Islamic Finance: Issues Surrounding Islamic Law as a Choice of Law under German Conflict of Laws Principles

Andreas Junius
Islamic Finance:
Issues Surrounding Islamic Law as a Choice of Law under German Conflict of Laws Principles
Dr. Andreas Junius*

Two years ago, in the matter of *Shamil Bank of Bahrain EC v Beximco Pharmaceuticals Ltd.*, the English Court of Appeal ("English Court") decided for the first time questions of the validity, interpretation, and breadth of a choice of law provision in a *murabaha* agreement. The judgment is of far-reaching significance in the fields of Islamic finance and Shari'ah-compliant investments. This is because the English Court evaluated the agreement solely under English law, even though the disputed choice of law provision stated that English law was only to be applied "[s]ubject to the principles of the Glorious *Sharia'a*." The English Court qualified this clause as a nonbinding statement of purpose. As Islamic investments and Islamic financial transactions become increasingly relevant in the US and continental European countries, the decision is likely to be considered by other courts in the future, and it is worth examining how German courts may react. To be sure, the decision was made under English law.

* Attorney-at-Law, New York, and Rechtsanwalt, Frankfurt am Main. The author would like to express his gratitude to and acknowledge the valuable contributions of Rechtsreferendar Dr. Florian Hoeld (now admitted to practice as Rechtsanwalt, Bonn, German manuscript), Benjamin Letzler (Harvard Law School, English translation), and Rechtsreferendar Dr. Heiko Bertelmann (Hamburg, editorial support) in the preparation of this Article.

1 WLR 1784 (CA 2004) (UK) (hereinafter *Beximco*).


3 *Beximco* ¶ 1.
The Beximco decision may nonetheless influence courts in other countries and not only those within the Anglo-American tradition.

I. INTRODUCTION

A. INTRODUCTION TO THE MATTER IN DISPUTE: ISLAMIC FINANCE

Factors driving the growing demand for Islamic finance products and Shari’ah-compliant investment opportunities for both borrowers and investors include the ongoing high price of oil, near-peak capacity oil production, and a growing commitment to religious codes of conduct in the Muslim world. This has led to the introduction of Islamic principles to broad reaches of economic activity. Recent years have seen the establishment of increasing numbers of Islamic financial institutions worldwide. A specifically Islamic capital market is now emerging and solidifying alongside conventional capital markets. The central characteristic of the Islamic financial system, apart from the prohibition of a number of trades considered religiously objectionable and illegal, is a comprehensive prohibition against the charging of interest (riba). Obviously, this prohibition is diametrically opposed to the essential importance of interest in modern banking. Muslim enterprises and Islamic financial institutions are required to do business on a wholly Shari’ah-compliant basis including their cross-border dealings and global investments. In this context, a widespread

---


5 Unacceptable businesses include those involving alcohol, gambling, pork, and pornography.

financing concept is the *murabaha*.

This method of financing was also the basis of the decision of the English Court.

The *murabaha* is a short-term business financing, often referred to as "cost-plus financing" or "mark-up sale." In this sort of financing, the bank, acting for a customer, buys a commercial good from a supplier and then resells the good to the customer at a contractually specified mark-up (either a percentage or a lump sum). This entails two different contractual relationships: a purchase agreement between the bank and the supplier and an additional purchase agreement between the bank and the customer. Though the bank pays the purchase price immediately to the supplier, it defers receipt of the resale purchase price from the customer. In lieu of interest, the bank then charges a "mark-up" or "cost plus" as payment for extending the purchase price in advance. Through the use of two purchase agreements and no credit agreement in the classic sense, the bank receives—from a legal standpoint—no interest, only profits from a sale. This is viewed as permissible in Islam. At times, agency agreements under property law are reached pursuant to which the customer takes possession of the goods directly from the supplier on behalf of the bank. The rules, like those in all areas of business, are not uniform because no single codification of the Shari`ah exists. Differences between regions and even between individual Shari`ah scholars are not uncommon.

