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LLOYD'S LAW REPORTS

Editor: Miss M. M. D'SOUZA, LL.B., Barrister

COURT OF APPEAL

Jan. 28, 2004

SHAMIL BANK OF BAHRAIN
v.
BEXIMCO PHARMACEUTICALS LTD.

[2004] EWCA Civ 19

Before Lord Justice POTTER,
Lord Justice LAWS and
Lady Justice ARDEN

Conflict of laws — Choice of law — Loan — Defendants borrowers and guarantors of loans made by claimant bank — Loans governed by English law but subject to principles of Shari'a law — Whether agreement could have two governing laws — Whether reference to Shari'a law should be given effect — Contracts (Applicable Law) Act, 1990.

The claimant Bank was incorporated under the laws of Bahrain. Ninety five per cent. of the population of Bahrain were muslims and the Bank held itself out as applying Islamic principles in the course of its business. Its Articles of Association provided for the appointment of a Religious Supervisory Board which was to ascertain that the Bank's activities conformed with the principles and provisions of Islamic Sharia'a. The Bank's own Religious Supervisory Board certified in respect of the years 1995 and 1996 that its business was "in full compliance with Glorious Islamic Sharia'a".

Sharia'a law did not permit the charging of interest, although it did recognize "Morabaha Financing Agreements". A Morabaha agreement was one under which a financier agreed to purchase goods required by the borrower and to sell them to the borrower for a deferred price, the difference between the sale and repurchase price being a profit to the financier known to and agreed on by the parties. In order to avoid the appearance or characteristics of a loan at interest and to provide for and preserve the features of a contract of sale, the financier purchased the goods in its own name and were at its risk until resold to the client. However, the financier could appoint the client as agent for the purchase on behalf of the financier and, once the client effected the purchase he could retain possession of the commodity on its own behalf.

The first two defendants were Bangladeshi companies in the Beximco Group, involved in the manufacture, export and import of pharmaceuticals. The third and fourth defendants were directors of the first and second defendants and of the fifth defendant, their parent company. In December, 1995 first two defendants entered into a Morabaha Financing Agreement with the Bank. Under the Agreement the Bank agreed to purchase, through the second defendant acting as its agent, certain goods from specified sellers for immediate onward sale to the first defendant. In return, the first defendant agreed to pay to the Bank the Morabaha price, defined in the agreement as the aggregate of the purchase price of goods purchased plus a Profit Element, calculated by reference to a Market Rate Agreement also entered into between the parties. Under the Market Rate Agreement, if any payment due remained unpaid for any period after its due date, compensation would be payable to the Bank. Under these Agreements, the Bank adavanced U.S.$15 m. to the second defendant.

In July 1996 the Bank advanced the second defendant a further sum of U.S.$15 m. under a second Morabaha Agreement and a Second Market Rate Agreement. By 1999 the first and second defendants had not paid the amounts due under the 1995 and 1996 Morabaha Agreements. On Sept. 14, 1999 the Bank and the first and second defendants entered into two Exchange in Satisfaction and User Agreements (ESUA), one relating to the 1995 Morabaha Agreement and the other relating to the 1996 Morabaha Agreement. Under the ESUAs the Bank agreed to discharge the amount then outstanding under the 1995 and 1996 Morabaha Agreements in exchange for being granted the right to receive unencumbered title to certain assets, subject to the grant of a right whereby the first and second defendants could use those assets in the ordinary course of their respective businesses in consideration for payment by instalments of a user fee. Accrued compensation was also payable. It was a condition precedent that the third, fourth and fifth defendants guaranteed the first and second defendants' obligations under the ESUAs. Personal and corporate guarantees were entered into on Feb. 6, 2001.

The ESUAs contained the following choice of law clause:

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

The guarantees stated that they were "governed by and shall be construed in accordance with English law". There was no reference to the principles of Sharia.

Various defaults and "Termination Events" provided for under the ESUAs occurred, and the Bank sent two default letters dated Aug. 18, 2002 to the defendants under the terms of the first and second ESUAs. In the present case the Bank claimed as against the first and second defendants: (1) U.S.$25,207,000, the amount due under the first ESUA relating to the 1995 Morabaha Agreement; (2) U.S.$21,472,800, the amount due under the second ESUA relating to the 1996 Morabaha Agreement; (3) U.S.$1,147,540.76, the accrued compensation due under the first ESUA; and (4) U.S.$1,884,169.75, the accrued compensation due under the second ESUA.

