamic Financial Jurisprudence in the Age of Financial Engineering', *Wis. Int'l L.J.* 25 (2007-2008), 605; Mathias Rohe, 'Application of Sharī'a Rules in Europe: Scope and Limits', *Die Welt des Islams* Vol. 44, Issue 3, Sharī'a in Europe (2004), 323; Balz 'Islamic Financing Transactions in European Courts' in Ali, *Islamic Finance: Current Legal and Regulatory Issues* (Harvard, 2005).
27. See Junius, *ibid*.
28. Heldrich, '*Article 27*', in Otto Palandt, *Burgerliches Gesetzbuch* (German Civil Code) P 3 at 2580-81 (Munich: 65th edn., 2006); and Martiny, '*Article 27*', in Kurt Rebmann, Franz Jiirgen Sacker, and Roland Rixecker, (eds.), 10 *Munchener Kommentar zum Burgerlichen Gesetzbuch* P 28 at 1686, P 33 at 1690 (CH Beck, 4th edn., 2006); these sources are cited by Junius (*ibid*.) and it should be noted that there have been more recent editions of both texts.

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between general legal provisions and those pertaining to a state.[29] An example pointed out by Junius[30] is section 1051 para. 1 sentence 1 of the German Code of Civil Procedure,[31] which relates to arbitration proceedings. That provision states that the arbitration tribunal must decide the dispute in accordance with the legal provisions the parties have identified as applicable to the cause of action. The second sentence of that section then goes on specifically to refer to 'the law or the legal order of a specific state'. That reference has been interpreted to include laws or rules pertaining to a non-state.[32] There is however no comparable provision in the EGBGB (namely the German implementation of the Rome Convention) suggesting therefore that only the law of a state might be the applicable law for judicial proceedings.

In contrast, the new Rome I Regulation expressly states in recital 13 of the Preamble that it 'does not preclude parties from incorporating by reference into their contract a non-State body of law or an international convention'. The legislative history to this provision is especially interesting. Initially the Commission had proposed an Article 3 which included the words 'the parties may also choose as the applicable law the principles and rules of the substantive law of contract recognised internationally or in the Community'. The intention was to allow for the incorporation of the UNIDROIT Principles of International Commercial Contracts, the Principles of European Contract Law (PECL), and potentially the European Contract Law. However, there were serious doubts raised about the lack of specific guidelines on what counts as 'substantive law of contract recognised internationally or in the Community'.[33] Another concern raised was about the lack of democratic legitimacy. The law of a non-state system is essentially not one which has been democratically sanctioned – for example if the parties chose the UNIDROIT Principles, those Principles have not been given legitimacy by any government and as such, the application of those principles to the contract by a judicial (as opposed to an arbitral) tribunal would mean a loss of legitimacy.[34] The proposal was subsequently dropped and in its place, the more opaque words in recital 13 were adopted.

This legislative history makes it interesting when considering the issue of Sharia law as the applicable law. If recital 13 were to treated as reflecting the original intent of the dropped proposal, then it might be suggested that as Sharia law is neither substantive contract law nor a body of contract law recognised internationally or in the Community, recital 13 could not be used to admit Islamic law as the applicable law. An analogy might be drawn from the Commission's rejection (from the scope of the now dropped proposal) of the *lex mercatoria*[35] for not being precise enough, or for being a mere set of private codifications which are not adequately recognised by the international community.[36] Recital 13 read in isolation may on the other hand cause us a little more difficulty. On the one hand, it might be argued that recital 13 is saying no more than the obvious[37] and lacks any clear impact. Recital 13 is clearly not backed by an explicit provision in the main body of the Regulation. On that basis, it is no more than a declaration of intent.

On the other hand, it might be argued that the free-standing recital should thus have a wider meaning than the now rejected proposed Article 3. After all, if the proposed paragraph is rejected that must mean it should no longer guide the interpretation of the Regulation. Under the Rome Convention, a link was made between the applicable law and the law of states. Without recital 13, a similar link might be made in the Rome I Regulation. After all, there are powerful references in Articles 3 and 4 to the law of a *country*. However, against this backdrop, we have to contend with recital 13 which clearly allows the parties to incorporate into their contracts a non-state body of law, and not merely substantive law of contract. That said, the order of words in the preamble as conveying legislative force is unclear. The recitals are obviously relevant to the interpretation of the main text but without a set of relevant provisions in the main text, a recital would seem to lack legislative force. Recital 13 perhaps should be seen as being merely a supportive provision to recital 14. Recital 14 makes it possible for the EU to introduce an instrument of substantive contract law (such as the European Contract Law) which *in itself* may provide that the parties may choose it as the applicable law of the contract. Recital 13 merely makes Rome I compatible with such an instrument if and when it is introduced into Community law.

The choice of Sharia law is therefore not further enhanced by the new Rome I Regulation. If anything,

29. Balz, 'Das islamische Recht als Vertragsstatut? zur Entscheidung des London High Court v. 1. 8. 2003, Shamil Bank of Bahrain v Beximco Pharmaceuticals Ltd. and Others', IPRax(Jan/Feb 2005), 44 at 45.
30. *Supra* n. 26.
31. *ZivilprozeBordnung* (ZPO) (civil procedure statute) May 12, 2005, *Bundesgesetzblatt* (BGB1) I, as amended.
32. See Balz, *supra* n. 26.
33. Leible, 'Rechtswahl', in Ferarri & Leible (eds.), *Ein neues internationales Vertragsrecht für Europa – der Vorschlag für eine Rom-I Verordnung* (Jena, 2007), 41, 47; Max Planck Institute for Comparative and International Private Law (MPI) 244.
34. Heiss argued in Ferarri & Leible, *Rome I Regulation – The Law applicable to Contractual Obligations* (European Law Publishers, Munich, 2009) at 11 that this argument is unpersuasive because the provision merely grants the parties autonomy to choose a law, not to impose the application of a law on the parties.
35. For the purposes of this article, we would not be considering the intriguing question of whether and to what extent Sharia principles of finance and commerce should constitute *lex mercatoria*, regional or otherwise.
36. See COM (2005) 650 FINAL p. 5.
37. Heiss, *supra* n. 34, at p 11.

