CA on appeal from QBD (Morison J) before Potter LJ; Laws LJ; Arden LJ. 28th January 2004.

JUDGMENT : Lord Justice Potter:

Introduction

1. This is an appeal from the judgment of Mr Justice Morison dated 1 August 2003 whereby he gave summary judgment in favour of the claimant Shamil Bank of Bahrain E.C. ("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 US $49.7million. The appellants were refused permission to appeal by Morison J, but permission was granted by Clarke LJ on 17 September 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 essentially to the Prophet's example as indicated by the practice of the faith. The only way to know the Sunnah is through the collection of Ahadith, which consists of reports about the sayings, deeds and reactions of the Prophet … "*

3. One principle expressly stated in the Qur'an and Sunnah is that the charging of interest upon a loan, in whatever form, is "Riba" and is contrary to the Sharia. At Sura II, 275-79 of the Qur'an it is stated that: *" … Allah has made buying and selling lawful and has made the taking of interest unlawful. Remember, therefore, that he who desists because of the admonition that has come to him from his Lord, may retain what he has received in the past; and his affair is committed to Allah. But those who revert to the practice, they are the inmates of the fire; therein shall they abide. … O Ye who believe, be mindful of your duty to Allah and relinquish your claim to what remains of interest, if you are truly believers. But if you do not, then beware of war from the side of Allah and his Messenger. If, however, you desist, you will still have your capital sums; thus you will commit no wrong, nor suffer any wrong yourself."*

   Sura III 130 states that: *"O Ye who believe, devour not interest, for it goes on multiplying itself; and be mindful of your obligation to Allah that you may prosper.":* The Quran, translated by Muhammad Zafrulla Khan, Curzon Press, 1971.

The Factual Background

4. The bank is incorporated under the laws of Bahrain and licensed to act as a bank by the Ministry of Commerce and Bahrain Monetary Agency. The Kingdom of Bahrain is a constitutional monarchy and 95% of its population are muslims. Nonetheless, while embracing and encouraging Islamic banking practice as a national policy, the principles of Islamic law, in particular the prohibition of Riba, have not been incorporated into the commercial law of Bahrain and there is an absence of any legal prescription as to what does and does not constitute "Islamic" banking or finance. In his survey of the commercial laws of the Arab Middle East, Professor Ballantyne states that: *"In our other jurisdictions, banking interest is, in practice, tolerated (Saudi Arabia) and even sanctioned by banking laws (Bahrain, Qatar and Oman), while any theoretical or hypothetical conflicts have been largely ignored." W M Ballantyne: Commercial Law in the Arab Middle East: the Gulf States* (1986) p.133

5. The unchallenged position as far as the charging of interest in Bahrain is concerned is that stated in *Unlawful Gain and Legitimate Profit in Islamic Law: Nabil Saleh* (2nd ed) p.9: *"The matter of interest is regulated as far as commercial transactions are concerned by the provisions of Article 81 of the Commercial Code of 1987. The latest amendment of Article 81, affected by Law no.4 of 1992, gives the following instructions to courts: (1) interest on overdue payments of commercial debts becomes due by the mere occurrence of maturity dates unless otherwise provided for by law or agreement. (2) Under no circumstances, and with regard to debts whose settlement does not exceed a period of seven years, may the aggregate amount of interest paid to the creditor exceed the initial indebtedness. (3) The provisions of the preceding (2) do not apply to debts which were contracted in*

foreign currencies. (4) The creditor is entitled to claim complementary damages in addition to interest on overdue payments with no need to prove that the additional damage was caused by the debtor's fraud or his serious fault."

6. Nonetheless, the Bank holds itself out as applying Islamic principles in the course of its business. The Bank's full title is "***Shamil Bank of Bahrain E.C. (Islamic Bankers)***". The main objects clause in its Memorandum of Association is in general terms: *"3.Notwithstanding the provisions of this Article, the company shall undertake at all times to comply with the Bahrain Monetary Agency Law and any circulars, rules or regulations issued by the BMA from time to time … According to the above, the company will carry on all banking, investment, financial activities, offshore units and all services relating thereto of various commercial, industrial, agricultural, real estate, tourism, housing and other services in the State of Bahrain and outside it."*

However, clause 34 of the Articles of Association provide for the Ordinary General Meeting to elect and appoint a Religious Supervisory Board *"which shall comprise at least three persons who are recognised specialists and qualified in Islamic jurisprudence, religious provisions and Islamic economy".*

