Bälz, Kilian, Islamic Financing Transactions in European Courts, In: *Islamic Finance Current Legal and Regulatory Issues*, edited by Ali, S. Nazim. Cambridge, Massachusetts: Harvard Law School, ILSP, Islamic Finance Project, 2005, pp.61-75

Islamic Financing Transactions in European Courts

Kilian Bälz[1]

INTRODUCTION

This paper explores the enforcement of Islamic financing transactions in European courts, an issue that is of particular relevance to any practitioner involved in the structuring and drafting of Islamic financing transactions. The use of Islamic financing techniques is no longer confined to the original Islamic banking strongholds of the Middle East and South Asia. Many, perhaps most, Islamic financing transactions today are implemented in Europe, with London and Geneva in particular having earned a reputation as Islamic banking hubs. In addition, the globalization of Islamic financing transactions seems to encourage corresponding litigation. Lenders default and Islamic banks sue and enforce their rights, once Islamic finance is disengaged from the cultural context of Islamic societies and freed from the shackles of communal ties.

The first part of this paper will discuss two recent English cases of relevance. The second part will address the issues discussed in these cases from the perspective of German law, thus complementing the common law perspective with that of the civil law tradition. The third part will proceed to discuss how to draft *shari'a* compliant agreements, which can also be enforced in a European court. The discussion will focus on *murabaha* agreements, since it is transactions of that type that have been litigated the most. Some of the more general questions discussed in this paper, however, will also be relevant to other Islamic financing structures, in particular *sukuk* and *ijara* transactions.

[1] Partner, GLEISS LUTZ (Frankfurt, Germany). The author specializes in international corporate and M&A work with a particular focus on the MENA region.

THE COMMON LAW APPROACH: RECENT DECISIONS OF ENGLISH COURTS

Islamic Financing Transactions in the English Courts

English law has become the standard for international financing transactions, at least in Europe, Africa, and the Middle East. It provides professionals with wide discretion in establishing law through practice, which suits the needs of the international business community.[2] Furthermore, the London High Court is a popular venue for commercial disputes of all sorts, including many cases geographically unrelated to the United Kingdom. It is no surprise, therefore, that most Islamic banking cases in Europe have so far been of English origin. As a general rule, the (English) common law approach to commercial agreements, in particular the obsession with a literal interpretation that construes clauses close to their wording, is sympathetic toward Islamic financing agreements, provided the agreements are properly drafted. However, the English courts tend to be at odds with issues of Islamic law, if they arise, and are reluctant to enter into discussions related to *shari'a* matters.

Symphony Gems

The first time an English court was concerned with an Islamic banking transaction[3] was in *Islamic Investment Company of the Gulf (Bahamas) Ltd. v. Symphony Gems N.V. and Others*, in the High Court of London.[4] The case illustrates the global reach of Islamic banking transactions and the resulting challenges for the Islamic finance industry. In the case the claimant, an Islamic bank incorporated in the Bahamas, had entered into a contract described as "*Murabaha* Finance Agreement" with the defendant. Upon instruction of the defendant, the claimant purchased two deliveries of precious stones from a diamond broker in Hong Kong. The precious stones allegedly never reached the defendant. When the claimant brought a claim

[2] Goode 1995: 162.

[3] Market Intelligence, cf. for example, www.islamic-banking.com/conference/conf-documentation-report.php. For a more comprehensive analysis of the case, see Umar F. Moghul and Arshad A. Ahmed, "Contractual Forms in Islamic Finance Law and *Islamic Investment Co. of the Gulf (Bahamas) Ltd. v. Symphony Gems & Ors*.," *Fordham International Law Journal* 25 (2003): 150, and Bälz 2004b: 117-134.

[4] February 13, 2002. To my knowledge, the case has not been published. The following quotations are taken from the transcript provided by Beverly F. Nunnery & Co.

for the balance due, the defendant argued, inter alia, that the transaction was a contract of sale, under which the defendant's obligation to pay was conditional on delivery of the goods. The defendant also alleged that the contract was void altogether, on grounds that it contravened the principles of the Islamic *shari'a*.