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there is now also a clear exhortation in recital 16 which requires that the conflict of law rules should be highly foreseeable so as to achieve legal certainty in the European judicial area. That should thus guide how national courts interpret choice of law agreements. In a case such as *Beximco*, the court could very well rely on recital 16 to find that an interpretation admitting Islamic law not only as an applicable law but as a set of rules qualifying the application of the applicable law (in *Beximco*, for example, it was argued that Sharia should qualify the application of English law, the applicable law) would not lend itself to supporting the legal certainty objective. That is especially so when it seems to be an accepted position that Sharia law is not merely law but a set of moral precepts.[38]

Secular applicable law but presence of Sharia compliance clause

Conflict of laws is not the only issue of some weight where commercial contracts are concerned. A commercial contract might very well be governed by Western law, such as the law of an EU Member State but the contract may specifically provide for performance which is compliant with Sharia. For example, the contract is expressed to be governed by English law but requires the parties to conduct themselves in a Sharia-compliant manner. This is different from the *Beximco* clause because here Sharia principles are not made the applicable law but the parties are contractually required to observe Sharia in their dealings. Effectively, a secular or civil court would be required to interpret the contract and decide whether the parties have acted in compliance with Sharia as ascertained by expert evidence.

In England, the recent case of *The Investment Dar Company KSCC v. Blom Developments Bank SAL*[39] shows how controversial the issue can be. Indeed, the case was described by Moody's Investors Services as having heightened the 'operational risk' of Islamic financial transactions.[40]

In that case, Dar and Blom had entered into a master *wakala*[41] contract under which Dar as *wakeel* (representative or agent) would invest monies deposited by Blom, the *muwakkil*. Dar would then pay Blom a fixed rate of return irrespective of the performance of the investments. The contract was expressed to be governed by English law. The contract explicitly provides in clause 5 that the *wakala* would be in accordance with Sharia as interpreted by the Sharia supervisory board and would not assert any provision of the contract or any transaction under the contract which might be in breach of Sharia.[42] The investments failed and Dar stopped making payments to Blom. Blom sued for the repayment of the amounts it invested as well as the specified rate of return profit element. The action was founded on breach of contract and breach of trust (Dar having promised to act as trustee (*wakeel*)). Dar however argued that the *wakala* as structured was contrary to Islamic law because it was effectively an investment associated to the payment of interest (*riba*). As such, they reasoned that to continue with the contract would be to contravene clause 5 of the contract. So what we see is a backdoor incorporation of Sharia, not as applicable law but as a matter of contractual performance.

When the matter went before the court, there was naturally some disquiet especially from Sharia supervisory boards and the Islamic finance sector.[43] The concern was that if these instruments had been certified by Sharia boards as Islamic law compliant, that decision should not be questioned before a secular court. The court was notably sympathetic to this concern. The judge, Purle J, said:

'It points to the undoubted fact that the Sharia committee of (I shall assume) respected scholars had authorised and approved of this form of contract which is a strong indication that the contract was indeed Sharia compliant. There was put in before the master for TID at the very last moment some rather exiguous evidence of Sharia law, which was answered overnight and then supplemented by further evidence on the part of TID.'[44]

38. *Supra* n. 24.
39. [2009] EWHC 3545 (Ch).
40. See news report of 8 July 2010 by Bloomberg at <www.bloomberg.com/news/2010-07-08/dar-blom-u-k-case-dismissal-removes-hurdle-for-market-islamic-finance.html>; also report in Gulf News on 27 May 2010 at <gulfnews.com/business/general/dar-blom-battle-raises-sharia-risk-1.632950?localLinksEnabled=false>.
41. A *wakala* contract is a Sharia-compliant investment contract. In the context of Value Added Tax on such investment contracts, a workable example is provided for by UK Revenue and Customs in these terms: 'An investor agrees to invest a sum with the bank for an agreed return (e.g. 5%). The bank pools the investor's funds with the funds of other investors and its own capital and invests in Sharia compliant assets. At the end of a given period (e.g. a month) the bank returns the invested sum to the investor along with the agreed 5%. Any additional revenue that the bank makes on the customer's money is kept by the bank (e.g. if the bank makes 6% then 5% is given to the customer and the additional 1% is kept by the bank). If the bank does not make the agreed percentage return then the investor gets what has been made whilst the bank gets nothing (e.g. if only 4% is achieved then the investor gets the full 4%).' (See United Kingdom HMRC Guidance, VAT FIN 8500.)
42. Clause 5.4 of the contract stipulated: 'The wakeel shall not utilise the wakala assets for any other purpose except what is permitted by muwakkil/depositor and within the Sharia parameters. The wakeel confirms that the terms of the master wakala contract and the transactions contemplated hereby are in accordance with the Sharia as interpreted by the Sharia committee and it undertakes that it will not at any time assert that any provision thereof or any transaction effected pursuant hereto contravenes the Sharia.'
43. *Supra* n. 40.
44. Para. 16 of the judgment (*supra* n. 39).

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The matter before the court was about summary judgment.[45] The court held that it was at least arguable that (a) the *wakala* contract was *ultra vires* because Dar's articles of association did not permit it to make investments contrary to Sharia and (b) that the *wakala* contract in question was not Sharia compliant. However, the court importantly decided that even if the transaction was void or unenforceable, Blom would have a restitutionary claim because it would have mistakenly paid money under a void or unenforceable contract. The judge thus said, 'one way or another Blom is bound to succeed'.