7. Clauses 35 and 36 of the Articles provide:

> *"35.a. The Religious Supervisory Board shall ascertain that the Company's investments and activities (and the activities of its subsidiary and affiliated companies) conform with the principles and provisions of Islamic Sharia'a. It shall, in particular, discuss with the members of the Board of Directors, managers of the Company or of any subsidiary or affiliated company under its control, such conformity and the business carried out by them and shall request any information it deems necessary. In particular, the Religious Supervisory Board shall adopt all the crucial decisions for applying the provisions of Islamic Sharia'a to ensure the realisation of the objects for which the company was incorporated. Also to ensure that the members of the Board of Directors, managers and employees are co-ordinating their activities according to such decisions which will be binding on all the shareholders. The Religious Supervisory Board shall within 6 months from the end of the Company's financial year, submit a written report stating that it fulfilled the obligations indicated herein and ascertained that the Company's investments and business activities (including its subsidiary companies) conform with the provisions of Islamic Sharia'a. …*
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> *36. The Board of Directors shall take the necessary actions to ensure that all the investments and other business transactions have been referred to the Religious Supervisory Board for approval before carrying out any other business transactions by the Company or by any subsidiary or affiliate company under its control."*

8. As made clear by the Bank's expert witness, provisions of this kind are not unusual. In the absence of legal prescription as to what does and what does not constitute "Islamic" banking or finance, most Islamic banks create Religious or Sharia Supervisory Boards which review annually the operations of the bank and determine whether or not these have been carried out in accordance with Islamic law. They examine on a test basis each type of transaction entered into by the Bank and evidence to show that the transaction and dealings entered into by the Bank are in compliance with Sharia rules and principles, submitting an annual report to the shareholders in that respect. In this case the Bank's own Religious Supervisory Board certified in respect of the years 1995 and 1996 that: *"The Board believes that all the bank's business throughout the said year, including investment activities and banking services, were in full compliance with Glorious Islamic Sharia'a."*

9. A certificate of compliance was also issued for that period by the Bank's auditors, reviewing the Bank's operation on the basis of the Financial Accounting Standards issued by the Accounting and Auditing Organisation for Islamic Financial Institutions.

10. Until their defences were filed in this action, the appellants had never given any indication to the bank that they were dissatisfied on religious grounds with the arrangements agreed between the parties or that they sought to challenge them on the grounds that they did not comply with the principles of Sharia.

11. The first two defendants are Bangladeshi companies (part of the **Beximco** group) involved in the manufacture, export and import of pharmaceuticals. The third and fourth defendants are directors of the first and second defendants and of the fifth defendant which is their parent company. I shall refer to the third, fourth and fifth defendants collectively as "***the guarantors***".

12. In 1995 the **Beximco** group wished to raise additional working capital to be used in its commercial activities. To this end, there were meetings between the Bank and, principally, Mr Chowdhury the **Beximco** Group Director of Finance and a director of the first and second defendants. The monies were advanced pursuant to the terms of two "***Morabaha Financing Agreements***" which, in form, related to the sale of goods.

13. It is not in dispute that a Morabaha agreement is a sale contract recognised as valid by Islamic law whereby the seller (the financier institution) agrees to purchase goods desired by the buyer and to sell them to the buyer (the client) for a deferred price, the difference between the original purchase price to be paid by the financier and the deferred price payable by the client being a stated profit known to and agreed upon by both seller and buyer. 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 purchases the goods in its own name, and the goods must come into its possession (actual or constructive), remaining at its risk until the commodity is sold to the client. However, for that purpose the financier may appoint the client as agent for the purchase on behalf of the financier and, once the client effects such purchase as the agent of the financier, the client may retain possession of the commodity on its own behalf. The detailed form and content of Morabaha agreements varies. There are no standard forms and, in practice, the detailed terms and conditions will be agreed by the bank and its customer around the essential characteristics I have mentioned. It is the function of an Islamic bank's Religious Supervisory Board to ensure that the Morabaha agreement complies with Islamic law as interpreted by the Religious Supervisory Board.

14. Following negotiations in which each side was advised, the Bank and the first and second defendants entered into a Morabaha Financing Agreement dated 28 December 1995 ("the 1995 Morabaha Agreement") under which, pursuant to clauses 2.1, 2.2 and 4.2, 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, pursuant to clause 2.1, 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 the Profit Element, calculated by reference to clause 2 of a Market Rate Agreement also entered into between the parties. Pursuant to clause 4.5 of the Morabaha Agreement, the payments to be made were set out in a letter from the Bank to the defendants dated 28 December 1995 ("the 1995 Payment Schedule Letter"). Pursuant to clause 3 of the 1995 Market Rate Agreement, if any payment due remained unpaid for any period after its due date, compensation would be payable to the Bank.

15. In accordance with clause 4.1 of the 1995 Morabaha Agreement, the Bank advanced to the second defendant US $15 million ostensibly for the purposes of purchasing the specified goods. Between 28 March 1996 and 28 September 1997, the first defendant made seven payments in accordance with the 1995 Payment Schedule Letter.

16. In April 1996, following an approach by the second defendant seeking further funds, the Bank agreed to advance the second defendant a further sum of US $ 15 million. On 11 July 1996 the Bank and the first and second defendants entered into a further Morabaha Agreement ("the 1996 Morabaha Agreement") and Market Rate Agreement in terms similar to those of the 1995 Agreements.