The loss of goods in transit is among the typical legal risks attached to a *murabaha* transaction.[5] In this event, the question arises whether the *murabaha* is to be treated as a sale of goods, which an analysis of traditional *fiqh*-rules may suggest, or whether it is to be treated as a financing transaction, which would conform to its contemporary use in trading practice. Islamic banks tend to mitigate the risk of a loss of the goods through detailed contractual provisions, making payment of the balance independent from any delivery of the supplies. In the present case, the agreement provided:

> 4.2 When the Seller shall have purchased Supplies, the Purchaser shall be absolutely, unconditionally and irrevocably obliged to purchase such Supplies from the Seller and to pay (a) all sums as mentioned in the Acceptance relating to such Supplies and (b) all other sums expressed or agreed to be payable hereunder in respect of such Supplies, in all cases notwithstanding any defect, deficiency or any loss or any other breach of any Supply Contract relating thereto by the Supplier or any other matter or thing whatsoever.[6]

This principle is reiterated in a subsequent clause in the agreement as follows:

> 4.4 The relevant instalments of the Sale Price in respect of each Purchase Agreement shall be payable by the Purchaser to the Seller on the due dates therefor, whether or not: (a) any property in the Supplies has passed to the Purchaser under the relevant Purchase Agreement and/or to the Seller under the relevant Supply contract ... and such payment shall not be conditional upon the happening of any event, in recognition by the parties of the facts that the source of the supply of the Supplies is selected by the Purchaser [...][7]

When interpreting these clauses, the High Court first highlighted the choice of law clause contained in the agreement, which stated that the "Agreement and each Purchase Agreement shall be governed by, and construed in accordance with, English law."[8] On this basis, the Court declined to be drawn into any discussions regarding the nature of *murabaha* under Islamic law. Instead, the Court interpreted the respective contractual clauses in accordance with English legal principles, holding that:

[5] Vogel and Hayes 1998: 141.
[6] *Islamic Investment Company of the Gulf v. Symphony Gems*, 4-5.
[7] Ibid., 5-6.
[8] Ibid., 12.

> What clauses 4.4, 5.1, 5.2 and 5.6 demonstrate is that all of the arrangements concerning the acquisition of the goods by the seller from the supplier fall to be made by the purchaser, for the very good reason that this is a financing agreement facilitating or apparently facilitating the purchase of the goods of the supplier. If therefore there has been no delivery of the goods from the supplier to the seller and thus from the seller to the purchaser, that can only be because the purchaser has not made the necessary arrangements. ... Clause 4.4 provides that the instalments are payable whether or not the seller is in breach of any of its obligations under the relevant purchase agreement, which must include failure to deliver.[9]

On this basis the High Court concluded that "delivery of goods is not a prerequisite to recovery by the seller of the relevant instalments of the sale price from the purchaser"[10] and held that the agreement was no orthodox contract of sale. The Court found that the *murabaha* was a financing transaction and that the defendant remained under the obligation to pay the purchase price even in the event of failure by the claimant to deliver the goods.

In addition, the Court saw no basis for the argument put forth by the defendant that the contract was altogether void on the grounds that it contravened Islamic law. Although it is debatable whether the allocation of risk under the transaction conformed to a more orthodox interpretation of traditional *shari'a* law and relevant expert evidence had been submitted in the proceedings, the Court declined to look into this issue. It held instead that these questions were irrelevant in the case in light of the express choice of law and the lack of any relationship with an Islamic legal order. As a result, the contract was construed as an English agreement and the defenses were altogether dismissed.

The *Symphony Gems* case was received with much relief by the international Islamic banking community. In essence, it affirmed that a *murabaha* agreement, if properly drafted, may be enforced in an English court, if and to the extent that the agreement is governed by English law. The same applies to contractual structures whose permissibility is, from a more orthodox *shari'a* standpoint, at least questionable.

[9] Ibid., 22-23.
[10] Ibid., 23.