It should, of course, be noted that the case went without much event only because there are distinct principles of restitution in English law which aided Blom. That is not necessarily the case elsewhere, including other common law jurisdictions.

The industry also was relieved that the court did not venture to decide whether the wakala was Sharia compliant. That said, it should be said that in English law, the onus of establishing an arguable case for the purposes of summary judgment is not especially difficult. An applicant only needed to show that its prospects of success were not merely fanciful. That said, the issues raised have the potential to cause problems for Islamic traders and their counterparts. Other than the question of Sharia compliance and the worry that the secular courts might overturn decisions by Sharia boards, is the equally knotty issue of whether the Islamic party has the necessary legal capacity to make contracts which are not Sharia compliant.

In the case, Dar was established in Kuwait and its constitution states patently that 'the objectives for which the company is established shall be Sharia compliant' and 'none of the objectives shall be construed and interpreted as permitting the company to practice directly or indirectly any usury or non-Sharia compliant activities.'[46] Whilst in English and EU law a company cannot generally avoid their contractual obligations on the basis of the lack of *vires* in their articles of association,[47] the position is not the same elsewhere.[48] This also raises the issue of enforcement especially at the place of incorporation. The issue of capacity may arise in three specific contexts. First, the articles of association and/or memorandum of association provide that the entity must act according to Sharia. Seccondly, the contract in question specifies (like in *Blom*) that the entity must act in accordance with Sharia. Thirdly, the country of incorporation may have specified in its constitution or public policy that the entity must act in a manner consistent with Sharia principles.

As regards the first context, the question is one of interpretation and enforcement of contracts. This places an enormous burden on the presiding court and where the compliance has been certified by a Sharia board may involve judicial intervention into the workings of the Sharia board which may not be welcome. This was effectively what happened in *Blom*.

The second raises the issue of capacity to be assessed on the basis of foreign law. The presiding court would have to apply its conflict of law rules to determine whether and to what extent the law of the place of incorporation would guide its decision on lack of capacity.

Last but not least, the constitution or law of the foreign state (may be the place of incorporation or the place where performance of the contract is sought or the place where enforcement of the contract is sought or the place where the enforcement of any judgment is sought) may dictate the issue of capacity. It is quite conceivable that the law of the foreign state may make Sharia a law which cannot be derogated from by contract or may prohibit the enforcement of any performance (contractual or otherwise) which falls foul of Sharia.

Interpretation of Capacity Clauses

This is largely a matter for domestic law. However, as was pointed out in *Blom*, the Islamic aspect may necessitate the secular court's intervention in the decisions of the Sharia boards. Although the case is primarily involved in investment products or instruments, it should not be assumed that the implications are not insignificant to sale arrangements. As alluded to earlier,[49] many international sale arrangements necessitate the use of non-interest bearing trade financing instruments. The sale contracts are usually structured by Islamic

45. Part 24.1 of the Civil Procedure Rules 1998 defines the summary judgment procedure in English law as a procedure 'by which the court may decide a claim or a particular issue without a trial'.
46. See para. 3 of the judgment which reproduces and translates Art. 5 of the company's memorandum of association (*supra* n. 39).
47. Section 39, Companies Act 2006 provides: 'The validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's constitution'. As far as EU law is concerned, Art. 9(2) of the First Company Law Directive provides that 'the limits on the powers of the organs of the company, arising under the statutes or from a decision of the competent organs, may never be relied on as against third parties, even if they have been disclosed'.
48. In China, for example, *ultra vires* is still a good defence for a company not to perform a contract which it claims not to have the *vires* to have entered into. See Minkang Gu, *Understanding Chinese Company Law* (Hong Kong University Press, Hong Kong, 2006), 50-52. In Islamic countries, the capacity of the company or legal person to act may also be constrained by Sharia which is incorporated by virtue of the country's constitution or public policy.
49. See above.

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businesses on *murabaha*[50] or *bai al-bithaman ajil*[51] or *salam*,[52] *istisna*[53] or *musharaka*[54] terms. These sale contract forms may all be subject to Sharia compliance procedures as determined by the participants' Sharia supervisory boards. This is particularly so as these transactions will usually involve a financial institution or an investment house which are expressed to be Sharia compliant. The significance of the ruling should not therefore be confined to investment contracts.

On the question as to whether the secular or civil courts could overturn the recommendations of a Sharia advisory board, it may be instructive to turn to a decision of the Malaysian High Court involving eleven conjoined cases.[55] The Malaysian situation is interesting because the country operates a dual formal system – Islamic law and civil law are applied in a complementary and joined up manner.[56] The civil court asserted: 'There is neither necessity nor reason to refer these concepts to the Syariah Advisory Council for any ruling, which in any case, while they are to be taken into consideration, are not binding upon the court'.[57]

The court thus decided that when applying Islamic principles to Islamic transactions, it did not need to refer to the Sharia Advisory Council for advice or instructions. Its judicial role is distinctive. This is an important judgment – not only does it involve some of the biggest names in Islamic financing in Asia, but, unlike many secular states, Malaysia has adopted an explicit and formal legislative framework for the implementation of Sharia principles to Islamic finance and commerce.

Capacity on the Basis of the Corporation's Constitution

The issue of *ultra vires* is troublesome where the party in question is a foreign corporation or legal person. The question is whether and to what extent, the company's constitution as deposited and recognised in its place of incorporation should also be observed by the *lex fori* where a cross-border transaction is being disputed before the forum. It is not the intention here to survey the different approaches to the issue of whether restitutionary remedies are available where the innocent party has made a contract with a public law institution which does not have the power to enter into such a transaction.[58] What is of more interest to this article is the legal and practical implications for turning to the law of the place of incorporation for assistance in dealing with the issue of capacity to contract.