17. In accordance with clause 4.1 of the 1996 Morabaha Agreement, on 15 July 1996, the Bank paid to the first defendant US $ 15 million ostensibly for the purpose of purchasing the specified goods. Between 15 October 1996 and 12 August 1997, the second defendant made four payments in accordance with the 1996 payment schedule letter.

18. By December 1999 the first and second defendants had not paid the amounts due under the 1995 and 1996 Morabaha Agreements, although admitting and agreeing in writing that such sums were owed. Following negotiations, the Bank and the first and second defendants agreed to enter into new agreements to discharge the first and second defendants' obligations in exchange for the first and second defendants undertaking alternative obligations to the Bank which the third, fourth and fifth defendants were to guarantee.

19. On 14 September 1999 the Bank and the first and second defendants entered into two Exchange in Satisfaction and User Agreements, one relating to the 1995 Morabaha Agreement ("the First ESUA") and the other relating to the 1996 Morabaha Agreement ("the Second ESUA") which were each subsequently amended and restated by agreement on 4 February 2001 and 30 January 2002. The re-amended ESUAs became effective on 4 April 2002. Under clause 2.1 of the ESUAs the Bank agreed to discharge on the Effective Date 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. Pursuant to clauses 3.1 and 3.3, the Bank agreed to grant the first and second defendants the right to use those assets in the ordinary course of their respective businesses in consideration for payment by instalments of a user fee determined in accordance with clause 3.4. The first and second defendants were also obliged to make certain payments of accrued compensation. Under clause 4.1 of the ESUAs, it was a condition precedent that the third, fourth and fifth defendants guaranteed the first and second defendants' obligations under the ESUAs.

20. The form of the ESUAs, whereby the Bank, having acquired the ownership of the first and second defendants' assets, permitted their retention and use in return for regular payment of the scheduled user fees was in principle a method of financing recognised as legitimate by the Sharia as "Ijarah", the giving of something in rent. However, when that method of financing is adopted by a bank in place of a simple interest-bearing loan, the question of whether the transaction is legitimate according to the principles of Sharia depends upon an analysis of the particular terms and conditions of the agreement and may prove controversial.

21. In this case, various defaults and "Termination Events" provided for under the ESUAs occurred and, as the Bank was entitled to do, it sent two default letters dated 18 August 2002 to the defendants under the terms of the first and second ESUAs in respect of the sums subsequently claimed in this action.

The Bank's claims against the first and second defendants

22. The Bank's claims against the first and second defendants are made up as follows:
"(1) US $ 25,207,000 being the amount due under the first ESUA relating to the 1995 Morabaha Agreement;
(2) US $ 21,472,800 being the amount due under the second ESUA relating to the 1996 Morabaha Agreement;
(3) US $ 1,147,540.76 being accrued compensation due under clause 4.2.4 of the first ESUA;
(4) US $ 1,884,169.75 being accrued compensation due under clause 4.2.4 of the second ESUA."

The Bank's claims against the guarantors

23. On 6 February 2001 the Bank and the third and fourth defendants entered into two personal guarantees, one relating to the first ESUA and one relating to the second ESUA ("the personal guarantees"). On the same date the Bank and the fifth defendant entered into two corporate guarantees, one relating to the first ESUA and one relating to the second ESUA ("the corporate guarantees"). The guarantees were all in materially similar terms. Each states that it is "governed by and shall be construed in accordance with English law", with provision also for the jurisdiction of the English courts. There is no reference to the principles of Sharia.

24. Each guarantee recites the relevant Morabaha financing agreement, the "Outstanding amount" pursuant thereto and the relevant ESUA Agreement as amended.

25. The relevant provisions of the guarantee for the purposes of this appeal are as follows:
*"**2.1 Covenant to pay***
*In consideration of Shamil agreeing to discharge the Outstanding Amount in return for being granted the right to acquire title to the Assets and Shamil permitting **Beximco** and BEIC to use the Assets in return for the User Fee pursuant to the Exchange Agreement [i.e. the ESUA] the Guarantor hereby guarantees to Shamil **Beximco** and BEIC's obligation to transfer title to the Assets to Shamil and guarantee to pay to Shamil, on demand by Shamil, the User Fee and all monies and discharge all obligations and liabilities now or hereafter due, owing or incurred by **Beximco** and BEIC (or either of them as the case may be) to Shamil under or pursuant to the Exchange Agreement and the other New Transaction Documents when the same become due for payment or discharge whether by acceleration or otherwise, and whether such monies, obligations or liabilities are express or implied, present, future or contingent, joint or several, incurred as principal or surety, originally owing to Shamil or purchased or*

otherwise acquired by it, denominated in Dollars or in any other currency, or incurred on a banking account or any other manner whatsoever …

2.2 Guarantor as principal debtor; indemnity

As a separate and independent stipulation, the Guarantor agrees that if any purported obligation or liability of ***Beximco*** *and/or BEIC (as the case may be) which would have been the subject of this Guarantee had it been valid and enforceable is not or ceases to be valid or enforceable against* ***Beximco*** *and/or BEIC (as the case may be) on any ground whatsoever whether or not known to Shamil (including, without limitation, any irregular exercise or absence of any corporate power or lack of authority of, or breach of duty by, any person purporting to act on behalf of* ***Beximco*** *and/or BEIC (as the case may be) or any legal or other limitation … the Guarantor shall nevertheless be liable to Shamil in respect of that purported obligation or liability as if the same were fully valid and enforceable and the Guarantor were the principal debtor in respect thereof …".*

26. The Bank claims against each of the guarantors the same sums as are claimed against the debtors as set out in paragraph 22 above.