Beximco

This issue was then taken up in *Shamil Bank of Bahrain v. Beximco Pharmaceuticals Ltd. and Others*.[11] The *Beximco* case was based on a similar set of facts, at least to the extent that it concerned a defaulting debtor under a *murabaha* agreement who raised, inter alia, the defense that the agreement did not comply with Islamic legal principles. When the claimant brought an action over the amount of the balance due in the London High Court, the defendant argued that the transaction was altogether void, alleging it was only dressed up as a *murabaha* agreement, but was in fact an interest bearing loan. Thus it violated the Islamic prohibition of *riba* and was unenforceable.

Given its facts and in light of the *Symphony Gems* case, it may be surprising that this case actually made it to the Court of Appeal. The reason is that the agreement in the *Beximco* case contained a choice of law clause which, unlike the one in the *Symphony Gems* agreement, also made explicit reference to Islamic law. The relevant clause reads: "Subject to the Principles of the Glorious *Shari'a*, this Agreement shall be governed by and construed in accordance with the laws of England."[12]

This choice of law is rather ambiguous, to say the least, and raises a whole set of questions.[13] One is whether and to what extent the parties can validly agree on Islamic law as the governing law of a financial transaction. This is a question that has not been fully resolved so far.[14] In view of the interpretative pluralism in Islamic law, both past and present, and the extensive controversies regarding financial innovations among Islamic scholars, it seems a difficult if not impossible task for any court to come up with an interpretation of Islamic law that will satisfy all circles concerned. Moreover, as far as English private international law is concerned, it is questionable whether the parties can validly opt for a choice of law other than that of a particular national jurisdiction. According to the prevailing opinion, it is only permissible to opt for the law of a particular country to govern the contract.[15]

[11] January 28, 2004, [2004] EWCA Civ 99. The following quotations are taken from the transcript by Smith Bernal Wordwave Ltd.
[12] Ibid., no. 1
[13] For a more comprehensive discussion, see Bälz 2004a. Among these questions are whether the parties indeed intended to subject the agreement simultaneously to two legal orders (Islamic and English Law) or at least, in effect, subject the exercise of rights granted under the agreement to the mandatory principles of Islamic law. Further, one may raise the question of whether the parties did intend to determine a proper law of the contract pursuant to which the transaction contemplated in the agreement may be deemed void.
[14] For a more detailed discussion see Bälz 2001: 73-85.
[15] Collins 2000: 1223.

In the end, therefore, both the London High Court and the Court of Appeal declined to attribute any legal effect to the reference to Islamic law contained in the agreement. First, it was argued that pursuant to the applicable conflict rules the choice of any non-national legal order—such as the *shari'a*—was irrelevant. Art. 3(1) of the Rome Convention provides:

> A contract shall be governed by the law chosen by the parties. The choice must be expressed 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 only of the contract.

Both the High Court and the Court of Appeal held that this provision permits only the selection of a specific national law as the governing law of the contract. Any reference to transnational legal principles such as the *lex mercatoria* or the Islamic *shari'a*, understood as the historic (but living) legal order of Islam, is no valid choice of law. Second, and maybe more important, the courts also decided against an incorporation of Islamic legal principles into the contract (being in principle governed by English law). The doctrine of incorporation is acknowledged in English law, and it is thus possible to make selected foreign legal principles part of an English law agreement. The courts held, however, that such incorporation requires that reference be made to a specific "black letter" rule (be it of a foreign legal order or of a set of international principles). In the words of the Court of Appeal:

> 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 regards to evidence from those experts in foreign law as to the way in which the provisions identified have been interpreted and applied in their "home" jurisdiction.[16]

The Court of Appeal held that the reference to the "Glorious *Shari'a*" was too vague to have any legal meaning:

> The general reference to principles of *shari'a* in this case affords no reference to, or identification of, those aspects of *shari'a* law which are intended to be incorporated into the contract, let alone the term in which they are framed. It is plainly insufficient for the defendants to contend that the basic rules of the

[16] *Shamil Bank v. Beximco*, no. 51.