The defendants denied liability. The principal argument was that: (a) on a true construction of the governing law clause, the Morabaha Agreements and the ESUAs were only enforceable insofar as they were valid and enforceable both (i) in accordance with the principles of the law of Islam and (ii) in accordance with English law; and (b) the agreements were unlawful, invalid and unenforceable under the principles of the Sharia in that, despite their form as Morabaha Agreements, in the case of the 1995 and 1996 Morabaha Agreements, and as Ijarah leases, in the case of the first and second ESUAs, the transactions were in truth disguised loans at interest. The defendants also argued that the guarantees were void on the ground that they had been entered into by the parties on the basis of a common mistake of a fundamental nature, namely that the first and second defendants were under enforceable obligations to the Bank under the Morabaha Agreements at the time when, and in respect of which, the ESUAs and guarantees were entered into.

Mr. Justice Morison held that the agreements were governed by English law and that he was not concerned with the principles of Sharia at all: (a) there could not be two separate systems of law governing the contract, so that either English law or Sharia law applied; (b) the clause did not amount to a choice of Sharia law, as Article 3.1 of the Rome Convention (given effect in the United Kingdom by the Contracts (Applicable Law) Act, 1990), required a chosen law to be the law of a country rather than a non-national system of law; (c) the principles of the Sharia were not simply principles of law but principles which applied to other aspects of life and behaviour; and (d) even if the principles of Sharia were principles of law, there was controversy as to the strictness with which principles of Sharia law was to be interpreted or applied and 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. Mr. Justice Morison concluded that the words "subject to the principles of Glorious Sharia'a" were no more than a reference to the fact that the Bank purported to conduct all its affairs according to the principles of Sharia.

The defendants appealed.

———*Held*, by C.A. (POTTER, LAWS and ARDEN, L.JJ.) that the appeal would be dismissed.

(1) English law was the governing law of the financing contracts.

(a) It was common ground that, when the parties entered into the Morabaha Agreements, neither side was under any illusion as to the commercial realities of the transactions, namely the provision by the Bank of working capital on terms providing for long term repayment, and both were content to dress the loan transactions up as Morabaha sales (or Ijarah leases), whilst taking no interest in whether the proper formalities of such a sale or lease were actually complied with. Nor was it ever intended in relation to any of the agreements made that they should be other than binding on the parties. In those circumstances the Court, in approaching its task, should lean against a construction which would or might defeat the commercial purpose of the agreements. Accordingly, insofar as each of the clauses provided in clear terms that "this agreement shall be governed by and construed in accordance with the laws of England", the proviso that such provision shall be "subject to the principles of the Glorious Sharia'a" was to be approached on a basis which was reconcilable with the purpose evident from the words which follow, rather than operating to defeat such purpose (*see* par. 47).

(b) The Rome Convention as a whole contemplated and sanctioned only the choice of the law of a country. It was not applicable to a choice between the law of a country and a non-national system of law, such as the lex mercatoria or "general principles of law" (*see* par. 48).

(c) While it was possible to incorporate into a contract governed by English law identified specific provisions of a foreign law or an international code or a set of rules, English law was applied as the governing law to a contract into which the foreign rules had been incorporated. The general reference to principles of Sharia in this case afforded no reference to, or identification of, those aspects of Sharia law which were intended to be incorporated into the contract, let alone the terms in which they were framed. It was plainly insufficient to contend that the basic rules of the Sharia were not controversial. Such "basic rules" were neither referred to nor identified. Thus the reference to the "principles of . . . Sharia" stood unqualified as a reference to the body of Sharia law generally. As such, they were inevitably repugnant to the choice of English law as the law of the contract and rendered the clause self-contradictory and therefore meaningless (*see* pars. 51 and 52).

(d) The reference to Sharia was not mere surplusage. The words were intended simply to reflect the Islamic religious principles according to which the Bank held itself out as doing business rather than a system of law intended to "trump" the application of English law as the law to be applied in ascertaining the liability of the parties under the terms of the agreement (*see* par. 54).