The issues on this appeal

27. A number of defences were advanced by the defendants before the judge below, certain of which were regarded by the judge as having the hallmarks of trumped-up defences designed to avoid or delay payment. However, the principal defence advanced was that, (a) on a true construction of the governing law clause quoted in paragraph 1 of this judgment, 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 Sharia (i.e. the rules or laws of Islam) and (ii) in accordance with English law; (b) in fact, 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, (which would be enforceable if they were a true reflection of the underlying transaction) the transactions were in truth disguised loans at interest. As such they amounted to unlawful agreements to pay Riba and were thus void and/or unenforceable.

28. In this connection it was stated in the witness statement of Mr Choudhury for the defendants that he made it clear that the monies sought from the Bank by the first and second defendants were required as working capital for the **Beximco** group and that it was the Bank which required that the transaction be structured in the forms adopted in order to comply with Sharia law. The fourth defendant, as a director of the first, second and fifth defendants' and a personal guarantor of the ESUAs, stated that: *" … it is not uncommon for banks, in their enthusiasm to make profitable loans, to use a Morabaha Agreement to disguise what is, as a matter of commercial reality, an interest-bearing loan. That is precisely what happened in the present case and both the Claimant and the Defendants were quite content that this should happen. Neither was under any illusion as to the commercial realities of the transactions, and the claimant was happy 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."*

29. The rival expert evidence as to the validity of the agreements under Islamic law was as follows. The Bank's expert, Dr Lau, the former director of the Centre of Islamic and Middle Eastern Law, stated that the precise scope and content of Islamic law in general, and Islamic banking in particular, are marked by a degree of controversy within the Islamic world, best exemplified by the fact that the actual practice of Islamic banking differs widely within the Islamic world. Even within particular jurisdictions such as Pakistan, which are committed and constitutionally obliged to introduce Islamic financial systems, the issue is subject to on-going debate and a high degree of uncertainty. In the absence of any agreement on the boundaries of 'Islamic banking' or, indeed, on what ought to be the precise ingredients of a Morabaha agreement, it is in practice up to individual banks to determine the issue. In the absence of any legal prescription as to what does and what does not constitute Islamic banking or finance, most Islamic banks, including those in Bahrain, seek the advice of Islamic scholars who examine and approve particular agreements and forms of agreement, the role of the Religious Supervisory Committee being to formulate the bank's interpretation of the Sharia.

30. Strictly interpreted " the Glorious Sharia'a" refers to the divine law as contained in the Qur'an and Sunnah. However, most of the classical Islamic law on financial transactions is not contained as 'rules' or

'law' in the Qur'an and Sunnah but is based on the often divergent views held by established schools of law formed in a period roughly between 700 and 850 CE. The particular form and content of Morabaha agreements varies. If a bank's Religious Supervisory Board is satisfied that the bank's activities are in accordance with Sharia law, that concludes the matter, there being no provision in Bahrain law, or Islamic law generally, for an appeal by a customer of the bank against the Board's rulings and certifications. Finally, even if the relevant agreements amounted to agreements to pay Riba, the principal sums advanced could be validly claimed.

31. Dr Lau's conclusion was that the concern of the defendants that the sums advanced were not used to purchase the goods and/or equipment, the subject of the 1995 and 1996 Morabaha Agreements, but rather as part of the general working capital of the first and second defendants was of no relevance to the question whether or not the Morabaha agreements complied with Islamic law. He stated: *"In my opinion for the Morabaha Agreements to be in accordance with Islamic law all that is required is that they are certified as such by Shamil Bank's Religious Supervisory Board and the principal amounts are dispensed in accordance with the terms of the 1995 and 1996 Morabaha Agreements."*

32. The position of the defendants' expert, Mr Justice Khan, former chairman of the Sharia Appellate Bench of the Supreme Court of Pakistan, shortly stated was as follows. He acknowledged that *"wherever a question of interpretation of the principles contained in the Qur'an and Sunnah is involved, the application of the rules of Sharia'a has and will continue to give rise to disputes between different jurists".* He also did not contradict the assertion of Dr Lau that most of the classical Islamic law on financial transactions was not to be found in the Qur'an and Sunnah. However, he made clear (as Dr Lau did not dispute) that the injunction against the payment of Riba is contained in both those holy books and that it is uncontroversial that under Islamic law interest charged on loans by banks is Riba and prohibited. Equally, any agreement in which, in substance, interest is being charged upon a loan is unlawful, void and unenforceable.