> *shari'a* applicable in this case are not controversial. Such "basic principles" are neither referred nor identified. Thus the reference to the "principles of ... *shari'a*" stand unqualified as a reference to the body of *shari'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. ... The words are intended to simply reflect the Islamic religious principles according to which the bank holds itself out as doing business rather than a system of law to be applied in ascertaining the liability of the parties under the terms of the agreement.[17]

In addition, in light of the interpretative pluralism in Islamic law, it would be an impossible task for the court to determine the applicable principles, as there are, in the words of the Court of Appeal, "indeed areas of considerable controversy and difficulty" in ascertaining the applicable *shari'a* rules.[18] Furthermore, the Court of Appeal argued that it is doubtful whether the parties intended to confer the authority to decide such questions on an English court. The Court supported this interpretation by arguing that the parties, who were fully aware of the economic realities of the transaction, could not possibly have intended to subject the agreement to legal rules invalidating the transaction.

As a result, both the High Court and the Court of Appeal declined to interpret *shari'a* principles, the strict application of which may well have resulted in sincere doubts as to the validity of the transaction. The transaction resembled a so-called "synthetic *murabaha*," carrying an allocation of risk comparable to a conventional financing transaction.[19] Instead, the Courts interpreted the agreement applying English legal principles only and confirming the validity of the agreement from the perspective of English law, but not opining on it from the viewpoint of the Islamic *shari'a*. The latter task is left to the Islamic financial community.

Islamic Financing Transactions under English Law

On the basis of the case law analyzed, it seems fair to conclude that an English court will enforce a *murabaha* agreement based upon a literal interpretation of its wording, provided that the mechanics of the transaction are intelligible and the agreement is properly drafted. In doing so, however, the court cannot be expected to enter into any discussions relating to the *shari'a*. Put differently, in the case law, however limited it is up to now, the courts have shied away from entering into any such analysis. An English

[17] Ibid., no. 52.
[18] Ibid., no. 55.
[19] For a more detailed discussion of this type of transaction, see Vogel and Hayes 1998: 142-143.

court will be prepared to assist an Islamic bank in collecting the balance outstanding under a *murabaha* agreement when due. However, it cannot be expected to also guarantee *shari'a* compliance.

THE CIVIL LAW APPROACH: HOW GERMAN COURTS WOULD DECIDE

Civil Law—An Altogether Different Approach?

Much has been written about whether the civil law approach is all that different from the common law approach. In fact, in many areas of law, the convergency thesis seems compelling and any juxtaposition of a civil law legal culture with a common law legal culture is, in light thereof, rather artificial. This, however, is not true for all areas of law. This paper argues that there is indeed a substantial difference between the English approach on the one hand and the German approach on the other, at least as far as non-national norms and the doctrine of incorporation is concerned. Unlike in England, there appears to be no relevant German case law relating to *murabaha* transactions. As a consequence, the following is something of a Continental European exercise in legal realism, a prophecy of what the German courts might decide when concerned with the choice of law clause of the kind included in the agreement in the *Beximco* case.

Choice of Law

With respect to the question of whether the parties may select the principles of Islamic law as the proper law of the contract, the situation under German private international law is somewhat similar to the English approach. Section 27(1) of the German Introductory Law of the Civil Code (*Einführungsgesetz zum Bürgerlichen Gesetzbuch—"EGBGB"*), which contains the applicable conflict rules, is based on the Rome Convention and reads:

> The contract is governed by the law chosen by the parties. The choice of law must be explicit or must be derived with sufficient certainty from the terms of the contract or the circumstances of the case. The parties may agree on a choice of law to comprise the entire contract or a part thereof.[20]

[20] English translation by the author.

This provision allows the parties to determine the law applicable to an international contract (and thereby reflects the international standard in that field). Moreover, according to the predominant opinion in German legal literature, only the law of a national legal order is a valid choice.[21] However, this opinion is not universally accepted and, by comparison to English legal writing, German lawyers seem more sympathetic toward non-governmental rules, such as the *lex mercatoria*, the UNIDROIT principles, or the principles of European contract law. In light of the increasing importance of private standardization in international commerce on the one hand, and the decreasing significance of the nation-state as legislator on the other, it has been argued that it is erroneous to limit the choice of law to national law; instead, there should be the possibility to select a particular set of non-national rules.[22] Accordingly, it should also be possible to select Islamic legal principles as the proper law of the contract.