It would be wrong to characterize the *murabaha* as circumvention of the interest prohibition. As Bälz notes, the *murabaha* is an alternative financing form with its own risks. For example, there are greater risks for the banks than in classic lending because property ownership and financing are combined. Furthermore, as real intermediaries, the banks face difficulties such as assumption of risk, guarantees, insurance, default, and maintenance. These difficulties are widely viewed as a necessity in order to be recognized as a genuine *murabaha* transaction and not as a circumvention of the prohibition on interest.

Default interest is also impermissible under Islamic law. To address this, "discounts" are routinely negotiated for timely payment. Obviously, such discounts have the disadvantage of being static and limited. Therefore, recourse

---

7 See Bälz, *Islamic Banking* at 5 (cited in note 6); Bälz, Zenith Bus at 36 (cited in note 6); Freshfields, *Islamic Finance* at 3 (cited in note 6); Sabahi, 24 Ann Rev Banking & Fin L at 495 (cited in note 4); and Tacy, 10 NC Banking Inst at 357–58 (cited in note 4).
8 Bälz, *Islamic Banking* at 5 (cited in note 6).
10 Bälz, *Islamic Banking* at 5 (cited in note 6).
11 Id.
12 Freshfields, *Islamic Finance* at 7 (cited in note 6).
is sometimes made to “late fees.” The general risk of the customer breaching the contract and refusing acceptance of the goods also exists. Here, Islamic finance uses breakage fees to protect against this risk. Lastly, a bank entering into a murabaha financing requires security in return for extending credit. The bank has a substantial interest in securing its deferred claim to payment of the purchase price. Ways to address this need include both personal and real security interests. In the case underlying the Beximco decision, the bank’s claim to payment was secured by sureties.

In practice, the aforementioned risks are also generally minimized by drafting the contract so as to distribute risk as closely as possible to the distribution under letter-of-credit financing. It is a common practice for the bank to refuse explicitly any guarantee and to place transportation risks with the customer. In return, the bank cedes to the customer its guarantee claims against the supplier. Similar terms and conditions are used in the field of lease financing. It is, therefore, fair to say that in their economic effect, murabaha structures often approximate interest-based lending structures, though they can be legally difficult to construct.

In the case decided by the English Court, the customer fell into arrears, and Shamil Bank, an Islamic bank, sued for payment in the London High Court. The murabaha agreement contained the following choice of law provision: “Subject to the principles of the Glorious Sharia’a, this Agreement shall be governed by and construed in accordance with the laws of England.” Because the only legal difficulties with the contract were those under Islamic law, the London High Court looked to the complex set of issues surrounding the questions of whether the principles of Shari‘ah had in fact been violated and whether the court should reach that question at all. Since no court had previously addressed these issues, the English Court had occasion to break new ground in judging them.

B. THE BEXIMCO DISPUTE

Beximco argued that it was not obligated to pay because the agreement violated Islamic law and thus was wholly invalid. Beximco further argued that

13 Id.
14 Bälz, Islamic Banking at 6 (cited in note 6).
15 Beximco ¶ 25.
16 Bälz, Islamic Banking at 6 (cited in note 6).
17 See also Bälz, IPRax at 44 (cited in note 2).
18 Beximco ¶ 1.
19 Beximco ¶ 27.
the choice of law provision in dispute should be interpreted to mean that the mutual rights and obligations arising from the agreement would only be binding and actionable if they conformed with the principles of both the Shari‘ah and English private law. These preconditions were not fulfilled because the agreement violated Islamic law. Beximco remarked that the murabaha financing in question was, in truth, a hidden loan at interest and thus prohibited by Islamic law. This defense is astounding since the parties had agreed on a murabaha financing, and the Beximco Shari‘ah Board had approved the transaction. Yet, as discussed above, murabaha financings in practice have come to closely approximate the conventional forms of business financing.