33. Mr Justice Khan acknowledged that the Sharia recognises two modes of financing as permissible, namely Morabaha and Ijarah agreements, but asserted that, for such transactions to be valid, the requirements prescribed and provided for in the agreement must be fulfilled, failing which the transaction as a whole will be void according to the principles and rules of Sharia. On the basis of the (uncontradicted) assertion of the defendants that the advances were never applied or intended to be applied in the purchase or lease of any property, the relevant agreements were void. The ESUAs were similarly void and unenforceable on the basis of a number of arguments advanced, the principal one of which was that, irrespective of their form as purported Ijarah leases of assets, the ESUAs simply constituted a rescheduling or roll-over of the 1995 and 1996 Morabaha Agreements, the bank charging interest or an additional amount over and above the sums due in consideration of the giving of time. This too was Riba and accordingly prohibited and void.

34. Finally, so far as the position of the Bank's Religious Supervisory Board was concerned, Mr Justice Khan stated that certification by the Board that the operations of the Bank were according to the Sharia would not be a decision binding on any court dealing with the dispute under the law of Sharia. The dispute would fall to be resolved by the court in the light of its own view of the position under Sharia 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.

35. So far as the liability of the guarantors was concerned, two arguments were advanced before the judge which are of relevance to this appeal. The first was simply that, under the general law of guarantee, if the principal debtor was discharged from liability in respect of the obligations guaranteed, then the guarantors were similarly discharged.

36. The second defence raised was that the guarantees 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.

The decision of Morison J

37. The paragraph numbers referred to in this section reflect the numbered paragraphs of the judgment of Morison J.

38. The judge held, and it is accepted by the Bank on this appeal, that if, on a proper construction of the applicable law clause, the court is obliged to concern itself with the application of Sharia law and its impact on the lawfulness of the agreements, it is arguable which of the two parties' experts was right and that it would offend the principles underlying CPR Part 24 to seek to resolve the conflict between them before a trial. That is so not only in respect of the recoverability of sums which were effectively interest upon the capital sums advanced, but also of the capital sums themselves (paragraphs 45 and 46).

39. However the judge concluded that, on the proper construction of the applicable law clause, he was not concerned with the principles of Sharia at all for the following reasons.

40. First, it was common ground by concession that there could not be two separate systems of law governing the contract (paragraph 43). Yet, by contending that Sharia law and not English law would determine the enforceability of the agreement, the appellants were in substance contending that the agreements were governed both by English and Sharia law (paragraph 48). The judge declined to construe the wording of the clause as a choice of Sharia law as the governing law for the following reasons. First, Article 3.1 of the Rome Convention (which by s.2(1) of the *Contracts (Applicable Law) Act* 1990 has the force of law in the United Kingdom) contemplates that a contract "*shall be governed by the law chosen by the parties"* and Article 1.1 of the Rome Convention makes it clear that the reference to the parties' choice of the law to govern a contract is a reference to the law of a country. There is no provision for the choice or application of a non-national system of law such as Sharia law (paragraphs 39, 48 and 51). In any event, the principles of the Sharia are not simply principles of law but principles which apply to other aspects of life and behaviour (paragraph 53). Even treating the principles of Sharia as principles of law, the application of such principles in relation to matters of commerce and banking were plainly matters of controversy (paragraphs 49 and 53). In particular there is controversy as to the strictness with which principles of Sharia law will be interpreted or applied. In consequence it was highly improbable that the parties to the agreements 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 (paragraphs 49 – 54).

41. The judge accepted the submission of the Bank 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. However, in respect of what those principles were and their effect upon the contract, the judge concluded the relevant part of his judgment as follows:

> *"54. Whilst in one sense this court will answer any question posed to it, however difficult, it is improbable in the extreme, that the parties were truly asking this court to get into matters of Islamic religion and orthodoxy. This is especially so when the bank has its own religious Board to monitor the compliance of the bank with the Board's own perception of Islamic principles of law in an international banking context.*
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> *55. So far as the bank was concerned, that is likely to have been sufficient for its own regulatory purposes but there is no suggestion that the defendants were in any way concerned about the principles of Sharia'a law either at the time the agreement was made or at any time before the proceedings were started. The Sharia'a law defence is, I think, a lawyer's construct, but for the reasons I have given, in my view it does not work."*

The submissions of the appellants

42. Before this court, Mr Hacker QC for the appellants has not resiled from his concession that there can only be one governing law of the agreements. He accepts, and indeed asserts that it was his case below, that the governing law is English law and English law alone. However, he submits that this does not preclude the possibility that the principles of Sharia have relevance. He submits that all the parties have done is to choose English law as the governing law but, at the same time to stipulate as a condition precedent that the contract is only to be enforceable insofar as it is consistent with the principles of Sharia, which principles amount to legal rules ascertainable and applicable by an English court. He submits that that is something different from an assertion that Sharia law governs the agreements.