In *Haugesund Kommune and Narvik Kommune v. Depfa ACS Bank*,[59] 430 local municipalities in Norway had entered into a number of swap agreements[60] with an Irish bank, Depfa ACS Bank. The investments were a failure. The local municipalities were therefore unable to repay Depfa the amounts owing under the swap agreements. The Norwegian municipalities commenced proceedings in the English court asking for a declaration that they were not liable under the

50. This is defined as a transaction where the seller makes clear the cost he has incurred on the goods for sale and sells it to another person by adding a profit or mark-up which is made known to the buyer. This is the so-called 'sale with profit'. See <www.qfinance.com/dictionary> (QFINANCE is a resource website created by Bloomsbury Information Ltd in partnership with the Qatar Financial Centre Authority (QFCA)).
51. A sale of goods in which a bank purchases the goods on behalf of the buyer from the seller and sells them to the buyer at a profit, allowing the buyer to make instalment payments (*ibid*.).
52. This is a contract for the purchase of goods to be delivered at a specified time in the future. Payment for the goods is made in advance (*ibid*.).
53. This is a contract for the manufacturing of a product in which the manufacturer agrees to produce a specified product to be delivered at a specified time for a specified price (*ibid*.).
54. A type of partnership in which all partners contribute capital to an enterprise (including the purchase and resale of goods), share profits in a prearranged way, and share losses equally (*ibid*.).
55. *Arab-Malaysian Finance Bhd v. Taman Ihsan Jaya Sdn Bhd & Ors* (Suit No D4–22A–067 of 2003); *Bank Islam Malaysia Bhd v. Ghazali bin Shamsuddin & Ors* (Suit No D4–22A–215 of 2004);*Bank Islam Malaysia Bhd v. Nordin bin Suboh* (Suit No D4–22A–1 of 2004); *Bank Islam Malaysia Bhd v. Peringkat Raya (M) Sdn Bhd & Ors* (Suit No D4–22A–185 of 2005); *Bank Islam Malaysia Bhd v. Ramli bin Shuhaimi & Ors* (Suit No D4–22A–399 of 2005) reported in [2008] 5 *Malayan LJ* 631. The subject matter of these cases was whether the *bai al-bithaman ajil* entered into by these parties was valid and consistent with the Malaysian Islamic Banking Act 1983 (which incorporates Sharia prohibition against interest (*riba*)).
56. Its Islamic finance and commerce legal infrastructure encompasses the following statutes: Islamic Banking Act 1983, Exchange Control Act 1953, Takaful Act1984, and the Capital Markets and Services Act 2007. These and other related laws can be found at the Malaysian International Islamic Financial Centre's website, <www.mifc.com/index.php?ch=menu_law&pg=menu_law_rel>.
57. At section 30 of the report (*ibid*.).
58. The problem has surfaced in the UK in a number of cases involving Scottish local authorities, Norwegian *kommunes*, German public transport corporation, Italian local government etc. See *Kleinwort Benson Limited v. City of Glasgow District Council* [1997] UKHL 43; *Haugesund Kommune and Narvik Kommune v. Depfa ACS Bank* [2010] EWCA Civ 579; *Berliner Verkehrsbetriebe (BVG) Anstalt Des Offentlichen Rechts v. JP Morgan Chase Bank N.A., JP Morgan Securities Limited* [2010] EWCA Civ 309; *Depfa Bank PLC (Depfa) and Dexia Crediop SpA (Dexia) v. Provincia di Pisa (Pisa)* [2010] EWHC 1148 (Comm) respectively.
59. *Ibid*.
60. Lord Goff in *Westdeutsche Landesbank Girozentrale v. Islington London BC* [1996] AC 669, at 680 defined a swap in these terms: 'Under such a transaction, one party (the fixed rate payer) agrees to pay the other over a certain period interest at a fixed rate on a notional capital sum; and the other party (the floating rate payer) agrees to pay the former over the same period interest on the same notional sum at a market rate determined in accordance with a certain formula. ... One form of interest rate swap involves what is called an upfront payment, i.e. a capital sum paid by one party to the other, which will be balanced by an adjustment of the parties' respective liabilities. Thus, as in the present case, the fixed rate payer may make an upfront payment to the floating rate

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swap agreements because under Norwegian law, they had no legal power or competency to enter into such agreements.[61] The question was how and to what degree the English court should give force to the Norwegian law which provided for the legal capacity of the municipalities.

The starting point is that under the English private international law, the question whether the municipalities had the capacity to enter into the contracts with Depfa is governed by the law by which the municipalities are constituted, here Norwegian law.[62] The Court of Appeal found that although the concept of capacity in Norwegian law was very different from that in English law, for the purposes of English conflict of law rules, the concept of 'capacity' should be given a broad autonomous and internationalist meaning. Hence, the constitutional documents which an English court would look at when determining the issue of capacity of an English company would not necessarily be used when assessing the capacity of a foreign corporation or legal person. A lack of substantive power under Norwegian law principles was therefore equivalent to a lack of capacity in English legal terminology and, therefore, it followed that the swap agreements were, as a matter of English law, invalid and void. To what extent this would translate to a public undertaking in an Islamic jurisdiction is particularly interesting. If *Haugesund Kommune* applies, the secular court (say, the English court) would seek out expert evidence of Sharia requirements and then decide whether the failure of the Islamic institution or legal entity to comply with Sharia requirements is tantamount to a lack of capacity, as understood in an autonomous, internationalist way. That is a difficult question because whilst a breach of Sharia law might render the actions of the public institution *ultra vires* from a public law perspective, at private law, the action might well enforceable in the light of good faith or morality.