II. THE DECISION OF THE ENGLISH COURT

The English Court, by upholding the decision of the London High Court, explicitly rejected Beximco’s argument. The English judges found that the agreement was subject solely to English law, and that a review for legality under Islamic law was not appropriate. The English Court emphasized at the outset that it would be non-justiciable, and therefore impossible for contracts, to be subject to two different legal systems since the relevant Rome Convention on the Law Applicable to Contractual Obligations states that “[a] contract shall be governed by the law chosen by the parties.” This needs to be read in conjunction with Article 1 of the Rome Convention, according to which the rules of the Convention “shall apply to contractual obligations in any situation involving a choice between the laws of different countries.” This means that only the choice of a national legal system is a valid choice of law. The Rome Convention as a whole does not contemplate the choice of a non-state legal system such as Islamic law. In addition, the English Court characterized the principles of Shari‘ah as representing a socio-religious code of conduct, something different from, and at the same time more and less than, a classic state legal system.

20 Id.
21 Id.
22 Shari‘ah boards are internally appointed institutions that oversee the work of Islamic banks, and which must approve transactions from a religious perspective. The Boards are made up of members who have been educated or have taught at highly prestigious contemporary Shari‘ah schools. Freshfields, Islamic Finance at 2 (cited in note 6).
23 Bilz, Islamic Banking at 5 (cited in note 6).
25 Id at art 1, § 1.
26 Beximco ¶ 48.
Islamic law, in the view of the English Court, was also insufficiently determinate since it is debated even among its own legal scholars, and on the whole inadequately codified.\textsuperscript{27} The English Court further found it highly improbable that the parties to the contract would wish for a secular English court to decide a legal dispute on the basis of Islamic law.\textsuperscript{28} This reasoning by the English Court upheld the lower court’s observation that there was no compelling interest to examine religious questions, since the Shari’ah boards of the relevant parties had already done so and passed their judgment.\textsuperscript{29} Both the English Court and the London High Court thus reached the result that the contractual reference to Islamic law was nothing more than a nonbinding statement of purpose by the bank to pursue Shari’ah-compliant financing.\textsuperscript{30} The English Court concluded with the self-confident assertion that English law, distinguished internationally for its popularity and high quality, should not be diluted by religious principles.\textsuperscript{31} In doing so, the English Court rejected the defense by noting that the commercial reality of the agreement was clear to both parties from the beginning, and this reality must be considered in interpreting the agreement.\textsuperscript{32} A loan transaction was hidden in \textit{murabaha} clothing.

The English Court made it unmistakably clear that it would generally uphold agreements in which religious Islamic parties are participants so long as the agreements can be reconciled with English law. Furthermore, English courts will not take the place of the Shari’ah boards by reviewing a contract’s consistency with Islamic law. The judgment takes care to secure substantial legal certainty for financial institutions. It thus shifts and reduces the particularities of Islamic finance to the preparation of the contract and the internal review of the relevant materials. This ultimately makes dependable legal advice necessary.

\textbf{III. ISLAMIC LAW AS A CHOICE OF LAW UNDER GERMAN CONFLICT OF LAWS DOCTRINE}

The following discussion aims to consider how a German court would treat the choice of law provision selected by the parties in the Beximco case. This question was initially addressed by Kilian Bälz in his commentary on the first impression decision of the London High Court, the lower court. It is of growing practical relevance, however, not only because the English Court

\textsuperscript{27} Id ¶ 55.
\textsuperscript{28} Id ¶¶ 40, 54.
\textsuperscript{29} Id ¶ 41 (discussing the lower court rationale).
\textsuperscript{30} Id ¶ 54.
\textsuperscript{31} Id.
\textsuperscript{32} Id ¶ 47.
confirmed the lower court’s decision, but also because Continental legal systems, including German law, are gaining prominence alongside the classic choices of English and American law, as options for investors from the Persian Gulf. German-based assets are becoming increasingly attractive to these investors for a variety of reasons. The applicability of German law will therefore play an increasingly significant role in the future.