43. Mr Hacker accepts that the Rome Convention precludes the choice of Sharia, as a governing law, being concerned only with a potential choice between the laws of different countries. However, he submits that the construction of the governing law clause for which he contends produces a result no different from the incorporation by reference of a codified system of rules, such as the Hague Rules or the Warsaw Convention, into a contract governed by English law c.f. ***Nea Agrex SA v Baltic Shipping Co Ltd*** [1976] 1 QB 933 (CA) in which this court rejected the conclusion of Donaldson J at first instance that a paramount clause provision was to be treated as ineffective to incorporate the Hague Rules into a charterparty. He submits that such a construction is fully consistent with the bank's self-proclaimed mode of business as an Islamic bank carrying on an Islamic banking business.

44. Mr Hacker submits that, contrary to the view of the judge, it is neither unusual nor improbable that the parties to the contract should intend the English court to determine and apply the Sharia, nor, as he submits, is the English court ill-equipped to do so when assisted by expert evidence, in which respect he refers to the decision of Moore-Bick J in ***Glencore International AG v Metro Trading International Inc*** [2001] 1 Lloyds Law Rep 284 at paras 113-125 and that of Hart J in ***Al-Bassam v Al-Bassam*** [2002] EWHC 2281 (Ch).

45. He further submits that the reasoning of the judge was influenced by an erroneous view that the principles of Sharia constituted a body of controversial religious (as opposed to legal) principles, which view he was wrong to form on the evidence before him. In this respect, Mr Hacker relies heavily upon the fact that the evidence of Mr Justice Khan was that the principles of Sharia *raised in this case* i.e. the proscription of Riba and the essentials of a valid Morabaha Agreement are not controversial. In this respect he referred us to the judgment of Tomlinson J in ***Islamic Investment Company of the Gulf (Bahamas) Ltd v Symphony Gems NV*** (unreported) 13 February 2002 in which, it is clear that, when giving expert evidence in that case, Dr Lau did not suggest that there was any difficulty in identifying the requirements for an effective Morabaha contract under Sharia law. He therefore submits that the judge's conclusion that the principles of Sharia law *relevant to this case* were controversial, so as to render it improbable that the parties would have chosen the English court to resolve a dispute as to the enforceability of the agreements, was incorrect or, at the very least, involved him in conducting a mini-trial in relation to the parties' expert evidence contrary to the principles laid down in ***Swain v Hillman*** [2001] 1 All ER 91.

Discussion

The Governing Law Clause

46. The central question in this appeal is one of construction in respect of the relevant 'Governing Law' clause, expressly so described and couched in the short form already quoted in paragraph 1 of this judgment. The task of construction is to ascertain the presumed intention of the parties bearing in mind that: *"In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating."* (per Lord Wilberforce in ***Reardon Smith Line Ltd v Yngvar Hansen-Tangen*** [1976] 1 WLR 989 at 996.)

47. It is common ground in the context of the summary judgment application that, when the parties entered into the Morabaha Agreements and subsequently, 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"* (see paragraph 28 above). Nor, as Mr Hacker expressly accepted at the outset, 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, as it seems to me, 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 provides 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"* should be approached on a basis which is reconcilable with the purpose evident from the words which follow, rather than operating to defeat such purpose.

48. It is conceded by Mr Hacker that there cannot be two governing laws in respect of these agreements. He further concedes that the governing law is that of England. It seems to me that he is rightly driven to this concession. The wording of Article 1.1 of the Rome Convention ("the rules of this Convention shall apply to contractual obligations in any situation involving a choice between the laws of different countries.") is not on the face of it 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*", or as in this case, the law of Sharia. Nevertheless, that wording, taken with Article 3.1 ("*a contract shall be governed by* ***the*** *law chosen by the parties"*) and the reference to choice of a "*foreign law*" in Article 3.3, make it clear that the Convention as a whole only contemplates and sanctions the choice of the law of a country: c.f. *Dicey & Morris* on *The Conflict of Laws* (13th ed) vol 2 at 32-079 (p.1223) and *Briggs: The Conflict of Laws* at p.159.

49. Mr Hacker thus opts for a construction that the wording is apt, and intended, to incorporate into English law for the purposes of its application to the contract, the "*principles of … Sharia*". In this respect, and no doubt to avoid the difficulty that the principles of Sharia, generally stated, are of broad nature and application (indeed they are unexplored for the purposes of this litigation), Mr Hacker argues that the clause should be read as incorporating simply those specific rules of Sharia which relate to interest and to the nature of Morabaha and Ijarah contracts, thus qualifying the choice of English law as the governing law only to that extent.