It was also held by the Court of Appeal that the local municipalities had failed to establish a public policy defence that a restitutionary claim would contravene the object of the Norwegian statute which governed the powers of the local authorities. The reason for this was primarily that although Norwegian public law did not confer on its local authorities the power to enter into swap agreements, its private law allows persons who erroneously but in good faith enter into contracts with the local authorities to enforce those agreements.[63]

The issue was also recently made the subject of application for a preliminary ruling from the European Court of Justice. In Case C-144/10 *Berliner Verkehrsbetriebe (BVG), Anstalt des öffentlichen Rechts v. JPMorgan Chase Bank N.A., Frankfurt Branch*,[64] JPMorgan sought payment under certain credit default swaps in proceedings commenced in England. Berliner responded by suing JPMorgan in Germany claiming that its board decisions to enter into the credit default swap were *ultra vires* as a matter of German law. Berliner also challenged the jurisdiction of the English courts on the basis of the provisions of Article 22(2),[65] Council Regulation No 44/2001.[66] The Berlin court thus referred the following question to the European Court of Justice – whether Article 22(2) extends to proceedings in which a company or legal person objects that decisions of its organs which led to the conclusion of the legal transaction are ineffective as a result of infringements of its articles of association? Whilst the case is not likely to impact on companies established in Islamic jurisdictions because those countries are not Member States for the purposes of Article 22(2), what it shows is how incapacity problems in the country where the company is established or incorporated could well have serious implications not only for the enforceability of the contract but also for jurisdiction contests. Most Member States in the EU will have a counterpart to Article 22(2) in its domestic private international law as applicable to non-EU domiciliaries. In England and Wales, when Regulation 44/2001 is inapplicable, the doctrine of *forum conveniens* would apply. In that context, England is likely not the *forum conveniens* where the proceedings are instituted challenging the validity of a decision of an organ of a foreign contracting party (as in *Haugesund*

payer, and in consequence the rate of interest payment by the fixed rate payer is reduced to a rate lower than the rate which would otherwise have been payable by him. The practical effect is to achieve a form of borrowing by, in this example, the floating rate payer through the medium of the interest rate swap transaction.'

61. It should be noted that the Irish bank had sought legal advice from reputable Norwegian lawyers prior to the making those swap agreements. The advice was that the municipalities had the requisite power to make those agreements. A counterclaim made by the bank was therefore against those lawyers for negligent advice.
62. See Dicey, *Morris & Collins, The Conflict of Laws*, (London: Sweet & Maxwell, 14th edn., 2008), Rule 162; domestic English law is relied on because under Regulation 593/2008 (Rome I), Art. 1(2)(f) specifies that the EU regime for ascertaining choice of law will not apply to 'questions governed by the law of companies and other bodies, corporate or unincorporated, and the personal liability of officers and members as such for the obligations of the company or body'.
63. Para. 121 of the judgment.
64. Reference for a preliminary ruling from the Kammergericht Berlin (Germany) lodged on 18 March 2010; OJ C 148 from 05.06.2010, p. 17.
65. Art. 22(2) states: 'The following courts shall have exclusive jurisdiction regardless of domicile: in proceedings which have as their object the validity of the constitution, the nullity or the dissolution of companies or other legal persons or associations of natural or legal persons, or of the validity of the decisions of their organs, the courts of the Member State in which the company, legal person or association has its seat. In order to determine that seat, the court shall apply its rules of private international law.'
66. Regulation of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

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and *Berliner Verkehrsbetriebe*) or the capacity of the foreign contracting party itself.

The issue of capacity under the articles the company has been established is a serious one in the eyes of Sharia as it relates specifically to authority to act whether domestically or abroad – the lack of legal authority to act will render any ensuing contract incapable of performance.[67] Although the issue of legal capacity or authority is not peculiar for those familiar with doing business with emerging markets, the lack of capacity as a result of non-compliance with Sharia is quite unique. Most cases involving a lack of capacity are brought about by a failure to secure a trading licence or governmental authorisation to enter into the contracts in question. Whilst it is fairly straightforward to determine whether a party has a licence or authorisation, it is much more problematic to ascertain if an entity has failed to satisfy the more nebulous Sharia principles (whether or not these principles form part of the Islamic entity's constitutional documents). This is a gap which the private law of Western countries seeking to encourage or exploit the Islamic market must grapple with.

The decision in *Blom* is sure to instigate lawyers and trading parties to examine carefully the question of capacity and authority under the law of the place of incorporation or establishment when dealing Islamic clients. Major law firms have therefore suggested that advisory or transactional lawyers should:

(a) request from their Islamic clients a copy of the *fatwa* (or other relevant certificate or approval given by an appropriate body such as a Sharia advisory board) confirming their detailed consideration of the structure and documents and that the transactions are Sharia compliant;
(b) ensure that the documents include detailed representations regarding (i) Sharia compliance and (ii) non-conflict with constitutional and other authorisation documents; and
(c) obtain an express waiver of any Sharia-related defences.[68]

It would also be helpful to check the entity's constitutional documents to ensure that the proposed transaction is within the company's powers or authority. Of course, it would be especially needful to consider carefully incorporating relevant applicable law and jurisdiction clauses to provide the best protection against any potential default or problems with enforcement. It is not enough to be satisfied that the Sharia board has approved the transaction; what is additionally needed is satisfaction that the party in question would be prevented as far as possible from raising the defence of incapacity.

Sharia as a mandatory requirement and a matter of public policy

The issue of capacity may also be framed by the treatment of Sharia as a mandatory requirement or public policy of a foreign country. That could impact on the recognition of the applicable law to the contract and also on the recognition and enforcement of a judgment rendered on the transaction in question.