Even following the predominant opinion, the selection of Islamic legal principles must be permitted if the dispute is submitted to arbitration. In relation to the substantive law applicable in arbitration proceedings, the German Code of Civil Procedure (*Zivilprozessordnung—"ZPO"*) provides in Section 1051(1) that the tribunal shall decide pursuant to the "legal rules" determined to be applicable by the parties.[23] This wording is understood by prevailing opinions to allow also for the selection of non-national rules.[24] As a consequence, it should be possible to select Islamic law as the proper law of contract if and to the extent that the agreement contains an arbitration clause. It follows that if the parties insist on defining the Islamic *shari'a* as the proper law of the contract, they should also be advised, if German conflict rules apply,[25] to include an arbitration clause in the contract. An arbitration tribunal is likely to respect such a choice of law. However, it is highly recommended to provide in the contract that the arbitrators will have the required knowledge of Islamic law and, more importantly, Islamic banking practice. It follows that at least some of the arbitrators should be required to have the appropriate qualifications, i.e., be well-versed in *shari'a* matters and experienced in the current Islamic banking practice. The effect of the choice of law will in practice depend on the wording of the arbitration clause.

[21] This opinion is forcefully put forth, e.g., by Von Bar and Mankowski 2003: 87-88. It conforms to the predominant, albeit not entirely uncontested opinion in German legal literature (see the references ibid.).

[22] Wichard 1996: 262-302; Berger et al. 2002: 12-37. Both authors emphasize the importance of non-governmental rule-making from an empirical/sociological perspective.

[23] English translation by the author.

[24] Wagner 2002: 791 with further references.

[25] Which is, practically speaking, the case if the venue or place of arbitration, as the case may be, is located in Germany.

Incorporation of Islamic Legal Principles into a German Law Agreement

German law acknowledges the doctrine of incorporation and the parties may, by reference to a defined set of rules or standards, make them part of their agreement. This is true even if the rules are of a non-national nature and would therefore not qualify as law in the positivist sense.[26] Thus, this approach allows one to make reference to Islamic legal principles even though the contract is otherwise governed by German law. This situation, with respect to the underlying principle, is not all that different from the position of English law. One exception may be that the German courts are likely to be somewhat more lenient with respect to the formal requirements of such an incorporation. As a general rule, German courts will be less obsessed with the wording of a particular contractual clause and more likely to investigate what the parties actually intended (or, alternatively, what the court believes the parties should have written in the contract).[27] In practice, this can make a significant difference, and a German court may well have interpreted the choice of law clause in the *Beximco* agreement to the effect that the parties had indeed intended to subject the exercise of their rights to the Islamic *shari'a*. According to this interpretation, the exercise of any rights may be limited by its permissibility according to *shari'a* principles. Therefore, the claimant in the *Shamil* case may have faced difficulties in collecting the monies due, if and to the extent that the defendant was in a position to ascertain that the agreement did in fact contravene Islamic *shari'a*.[28]

In addition, and perhaps more important, German courts have in the past interpreted certain agreements pursuant to Islamic legal principles even without any explicit reference to *shari'a* law. This approach has, in particular, been followed with Islamic marriage contracts that are formally governed by German law pursuant to the applicable conflict rules, but based

[26] Von Bar and Mankowski 2003: 87-88.

[27] For a critical discussion from a comparative perspective, see Zweigert and Kötz 1987: 433-434.

[28] One can only speculate about the outcome. The agreement at hand, which resembled a synthetic *murabaha*, may well be contrary to a more orthodox interpretation of *shari'a* principles. The possible consequences, however, are not very clear. One approach would be to hold that the agreement is void only as far as the payment of "interest" is concerned. Based on such an understanding the bank would be able to collect the principal without, however, being entitled to the mark-up. If and to the extent one holds that the agreement is void altogether, the question arises whether the bank may nevertheless collect the principal pursuant to the rules of unjustified enrichment (which would be the position under German law; see Bundesgerichtshof, judgments of July 29, 1989, *Wertpapiermitteilungen* 1083 and June 15, *Neue Juristische Wochenschrift* 1993, 2108).