A. THE PRINCIPLE OF THE FREE CHOICE OF LAW

In the Federal Republic of Germany, the law that governs in a conflict between multiple legal systems is determined under German International Private Law (Internationales Privatrecht), which is codified in the second chapter of the Einführungsgesetz zum Bürgerlichen Gesetzbuch (“EGBGB”). The relevant provision for contractual obligations states the basic rule that the contract will be subject to the law chosen by the parties (the principle of the free choice of law). The choice of law must be made explicitly or must derive with sufficient certainty from the provisions of the contract or the totality of the circumstances of the case. The parties may make a choice of law effective for the entire contract or only for a single part. The obvious precondition for the latter is that the contract be logically divisible. In theory, the parties to Shari’ah-compliant transactions have three options: the agreement may be subject solely to Islamic law, subject solely to a state legal system (with purely internal Shari’ah compliance), or subject to a mixed system pairing a state legal system with typical Islamic principles.

If the law to be applied is not agreed upon under EGBGB, Article 27, Paragraph 1, then EGBGB, Article 28, Paragraph 1, makes the contract subject to the law of the state with which it displays the closest connections. There is, however, an important exception to these principles: a legal norm of another state will not be applied when its application leads to a result that is clearly incompatible with the essential principles of German law. EGBGB, Article 6, Sentence 2, places particular emphasis on applications of foreign law that are incompatible with German constitutional or human rights. The specific result of

34 Andreas Heldrich, Article 27, in Otto Palandt, Bürgerliches Gesetzbuch (German Civil Code) ¶ 9 at 2582 (München 65th ed 2006) (discussing EGBGB, art 27); Dieter Martiny, Article 27, in Kurt Rebmann, Franz Jürgen Säcker, and Roland Rixecker, eds, 10 Münchener Kommentar zum Bürgerlichen Gesetzbuch ¶ 70 at 1703 (CH Beck 4th ed 2006) (discussing EGBGB, art 27).
35 Atbani, 27 Co Lawyer at 55 (cited in note 4).
36 This is the so-called ordre public, referred to in Article 6 of the EGBGB, also referred to as public policy.
the application of the law (not the norm itself) must be entirely unbearable in the individual case. The violation must be considerable and must go against the basic values of German law. In addition, the *ordre public* requires a sufficient relationship to Germany. Also, such a norm will not be applied if it violates internationally mandatory German law, that is, a rule of domestic German law that is so essential that it is intended to prevail over an otherwise valid choice of law.

**B. THE INTERPRETATION OF UNCLEAR CHOICE OF LAW CLAUSES**

A contract’s choice of law, when unambiguously made, generally means that there will be no difficulty in selecting the relevant law to apply. Unclear choice of law clauses, by contrast, require interpretation. This applies both to content and scope, as is made clear by the English Court’s decision in favor of English law. The situation under German law is similar: for statutory interpretation, EGBGB, Article 32, Paragraph 1, dictates that the applicable law selected under EGBGB, Article 27, Paragraph 1, is also the law used in its interpretation. Under German law, the interpretation of unclear choice of law clauses is governed by general principles of interpretation under contract law. The interpretation of declarations of intent under contract law is determined from the point of view of the counterparty, who is assumed to use an objective standard. This also follows from EGBGB, Article 27, Paragraph 1, Sentence 2, which states that the choice of law must derive with sufficient objective certainty from the provisions of the contract and the surrounding circumstances. Here the principles of interpretation include not only an interpretation based on the literal wording, but also on teleology and systematics.

On the interpretation of choice of law clauses, the German Federal Court of Justice ("German Court") has decided that while the wording of the relevant clause needs to be examined, the requirements for the clarity of a choice of law clause may not be set too high. The German Court held that, for the choice of law as well as a subsequent amendment thereto according to EGBGB, Article 27, Paragraph 2, it is sufficient that the relevant intent of the contractual parties

---

38 See Heldrich, *Article 6 ¶ 6* at 2492 (cited in note 34).
39 EGBGB, BGBI. 1 at art 34 (cited in note 33).
40 EGBGB, BGBI. 1 at art 32 ¶ 1 (cited in note 33).
followed from the clause itself or from the circumstances. In that regard, the express reference to provisions of a certain law shall, according to the German Court, indicate a tacit choice of law.43