(a) Mandatory requirement and applicable law

The affirmation of party autonomy in EC Regulation 593/2008 on the law applicable to contractual obligations (Rome I)[69] is not absolute. Article 3(3) provides that where all other elements relevant to the situation at the time of the choice are located in a country other than the country whose law has been chosen, the choice of the parties shall not prejudice the application of provisions of the law of that other country which cannot be derogated from by agreement. It seems common ground that Article 3(3) is quite narrow in scope – all the other elements relevant to the situation when the choice was made have to be located in another country. The article is generally structured to prevent parties to a purely domestic contract avoiding the mandatory[70] rules of that country by adopting a foreign law clause.[71] Be that as it may, where the other elements point to a country which has as its mandatory rules, Sharia, it would follow that subject to the principle of legal certainty, the Member State court must apply the applicable law subject to those Sharia rules. That said, some Sharia principles are not immediately and easily ascertainable;[72] there are also problems with the hierarchy of norms and rules – especially as regards whether there are some norms which trump others.

Another relevant provision is Article 9(3) which provides that 'effect may be given to the overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be or have been performed, in so far as those overriding mandatory provisions render the performance of the contract unlawful'. 'Overriding mandatory provisions' is then defined in Article 9(1) as 'those provisions the respect for which is regarded as crucial by a country

67. Reza Djojosugito, *Mitigating legal risk in Islamic banking operations*, Humanomics, (2008) Vol. 24 Iss: 2, 110.
68. See Clifford Chance Client Briefing of 8 March 2010 (<www.cliffordchance.com/publicationviews/publications/2010/03/islamic_finance_whenwillanenglishcour.html>).
69. OJ L 177/6 (4 July 2008).
70. Though, the word 'mandatory' is used, it is noted that the Rome I Regulation makes a distinction between 'overriding mandatory provisions' and 'rules which cannot be derogated by contract'. Art. 3(3) refers to the latter whilst Art. 9, to the former. Further, recital 37 of the Preamble states that 'the concept of "overriding mandatory provisions" … should be construed more restrictively'.
71. C.G. Morse, 'The EEC Convention on the Law Applicable to Contractual Obligations', YBEL 2 (1982), 107 at 124.
72. See Jafarzadeh, 'Buyer's Right to Specific Performance: A Comparative Study under English law, the CISG, Iranian and Shi'ah Law' in *Pace International Law Review* (ed.), *Review of the CISG 2002-2003* (The Hague: Kluwer, 2004), 133-144.

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for safeguarding its public interests, such as it political, social or economic organisation, to such extent that they are applicable to any situation falling within their scope', irrespective of the applicable law of the contract. As regards Sharia, it is not inconceivable that for the Islamic country in question, its preservation and adherence have to be crucial for the safeguarding the country's social organisation. Under Article 9, the forum does not *have* to give effect to the mandatory provisions. It has discretion,[73] but the principles guiding the exercise of that discretion are limited. Article 9(3) simply suggests that when considering whether to give effect to those mandatory provisions, 'regard shall be had to their nature and purpose and to the consequences of their application or non-application'. It is quite understandable that the Regulation should not over-restrict the exercise of judicial discretion by the forum.[74] However, this matter is of some delicacy because accusations of legal chauvinism may be made about the presiding forum. In the light of the strained relations as that seen in Oklahoma, that is not a fanciful prospect.

The introduction of discretion was so that the forum judiciously will not create undue uncertainty to the transaction when deciding whether or not to apply the mandatory rule in question.[75] That element of judicial control is thus important but given the EU-wide dimension of the Regulation, a requirement to apply the Regulation in a uniform manner would be particularly useful. In the Regulation, an exhortation usually found in international conventions calling for national courts to apply the law in an internationalist manner seems absent.[76] In the CISG, for example, Article 7(1) states quite explicitly that 'in the interpretation of [the] Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade'. There is a real likelihood as far as Sharia is concerned that one Member State might hold a Sharia principle to be a mandatory requirement whilst another might not. Very little damages the growth of transnational finance and commerce more than legal and commercial uncertainty.

(b) Enforcement of judgments and Sharia as public policy

This is not the place to concentrate too much on the enforcement in an Islamic jurisdiction of a judgment rendered by an EU Member State. However some valuable lessons might be learnt – after all, there is no point for lawyers and judges in a Member State to allow a long and convoluted trial to proceed when there is little likelihood of recognition and enforcement of the ensuing judgment at a place where the assets are located.

In general, the law on enforcement and recognition in a number of Islamic countries,[77] like in many countries globally, is constrained by two important pillars – the presence of reciprocity and the incorporation of a public policy exception. These principles are especially pronounced in the Arab League Conventions of 1952[78] and 1983.[79] Although the Conventions are relevant only to the members of the Arab League, their provisions are especially useful in aiding our understanding of the role of Sharia in the enforcement of foreign judgments.

Foreign judgments and awards would not be enforced unless there is some sort of reciprocity, generally. The 1952 Convention is based on the Geneva Convention on the Execution of Foreign Arbitral Awards 1927 which requires reciprocity from its contracting countries.