on and inspired by traditional Islamic structures. Here, the German Federal Court has explicitly referred to the concept of a *mahr* under Islamic law when dealing with an Islamic marriage contract that was entered into between two German residents, dressed up as a prenuptial agreement governed by German law, and notarized by a Bavarian notary public.[29] A German court is likely to adopt a similar approach with *murabaha* agreements governed by German law. In this case the court may investigate in further detail whether the *murabaha* is in fact a sale of goods or a financing transaction; it may also look into the details of whether the purchaser is under any obligation to repay the "loan" if the goods are lost in transit. The court may also ask whether parties intending to transact in "the Islamic way" can be barred from exercising certain rights formally granted to them under the agreement, if this contravenes fundamental *shari'a* principles.

Islamic Financing Transactions under German Law

Compared to the English courts, it is likely that a German court would pay more attention to Islamic legal rules. It is unlikely that a German court would dismiss outright any reference to the Islamic *shari'a* or a traditional Islamic contractual model by arguing that German law governs the agreement. It is more likely that a German court would try to give the agreement a specific Islamic interpretation (or, more precisely, whatever the court would assume such an Islamic interpretation to be). It should be emphasized that this may at times, from the point of view of the Islamic financing industry, be a problematic approach. The legitimacy of some widely spread contractual structures, such as the synthetic *murabaha*, is still being debated among Islamic scholars. A German court concerned with such agreements may well take defenses derived from Islamic law more seriously than the English courts have done. This may ultimately hinder enforcement of at least some of the rights under such an agreement.

[29] Bundesgerichtshof, judgment of October 14, 1998, *Neue Juristische Wochenschrift* 1999, 574 f.

LESSONS FOR THE STRUCTURING AND DRAFTING OF ISLAMIC FINANCING AGREEMENTS

Generating Islamic Legitimacy in a Secular Legal Environment

Ensuring *shari'a* compliance in a secular legal environment is not an easy task, and Islamic financial institutions employ various techniques to assure their customers that their dealings are Islamic (and thereby generate the Islamic legitimacy on which their business model is based). On an institutional level, most Islamic financial institutions rely upon a *shari'a* board entrusted with advising the institution's management in connection with Islamic questions and ascertaining that the business transacted complies with *shari'a* principles.[30] In addition, and more debatable from a legal perspective, some Islamic financial institutions also include a reference to Islamic legal principles in the agreements themselves (as, for example, in the *Beximco* case). In this case, the Islamic orientation of the transaction is not merely expressed by a general policy statement in the institution's articles of association or the use of Islamic contractual structures. The claim to abide by Islamic legal principles is also expressed through a choice of law clause establishing Islamic law as the proper law of the contract. Such an approach most clearly reflects the business policy of Islamic financial institutions being guided by the Islamic *shari'a*. In light thereof, it is only consistent to include a provision in the agreement providing for a choice of Islamic law. The case law of the English courts discussed in this paper demonstrates the difficulties of such an approach. I would like to make two specific suggestions as to how these difficulties might be overcome, both on a substantive and on a procedural level.

Defining Applicable *Shari'a* Rules

One of the key difficulties for any court concerned with applying *shari'a* law to an agreement is determining the substance of the relevant rules. The attitude of many English courts regarding the alleged vagueness of *shari'a* law, and the notion that it is more of a moral code than a legal system, is unfair and indicative of a persistent orientalist bias. It must be conceded, however, that in light of the diversity of opinion among Islamic scholars, it is not always easy to resolve a specific issue on the basis of Islamic law, particularly when financial innovations are concerned.

As a starting point, any reference to Islamic legal norms, be it a choice of law proper or by way of incorporation into the agreement, must be

[30] Saeed 1999: 108-118.

specific and must allow a third party interpreting the agreement to ascertain its content. This requires precise definition and description of the sources of such rules. One approach may be to refer to a specific *madhhab*, or even more precisely, a specific work of *fiqh*, defined as the authoritative source of Islamic law for the purpose of the agreement. Both techniques are known approaches in family law reform. They could be extended to the realm of financial transactions as well. However, the downside of this approach is that if a certain *madhhab* is selected, it will not exclude but in the best scenario only narrow down ambiguities and differences in opinion. As for the selection of certain authoritative *fiqh* books, it must be noted that even contemporary expositions of Islamic contract law do not focus on modern financial transactions and leave many intriguing questions open. It follows from this that even if a certain *madhhab* or treatise of law is specified, this will provide only limited certainty with respect to the outcome of a potential dispute.