Like the English Court, therefore, a German court would also interpret choice of law clauses that are not entirely clear. If one looks at the choice of law clause that was at issue in the English Court’s decision, one is faced with the problem that both the wording as well as the teleological construction, each viewed individually, permit diverging interpretations. Furthermore, the clause does not favor one interpretation over another. The choice of English law subject to Islamic principles, however, shows that the agreement should not just be subject to English law but also subject to Islamic principles of law. It shows that the contractual parties emphasized, on the one hand, conformity with Islamic law, not the least because the financing method originated especially from the requirements of Islamic law. On the other hand, the reference to English law shows the intention to base the agreement on a solid and reliable body of law. Based on a literal interpretation, one cannot simply view the proviso at issue as a mere programmatic statement that need not be recognized. It is therefore surprising, at first glance, that neither the English Court nor the lower court decision discusses the various interpretive possibilities based on the wording. But in the final analysis, that discussion was circumvented given the decision that Islamic law is not a valid governing law.44

A plausible way to interpret the clause would be that English law should apply to the extent that it does not collide with Islamic law principles. In instances in which English and Islamic law conflict, Islamic law should prevail. If that were the right interpretation, a national secular court could potentially be forced to take evidence on the principles of Shari‘ah and, in the final analysis, to decide upon them. The English Court expressed that opinion in reference to specific substantive law that was sufficiently clear.45 In this context, the determination of how the two legal systems relate to each other would become relevant. One could also conclude that the choice of law clause, if interpreted in that fashion, would be deemed as not having made any valid choice of law at all. Under EGBGB, Article 28, Paragraph 1, this would lead to the application of the law of the state that has the closest connection with the agreement. One would not get to that point in a German court, however, if, as the English Court

44 Beximco ¶¶ 39, 52.
45 Id.
determined for English law,\textsuperscript{46} Islamic law is not a contractually valid choice of law.

C. ISLAMIC LAW AS A LEGAL SYSTEM CAPABLE OF BEING CHOSEN

Whether Islamic law can be chosen appears to be problematic in various respects. It is clear, however, that the requirements of EGBGB, Article 27, Paragraph 1, play a pivotal role in this respect.

1. Requirement of the Choice of a State Law

According to EGBGB, Article 27, Paragraph 1, an agreement is governed by the “law” chosen by the parties. The prevailing view among German legal scholars is that the term “law” in the context of EGBGB, Article 27, means the law of a state.\textsuperscript{47} This follows readily from the wording of the provision. EGBGB, Article 27, Paragraph 3, talks about “the law of another state” or refers to the law of “that state.” In addition, the legislative history of the provision confirms that the term “law” means the law of a specific state.\textsuperscript{48} Furthermore, other statutes differentiate between legal provisions in general and those of a state, as Bälz correctly points out.\textsuperscript{49} For instance, Section 1051, Paragraph 1, Sentence 1, of the Code of Civil Procedure,\textsuperscript{50} which relates to arbitration proceedings, provides that the court of arbitration must decide the dispute in accordance with the legal provisions that the parties have identified as applicable to the cause of action. The second sentence of the provision then specifically deals with “the law or the legal order of a specific state.” With reference to the genesis of this provision, it is interpreted such that it also allows the application of other, non-state-based legal principles.\textsuperscript{51} Consequently, that provision specifically allows the choice of not only state-based law but also the law of a

\textsuperscript{46} Id.

\textsuperscript{47} Heldrich, Article 27 § 3 at 2580–81 (cited in note 34); Martiny, Article 27 § 28 at 1686, § 33 at 1690 (cited in note 34) (discussing EGBGB, art 27); Gerhard Hohloch, Einführungsgesetz zum Bürgerlichen Gesetzbuch, in Harm Peter Westermann, ed, Ermann, Kommentar zum Bürgerlichen Gesetzbuch § 9 at 5631 (Verlag Dr. Otto Schmidt 11th ed 2004) (discussing EGBGB, art 27); Christian von Bar and Peter Mankowski, Internationales Privatrecht § 2 ¶ 86 (CH Beck 2d ed 2003); Jan Krohpoller, Internationales Privatrecht § 52 II (3)(e) (Mohr Siebeck 4th ed 2001); Ulrich Magnus, Article 27, in Ulrich Magnus, ed, 14 J. von Staudinger, Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetz und Nebengesetzen ¶ 49 at 120 (Sellier 2002) (focusing on lex mercatoria).