On the link between public policy and Sharia, the connection was implied in the Arab League Convention 1952 – Article 2 provides that enforcement[80] may be withheld where the foreign judgment does not accord with the public order or morals in the State or when it violates the international public order. In the newer 1983 Convention, the connection is more explicit. Article 30 states that a judgment which violates the Sharia, the Constitution, the public order or morals of the country where recognition is sought would not be enforced. What is especially interesting is the clear demarcation drawn between Sharia and the

73. Uncertainty was a major concern of the UK when it decided to opt out of Art. 7(1) of the Rome Convention (the predecessor to the Rome I Regulation). Art. 7(1) read: 'When applying under this Convention the law of a country, effect may be given to the mandatory rules of the law of another country with which the situation has a close connection, if and in so far as, under the law of the latter country, those rules *must* be applied whatever the law applicable to the contract. In considering whether to give effect to these mandatory rules, regard shall be had to their nature and purpose and to the consequences of their application or non-application.' (emphasis added). Art. 9(3) is more acceptable to the UK because it does not make it mandatory but discretionary to give effect to such overriding provisions.
74. *Ibid*.
75. McClean, '*Perspectives on Private International Law at the Turn of the Century*', (The Hague: Martinus Nijhoff Publishers, 2000), 214-215.
76. The closest equivalent in the Regulation is recital 16 of the Preamble – 'to contribute to the general objective of this Regulation, legal certainty in the European judicial area, the conflict-of-law rules should be highly foreseeable. The courts should, however, retain a degree of discretion to determine the law that is most closely connected to the situation.'
77. The term is used fairly loosely here to include countries which have a significant Islamic tradition.
78. Officially called the Convention on the Enforcement of Foreign Judgments and Awards 1952.
79. Officially called the Convention on Judicial Cooperation between States of the Arab League 1983. Signed by many of the Arab League nations but not ratified by all. Where not ratified, the Arab League Convention 1952 would apply.
80. Interestingly, the Arab League Convention 1952 does not provide for recognition of foreign judgments and awards, only enforcement of such judgments and awards.

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constitution of the state; it seems therefore to place emphasis not only on those Sharia principles which are part of the state's domestic legislative provisions but also the wider less formal provisions of Sharia.

Regard for the place of performance

When applying a foreign law, the court is also required, under Article 12(2) Rome I Regulation, 'in relation to the *manner of performance* and the *steps to be taken in the event of defective performance*' to have regard 'to the law of the country in which performance takes place'. This provision is especially relevant when the applicable law is not the law of the country where performance takes place. This article is thus capable of causing some difficulties where the place of performance (say, in an Islamic jurisdiction[81]) prohibits the charging of interest (say, for late performance) but the applicable law is the law of an EU Member State which allows it.

It should be said that this provision would only apply where the issue relates to the 'method and manner of performance'; in matters relating to 'performance', Article 12(1)(b) makes it quite plain that that is for the applicable law to deal with. The question thus is whether the payment of interest for late performance, etc., is a matter relating to the method and manner of performance, or merely a matter of performance. An old British Commonwealth case might be instructive. In *Mount Albert Borough Council v. Australasian Temperance and General Assurance Society*,[82] a New Zealand local authority had issued debentures to an insurance company in Victoria, Australia. The interest rate on the debentures was 5 2/3 per cent and payable in Victoria. In 1931 during the Great Depression, the Victorian legislature passed a statute reducing all mortgage rates to 5 per cent. It was held that the statute did not apply to the debentures because although Victoria was the place of performance, New Zealand law was the proper law of the debentures. The Privy Council (on appeal from the New Zealand Supreme Court) took the view that the question of amount of interest was material to the contract. It was not ancillary to the substance of the transaction. If that analysis is adopted, it would seem to follow the question of interest (say, for late performance) in a sale transaction is not about the method or manner of performance but the performance itself. Article 12(1)(b) would therefore apply leaving it a matter for the applicable law rather than the law of the place of performance. This analysis is largely supported by the Giuliano Lagarde Report[83] (which guided the interpretation of the Rome Convention, the predecessor to the Rome I Regulation). The Giuliano Lagarde Report gives the following as examples of what might constitute 'method and manner of performance' – rules governing public holiday, how the goods are to be examined and the steps to be taken to reject the delivery of goods. The Report also stressed that the following would be presumed to be matters relating to performance (as against method and manner of performance):

'the diligence with which the obligation must be performed; conditions relating to the place and time of performance; the extent to which the obligation can be performed by a person other than the party liable; the conditions as to performance of the obligation both in general and in relation to categories of obligation (joint and several obligations, alternative obligations, divisible and indivisible obligations, pecuniary obligations); where performance consists of the payment of a sum of money, the conditions relating to the discharge of the debtor who has made the payment, the appropriate of the payment, the receipt, etc.'[84]

All this serves to remind us that Article 12(2) is to be interpreted narrowly. The norm is for the applicable law to govern the performance of the contract. However there will be situations where the question is about the method and manner of performance thereby invoking the involvement of Sharia *as applicable in a foreign country.*[85] For example questions may arise about the extent to which pre-payments or rebates are permitted,[86] or what constitutes possession.[87]

Impact of Sharia on the workings of the CISG as an applicable law

The focus here is on the workings of the CISG as the contract's applicable law where there exists an Islamic legal dimension. The CISG was developed with a view to creating a legal framework of general application to

81. In the United Arab Emirates, for example, Part 2 of the Commercial Code – Commercial Obligations and Contracts states in Art. 76 that 'a creditor shall have the right to demand interest on a commercial loan in accordance with the rates stipulated in the contract … not [to] exceed 12 per cent'. (Dawoud Sudqi El Alami (transl.), *The Law of Commercial Procedure of the United Arab Emirates: Issuing Law No 18 of 1993*, (1993), 46). That said, the Dubai Court of Cassation, in Judgment No 261/96, held that a creditor was entitled to collect 15 per cent interest on a debt the payment of which had been considerably delayed. (Price & Al Tamimi, *United Arab Emirates Court of Cassation Judgments: 1989-1997* (1998), 51-52). Indeed, many Islamic countries (e.g. Pakistan, UAE, Morocco, Qatar, Kuwait, Egypt) have made a clear distinction between civil and commercial matters, and have permitted to some extent foreign commercial and financial transactions to be exempt from the proscription against *riba* and *gharar* (see Shaaban, 'Commercial Transactions in the Middle East', *Law & Policy in International Business* 31 (1999), 157).
82. [1938] AC 224.
83. See Official Journal of the European Communities of 31 October 1980 (OJ C282/1980).
84. At pp. 32-33 of the Report, *supra* n. 16.
85. It should be underscored that there is uncertainty as to the availability of Sharia as the applicable law of the contract under the Rome I Regulation (see above).
86. See Usmani, *An Introduction to Islamic Finance* (1999), 141-143 and al-Zuhayli, *Financial Transactions in Islamic Jurisprudence: A Translation of Vol 5 of Al-Fiqh al-Islami wa Adillatuhu* (2003), 328.
87. Usmani, *ibid*., p. 106.