50. In that respect, he seeks to rely upon the passage in *Dicey & Morris* (*supra*) at paragraph 32-086, which expounds the distinction between reference to a foreign law as a choice of law to govern the contract (or part of a contract) on the one hand and incorporation of some provisions of a foreign law as a term or terms of the contract in question. While observing that it is sometimes difficult to draw the distinction in practice, it is there stated that: *" … it is open to the parties to an English contract to agree e.g. that the liability of an agent to his principal shall be determined in accordance with the relevant articles of the French Civil Code. In such a case the foreign law becomes a source of law upon which the governing law may draw. The effect is not to make French law the governing law of the contract but rather to incorporate the French articles as contractual terms into an English contract. This is a convenient '* ***shorthand*** *' alternative to setting out the French articles verbatim. The court will then have to construe the English contract, '* ***reading into it as if they were written into it the words*** *' of the French statute.*

32-087 It often happens that statutes governing the liability of a sea carrier, such as the former Harter Act in the United States, or statutes implementing the Hague Rules … are thus 'incorporated' in a contract governed by a law other than that of which the statute forms part. The statute then operates not as a statute but as a set of contractual terms agreed upon between the parties. The parties may make an express choice of one law (e.g. English law) and then incorporate the terms of a foreign statute. In such a case the incorporation of the foreign statute would only have effect as a matter of contract."

51. It does not seem to me that the passage cited or the authorities referred to in the notes thereto, assist the defendants. The doctrine of incorporation can only sensibly operate where the parties have by the terms of their contract sufficiently identified specific ***'black letter'*** provisions of a foreign law or an international code or set of rules apt to be incorporated *as terms of the relevant contract* such as a particular article or articles of the French Civil Code or the Hague Rules. By that method, English law is applied as the governing law to a contract into which the foreign rules have been incorporated. In such a case, in construing and applying those rules, where there is ambiguity or doubt as to their ambit or effect, it may be appropriate for the court to have regard to evidence from experts in foreign law as to the way in which the provisions identified have been interpreted and applied in their 'home' jurisdiction. However, that is still only as an end to interpretation by the English court in the course of applying English law and rules of construction to the contract with which it is concerned. The authority of ***Nea Agrex v Baltic Shipping*** (*supra*) is no more than an illustration of this. The trial judge had held that a reference in the contract to the incorporation of a 'Paramount Clause' was ineffective for uncertainty, finding that he could not say whether the parties intended to incorporate the Hague Rules or part of the Hague Rules or, if so, which part. However, the Court of Appeal held that the clear meaning of ***'Paramount Clause'*** was that: *"It brings the Hague Rules into the charterparty so as to render the voyage or voyages, subject to the Hague Rules, so far as applicable thereto; and it makes those rules prevail over any of the exceptions in the*

charterparty. The judge, however, took a different view. He said that there are many different paramount clauses and he could not say which of them was applicable …

*I do not share the judge's view. It seems to me that when the '**Paramount clause**' is incorporated, without any words of qualification, it means that all the Hague Rules are incorporated. If the parties intend only to incorporate part of the Rules (for example Article IV), or only so far as compulsorily applicable, they say so. In the absence of any such qualification, it seems to me that a 'Clause Paramount' is a clause which incorporates all the Hague Rules."* (per Lord Denning MR at 943G – 944A)

52. The general reference to principles of Sharia in this case affords no reference to, or identification of, those aspects of Sharia law which are intended to be incorporated into the contract, let alone the terms in which they are framed. It is plainly insufficient for the defendants to contend that the basic rules of the Sharia applicable *in this case* are not controversial. Such 'basic rules' are neither referred to nor identified. Thus the reference to the "*principles of … Sharia*" stand unqualified as a reference to the body of Sharia 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.

53. In these circumstances, having rightly conceded that English law is the governing law of the contract, Mr Hacker is left with little room for manoeuvre, save to assert that the court should accept his submission on the basis that otherwise the proviso to the governing law clause would be mere surplusage.

54. I do not agree. It seems to me that there is an appropriate alternative construction, namely that favoured by the judge, i.e. 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 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. English law is a law commonly adopted internationally as the governing law for banking and commercial contracts, having a well-known and well developed jurisprudence in that respect which is not open to doubt or disputation on the basis of religious or philosophical principle. I share the judge's view that, having chosen English law as the governing law, it would be both unusual and improbable for the parties to intend that the English court should proceed to determine and apply the Sharia in relation to the legality or enforceability of the obligations clearly set out in the contract. Reference to authority does not assist the defendants in this respect. In ***Glencore International v Metro Trading*** (*supra*) the judge was concerned with, and heard evidence in relation to, the meaning and scope of the word '***ghasb***' (misappropriation) as a term used but undefined in Article 1326 of the Fujairah Civil Code which was the governing law in the case before him. As such he was obliged to interpret and apply the term in the dispute before him, with the assistance of rival experts in the law of Fujairah. The decision has no relevance to this case. As to the decision in ***Al-Bassam***, (*supra*) the court was concerned with Sharia law as being the law which the parties agreed was the law of succession applied in Saudi Arabia as the country of the deceased's domicile at the date of his death. Again, it has no relevance to this case, other than demonstrating that, where it is clear that a particular system of law governs a dispute before the English court, the court is obliged to apply it, with the assistance of expert evidence. Neither case was concerned with the construction of a disputed choice of law clause.