In my experience, the most advisable reference is to the AAOIFI *shari'a* standards. AAOIFI is a non-governmental organization based in Bahrain, which is active in the definition of the best practice applicable to Islamic financial institutions.[31] AAOIFI also has promulgated a set of *shari'a* standards that, currently in their second edition,[32] provide guidance for most Islamic financing transactions (and, furthermore, are deemed to represent the middle ground position for many disputed questions). The standards are a restatement of *shari'a* principles relevant to Islamic banking transactions, formulated in a language and manner intelligible even to lawyers without formal training in *shari'a* law. Therefore, if it is intended to incorporate *shari'a* principles into the contract, a reference to the AAOIFI standards is a workable solution. These principles are widely accepted among *shari'a* sholars, they focus on the areas of law relevant to financial transactions, and are formulated in a reasonably precise manner. From a practical point of view, however, it is not advisable to refer to Islamic legal principles without precisely defining what this will imply in the event of a dispute.

Dispute Resolution: Division of Labor Between Courts and Experts

Even if the relevant *shari'a* norms are precisely defined, their application to a specific transaction will easily give rise to ambiguities. This, to be fair, is not due to the nature of *shari'a* law, but is rather an unavoidable consequence of any legal interpretation. Consequently, the

[31] For details see www.aaoifi.com.
[32] Accounting and Auditing Organization for Islamic Financial Institutions 2003.

appointment of the authority on which this task is to be conferred may, in practice, be even more important than the selection and definition of the rules as such.

If Islamic legal rules are properly incorporated into an agreement, they will bind a court, which must then apply these rules. There is always a possibility that the court will treat these rules as a choice of foreign law, even if they are integrated into the agreement by incorporation. In this event, determining the substance of such rules will ultimately depend on relevant expert opinions. English and German approaches to that question will differ in detail. Whereas in Germany the expert will be appointed by the court and investigate the issues of foreign law *ex officio* and impartially, an English court will treat a question of foreign law as a factual question, left to the parties to ascertain. In any event, the involvement of foreign law experts can substantially slow down the proceedings, particularly if these experts are appointed *ex officio*, as would be the case in a German court. From a practical perspective, therefore, it is advisable to avoid, to the extent possible, the involvement of court appointed experts. This will hold true particularly when advising an Islamic bank.

One possible additional remedy to this situation is to determine in the agreement itself who shall have the authority to interpret the relevant *shari'a* rules in the event of a dispute. This can easily be done by providing that the institution's *shari'a* board shall also have the last word on such questions. Once a typical transaction has been sanctioned by the *shari'a* board, there will effectively be no further dispute with respect to their *shari'a* compliance. In such a case, however, the reference to Islamic legal principles will be more of a tautology that does not add anything substantive to the agreement. Another possibility, representing a compromise position, would be to name in the agreement an independent institution or a third party to exercise the function of the expert. This technique is fairly widespread in complex commercial agreements, where often specific questions relating to technical and accounting matters are referred to an institution other than the normal dispute resolution body. The expert decides a particular aspect of the dispute based on special expertise.[33] Such a structure can also be used where issues of Islamic law arise, and the questions could then be referred to an expert appointed pursuant to the agreement.

[33] For a more comprehensive discussion, see Bälz 2004a.

CONCLUSIONS

Based on the limited case law available, it is fair to conclude that *murabaha* agreements are enforceable under both English and German law, provided they are drafted in a professional manner that makes their underlying structure intelligible to a non-Muslim court. Any reference to *shari'a* norms should be precisely defined, and such references should also establish an authority other than the court entrusted with the interpretation of Islamic principles. A European court can be expected to enforce a commercial agreement according to its terms and conditions. It cannot, however, be expected to express any opinions on *shari'a* law.