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the international community of nations.[88] It is not the intention here to deal with the wider political question of whether the drafters of the CISG took into account the economic situation in developing countries[89] or Islamic countries.[90]

The role of an applicable law is seriously diminished if it cannot be applied and enforced by a chosen forum. In most parts, the CISG as an applicable law does not conflict with Sharia principles,[91] however there is major sticking point – Article 78. Article 78 provides that 'if a party fails to pay the price or any other sum that is in arrears, the other party is entitled to interest on it, without prejudice to any claim for damages recoverable under article 74'.[92] The CISG does not offer any guidance on how interest is to be calculated preferring to leave it to national law. However, where the national law in question is one which has adopted Sharia as its source or basis, it is not inconceivable for a judgment debtor to claim that the award of interest on the damages ordered would be invalid.

It is immediately obvious that this then is largely a matter of interpretation for the court or tribunal in question.[93] It has been suggested elsewhere[94] that different Islamic countries have dealt with the prohibition of interest in the award of damages in a somewhat pragmatic way. In Egypt, for example, Article 226 of the Civil Code expressly states that 'when the object of an obligation is the payment of a sum of money of which the amount is known at the time when the claim is made, the debtor shall be bound, in case of delay in payment, to pay the claimant, as damages for the delay, interest …'.[95] Similar provisions are found elsewhere despite the fact that in many Islamic countries, the state constitution will usually contain a provision prescribing Sharia as the principal source of law[96] or that no law shall contravene the beliefs and provisions of the sacred religion of Islam[97] or that the courts are obliged to refrain from executing statutes and regulations of the government that are in conflict with the laws or the norms of Islam.[98] The judicial construct of 'interest' in the context of compensation is especially interesting. In a case cited by Akaddaf,[99] the Egyptian Supreme Constitutional Court held controversially that Article 226 prevailed because it was enacted before the constitution. As can be seen this is a purely technical construct – it was not discussed whether substantially Article 226 might be reconciled to the proscription against riba/interest. Other devices to avoid the proscription in the context of compensation include treating the prohibition as applicable only to natural persons and not legal entities,[100] or not applicable to foreigners or foreign corporations[101] or calling it 'compensatory indemnity' instead of interest.[102]

The CISG as an international convention permits countries to opt out of certain provisions. It is clear that Islamic countries that have signed up to the CISG did not opt out of Article 78. Whilst some commentators suggest that this is reflective of these countries' desire not to be isolationists,[103] it might also be hypothesised that with the Islamic financial sector growing and the rise of resurgent sense of Islamic identity it is not inconceivable that these countries will seek to opt out or disapply Article 78 as being contrary to their constitutional legal commitment to Sharia.

Conclusion

This article has touched on a number of conflict-of-law problems which might occur in EU Member States where Sharia or Islamic law is an element in the parties' contractual relationship. From international conventions such as the CISG to transnational tools like the INCOTERMS 2010, or from domestic private international law to the Rome I regime, there is evidently a great desire to ensure that international commerce can

88. The Preamble reads: 'CONSIDERING that the development of international trade on the basis of equality and mutual benefit is an important element in promoting friendly relations among States,
BEING OF THE OPINION that the adoption of uniform rules which govern contracts for the international sale of goods and take into account the different social, economic and legal systems would contribute to the removal of legal barriers in international trade and promote the development of international trade …'.
89. Jeswald W. Salacuse, 'From Developing Countries To Emerging Markets: A Changing Role for Law in the Third World', *Int'l Law* 33 (1999), 875.
90. Akaddaf, 'Application of the United Nations Convention on Contracts for the International Sale of Goods (CISG) to Arab Islamic Countries: Is the CISG Compatible with Islamic Law Principles?', *Pace International Law Review* 13 (2001), 1.
91. *Ibid*.
92. Art. 74 in turn provides 'Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of contract.'
93. Art. 7(2) of the CISG requires that, '[q]uestions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.'
94. *Supra* n. 90.
95. See John Y. Gotanda, 'Awarding Interest in International Arbitration', *Am. J. Int'l L.* 90 (1996), 40.
96. Arts. 46 and 48, Constitution of Saudi Arabia; similarly Art. 7 of the Constitution of the United Arab Emirates.
97. Art. 3, Constitution of Afghanistan.
98. Art. 170, Constitution of Iran.
99. *Supra* n. 90.
100. *Supra* n. 90.
101. Shaaban, *supra* n. 81, at p. 170.
102. Klaus Peter Berger, *International Arbitral Practice and the UNIDROIT Principles of International Commercial Contracts*, 46 Am. J. Comp. L. 129 (1998).
103. *Supra* n. 90.

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take place in a harmonised legal province. However, with Islamic commerce bursting onto the international scene in recent times and against the backdrop of intensified perceptions of admissibility of Islamic law into Western societies, a legal recognition of Islamic principles in international commerce is not easy to achieve. What might help in a modest measure is a better understanding of the current legal framework.

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