\textsuperscript{48} See Bälz, IPRax at 45 (cited in note 2).

\textsuperscript{49} Id.

\textsuperscript{50} Zivilprozeßordnung (ZPO) (civil procedure statute) May 12, 2005, Bundesgesetzblatt (BGBI) I, as amended.

\textsuperscript{51} See generally, Bälz, IPRax at 45 nn 14–16 (cited in note 2).
non-state legal order. But it is limited in its application to arbitration proceedings and there appears to be no compelling reason to extend its application by way of analogy. Since German law does not allow the election of non-state law, Islamic law cannot be chosen as the law to govern a contract. As the English Court correctly pointed out, Islamic law is not state law, but a religious-philosophical code of conduct. Islamic law and the principles of Shari'ah are not codified as state law, but rather based on the Qur’an and the Sunnah, which provide citations, doctrines, and reported actions of the prophet Mohammed.

This interim result is not exceptional and certainly not exclusive to Islam. It is common among all religious and philosophical codes of conduct that they cannot be chosen as law to govern contractual relationships. For instance, a choice of law clause that read, "subject to the principles of the Holy Bible," would not be enforceable in accordance with EGBGB, Article 27, because the Holy Scripture also does not constitute state law.

2. No Cumulative Choice of Different Legal Systems

As discussed above, the wording of the choice of law clause at issue suggests that "subject to" means that the agreement would be governed by both English and Islamic law and that, in case of conflict, the Shari’ah would prevail. That result would contradict German choice of law principles because, as discussed in the preceding section, Islamic law cannot be chosen as governing law because it is not state law. It also violates the prohibition of choosing two laws, as put forth in EGBGB, Article 27.

EGBGB, Article 27, Paragraph 1, provides that the agreement is subject to the law chosen. That implies already that the statute assumes the choice of one law. But, EGBGB, Article 27, Paragraph 1, Sentence 3, allows the parties to choose different governing laws for different parts of the agreement. In conjunction, this indicates that each part must be governed by one choice of law and must not overlap with any other choice of law. This is the prevailing view among German scholars, who also base their position on the inherent danger of

52 Beximo ¶ 55.

Choice of law clauses subjecting the application of a certain state law to principles inherent in the Bible are merely theoretical and practically would be of no relevance. Rules of conduct conveyed by the Bible are not as detailed or far-reaching as the ones the Qur’an and the Shari’ah provide. Related bodies of law, such as Kirchenrecht (Church law) or Staatskirchenrecht (public Church law) are not amenable to choice of law clauses in commercial contracts, because the former presents the internal organizational law that the religious communities set for themselves, while the latter governs the relationship of the religious communities with the secular state. Both principles are reflected in Article 140 of the Grundgesetz (German constitution, Basic Law) in connection with Article 137, ¶ 3, of the Imperial Constitution of the Weimar Republic.
contradicting results; if more than one law could cumulatively be applicable to an agreement, it would create legal uncertainty.\textsuperscript{54}

If German law expressly allows the application of different laws to different parts of the contract, one might ask whether the Shari'ah clause at issue could be viewed in that way. This, however, is not the case. The clause is not worded such that parts of the agreement are subject to English law and other parts to Islamic law. If that had been the intention, then it would have remained entirely unclear how the agreement would have to be divided. If one were to allow a choice of both legal systems applicable to the same contractual agreement, there would never be certainty whether, in this case, English law would prevail because the Shari'ah is subject to interpretation by different schools of thought and individual scholars. With this in mind, it is indeed preferable that state law prevail, and, from a choice of law perspective, form the sole basis for the agreement. That, however, leaves the question of what effect reference to the Shari'ah actually has in a contract.