(2) As the financing agreements were valid, the guarantors were liable on the same basis and the mistake argument did not arise. A common mistake as to the legal consequences of the Morabaha agreements in this case would not in any event have qualified as a mistake apt to give rise to a defence. Even if it was assumed a mistake of law could give rise to mistake it was necessary for the guarantors to show that the mistake was such as to render the subject matter of the contract essentially and radically different from the subject matter which the parties believed to exist or that it rendered the thing contracted for essentially different from the thing that it was believed to be. Whether the mistake asserted should rightly be regarded as a mistake of fact or of law, it was plain that it was not a mistake based on a common assumption fundamental to the agreements in question. The defendants' sole interest was to obtain advances of funds to be used as working capital, and they were indifferent to the form of the agreements required by the Bank or the impact of Sharia law upon their validity (*see* par. 60).

————*Kleinwort Benson Ltd. v. Lincoln City Council*, [1999] 1 A.C. 153, *Brennan v. Bolt Burden and Others*, [2003] EWHC 2493 (Q.B.), considered; *Associated Japanese Bank (International) Ltd. v. Crédit du Nord S.A.*, [1989] 1 W.L.R. 255, *Bell v. Lever Bros. Ltd.*, [1932] A.C. 161, *Great Peace Shipping Ltd. v. Tsavliris Salvage (International) Ltd.*, [2003] Q.B. 679, applied.

The following cases were referred to in the judgments:

Al-Bassam v. Al-Bassam, [2002] EWHC 2281 (Ch.);

Associated Japanese Bank (International) Ltd. v. Crédit du Nord S.A., [1989] 1 W.L.R. 255;

Bell v. Lever Bros. Ltd., (H.L.) [1932] A.C. 161;

Brennan v. Bolt Burden and Others, (Q.B.) [2003] EWHC 2493;

Furness Withy (Australia) Pty Ltd. v. Metal Distributers (U.K.) Ltd. (The *Amazonia*), (C.A.) [1990] 1 Lloyd's Rep. 236;

Glencore International A.G. v. Metro Trading International Inc. (No. 2), [2001] 1 Lloyd's Rep. 284;

Great Peace Shipping Ltd. v. Tsavliris Salvage (International) Ltd., (C.A.) [2002] EWCA Civ 1407, [2003] Q.B. 679;

Islamic Investment Company of the Gulf (Bahamas) Ltd. v. Symphony Gems NV, Feb. 13, 2002, unreported;

Kleinwort Benson Ltd. v. Lincoln City Council, (C.A.) [1999] 1 A.C. 153;

Nea Agrex S.A. v. Baltic Shipping Co. Ltd., (C.A.) [1976] 1 Q.B. 933;

Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen, (H.L.) [1976] 1 W.L.R. 989;

Swain v. Hillman, (C.A.) [2001] 1 All E.R. 91.

This was an appeal from the judgment of Mr. Justice Morison dated Aug. 1, 2003, giving summary judgment in the sum of U.S.$49 m. in favour of Shamil Bank of Bahrain EC against the first and second defendants as principal debtors in respect of monies advanced to them by the Bank under various financing agreements and against the third, fourth and fifth defendants as guarantors of certain of those agreements.

The further facts are stated in the judgment of Lord Justice Clarke.

Brian Doctor, Q.C. and Sara Partington, instructed by Norton Rose, for the claimant; Richard Hacker, Q.C. and Mark Arnold, instructed by Jaswal Johnston, for the defendants.

Wednesday, Jan. 28, 2004

JUDGMENT

Lord Justice POTTER:

Introduction

1. This is an appeal from the judgment of Mr. Justice Morison dated Aug. 1, 2003 whereby he gave summary judgment in favour of the claimant Shamil Bank of Bahrain EC ("the Bank") against the first and second defendants as principal debtors in respect of monies advanced to them by the Bank under various financing agreements and against the third, fourth and fifth defendants as guarantors of certain of those agreements. The total judgment sum awarded was some U.S.$49.7 m. The appellants were refused permission to appeal by Mr. Justice Morison, but permission was granted by Lord Justice Clarke, on Sept. 17, 2003 in relation to a single issue relating to the construction and effect of the form of the governing law clause contained in the financing agreements. That clause reads as follows:

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

2. It is not in dispute that "the principles of the Glorious Sharia'a" referred to are the principles described by the defendants' expert, Mr. Justice (retd) Khalil-Ur-Rehmam Khan as:

> the law laid down by the Qur'an, which is the holy book of Islam, and the Sunnah (the sayings, teachings and actions of Prophet Mohammad (pbuh)). These are the principal sources of the Sharia. The Sunnah is the most important source of the Islamic faith after the Qur'an and refers