55. Finally, so far as the "*principles of … Sharia*" are concerned, it was the evidence of both experts that there are indeed areas of considerable controversy and difficulty arising not only from the need to translate into propositions of modern law texts which centuries ago were set out as religious and moral codes, but because of the existence of a variety of schools of thought with which the court may have to concern itself in any given case before reaching a conclusion upon the principle or rule in dispute. The fact that there may be general consensus upon the proscription of Riba and the essentials of a valid Morabaha agreement does no more than indicate that, if the Sharia law proviso *were* sufficient to incorporate the principles of Sharia law into the parties' agreements, the defendants would have been likely to succeed. However, since I would hold that the proviso is plainly inadequate for that purpose, the validity of the contract and the defendants' obligations thereunder fall to be decided according to English law. It is conceded in this appeal that, if that is so, the first and second defendants are liable to the Bank.

The Guarantors' Liability

56. It has necessarily been conceded that, if that is so, then the guarantors are similarly liable. The sole point relied on in this appeal to avoid their liability is the plea that the Bank and the guarantors entered into the guarantees on the basis of a mutual mistake, namely that the ESUAs constituted a binding obligation on the part of the Bank to discharge a pre-existing enforceable obligation, i.e. payment of the outstanding amounts as defined in the ESUAs. In this connection the guarantors rely upon the general law of guarantee and the fact that the opening line of the covenant to pay in clause 2.1 of the guarantees expressly made clear that they were given in consideration of the Bank agreeing to discharge the outstanding amount under the Morabaha agreements.

57. Although it is not necessary so to decide, I consider that the judge was correct in his view that a common mistake as to the legal consequences of the Morabaha agreements in this case would not qualify as a mistake apt to give rise to a defence.

58. Mr Hacker relies on recent authority to submit that, for the doctrine of mutual mistake to be operative at common law, it is no longer necessary for it to be a mistake of fact as opposed to a 'mere' mistake of law. He relies upon the decision of the House of Lords in ***Kleinwort Benson Ltd v Lincoln City Council*** [1999] 1 AC 153, in which the House of Lords held that there is no rule that only a mistake of fact would entitle a party to claim restitution on the grounds of mistake; also upon the statement of the position in *Chitty on Contracts* (28th ed) at paragraph 5-018 and the recent decision of Morland J in ***Brennan v Bolt Burden and others*** [2003] EWHC 2493 (QB) concerning the setting aside of a compromise agreement on the grounds of mistake of law when that agreement had been reached on the basis of a decision of the court of first instance which was subsequently overturned by the Court of Appeal. In coming to his decision that the agreement should be set aside, Morland J relied upon the speeches of Lord Goff and Lord Hoffmann in the ***Kleinwort Benson*** case at 379f and 398e-399 respectively and the paragraph in *Chitty*, as well as upon persuasive Commonwealth authority. Assuming, without deciding, that the decision of Morland J was correct, it was nonetheless reached upon the basis that the parties' common mistaken assumption as to the law "*was the fundamental basis for and a precondition of the compromise agreement, indeed its only springboard*" (see paragraph 52 of the judgment).

59. Before this court Mr Hacker has submitted that the mistake as to Sharia law was properly to be regarded as a mistake of fact by analogy with the position in respect of a mistake of *foreign* law: see ***Furness Withy (Australia) Pty Ltd v Metal Distributers (UK) Ltd ("The Amazonia")*** per Dillon LJ at 250.

60. If that analogy is correct, it is of course necessary for the guarantors to show that the mistake is such as to "render the subject matter of the contract essentially and radically different from the subject matter which the parties believed to exist" (per Lord Steyn in ***Associated Japanese Bank (International Ltd) v Crédit du Nord SA*** [1989] 1 WLR 255 at 268) or that it *"renders the thing [contracted for] essentially different from the thing [that] it was believed to be"* (per Lord Atkin in ***Bell v Lever Bros Ltd*** [1932] AC 161, as adopted and confirmed by this court in ***Great Peace Shipping Ltd v Tsavliris Salvage (International) Ltd*** [2002] EWCA Civ 1407 [2003] QB 679). Whether the mistake asserted should rightly be regarded as a mistake of fact or of law, it is plain to me that it is not a mistake based on a common assumption fundamental to the agreements in question. In that respect, the submissions of Mr Hacker inevitably founder upon the factual assertions of the defendants themselves, which demonstrate that their sole interest was to obtain advances of funds to be used as working capital and that they were indifferent to the form of the agreements required by the Bank or the impact of Sharia law upon their validity.

Conclusion

61. In my view the judge was correct in the conclusion to which he came, broadly for the reasons which he gave. I would dismiss this appeal.

Lord Justice Laws:

62. I agree.

Lady Justice Arden:

63. I also agree.

Mr R Hacker QC and Mr M Arnold (instructed by Jaswal Johnston) for the Appellants
Mr B Doctor QC and Miss S Partington (instructed by Norton Rose) for the Respondent