3. Islamic Principles Incorporated as Substantive Law

Bälz is of the view that the clause “subject to the principles of the Glorious Sharia’a” means, in substance, that the parties contractually agree that the exercise of their rights is made subject to Islamic law permitting such exercise.\textsuperscript{55} By way of contractual reference, Islamic law in its entirety thus becomes incorporated into the contract. The references to Shari'ah were therefore made on the substantive law level as distinct from the choice of law. That would mean that non-mandatory provisions of German law that conflict with Islamic law principles, such as provisions on default interest in the German Civil Code, would, by virtue of subjection to the Shari'ah, be contractually excluded. When in doubt, the agreement would have to be interpreted in light of the principles of Islamic law. That way, the ethical-religious orientation of the transaction, which by virtue of the conflict of laws principles embodied in the EGBGB would not be recognized, could find recognition on the level of substantive law.

The overwhelming opinion in German legal literature is that reference to substantive law embodied in non-state law is permissible, even if the dispute is brought before a state court.\textsuperscript{56} By way of incorporation, contractual parties can add rules embedded in state or non-state bodies of law to their contractual agreement. This position is corroborated in the inverse sense by the limitations on the extent to which foreign law can be incorporated into a contractual agreement.

\textsuperscript{54} Heldrich, \textit{Article 27} \textsuperscript{\textcopyright} 9 at 2582 (cited in note 34); Bälz, IPRax at 44 (cited in note 2).
\textsuperscript{55} Bälz, IPRax at 46 (cited in note 2).
\textsuperscript{56} Heldrich, \textit{Article 27} \textsuperscript{\textcopyright} 1 at 2580 (cited in note 34); Martiny, \textit{Article 27} \textsuperscript{\textcopyright} 30 at 1688 (cited in note 34) (discussing EGBGB, art 27); Magnus, \textit{Article 27} \textsuperscript{\textcopyright} 47 at 119 (cited in note 47).
arrangement, namely, internationally mandatory German law (EGBGB, Article 34) and German public policy (EGBGB, Article 6). But these examples do not allow the conclusion that a general reference to the Shari'ah would allow incorporation of Islamic law in its entirety into the contractual agreement. This would conflict with the requirement of determinability (Bestimmtheitsgebot) also applicable to contract law. Islamic law or the Shari’ah, if referred to in the proposed manner, is not sufficiently certain and cannot be ascertained.\(^7\)

Conceivable in this context, but equally indeterminate, would be a reference to specific rules of the Shari’ah. The incorporation of Islamic law in its totality as non-state law would still be a violation of the prohibition in EGBGB, Article 27, Paragraph 1, on cumulative choices of law. This cannot be circumvented by moving the application from the choice of law level to the substantive law level. Possible, and probably admissible under EGBGB, Article 27, Paragraph 1, would be a reference to specific and determined rules or regulations. In that case, the (secular) court would have to take evidence on the contents of the foreign rule of law by way of expert testimony. As Bälz concedes, this adds another layer of complication with respect to Islamic law, because as discussed above, many rules of the Shari’ah (especially their applications to specific factual situations) are controversial among Islamic schools and individual scholars.\(^8\)

If, therefore, the contractual parties intend to incorporate individual principles of Islamic law into the contract, this has to be done in a concrete, specific manner, whether by specific reference to individual rules of the Shari’ah (which would need to be spelled out) or by incorporating their specific content into the agreement as such. Failing this, one should assume, as the English Court did, that the general reference to Islamic law has to be viewed as a programmatic statement by the financial institution indicating that their activities are guided by the principles of Shari’ah.\(^9\)

**IV. CONCLUSION**

In summary, German conflict of law rules do not allow incorporating Islamic law as a legal order that can be chosen to govern agreements. This

\(^{57}\) See Bälz, IPRax at 46 (cited in note 2).

\(^{58}\) Id.

\(^{59}\) A related issue exists not in the context of choice of law clauses, but in corporate law: Islamic investors, when incorporating legal entities abroad, frequently add to the purpose clause of the articles of association or other constituent document a reference to the Shari‘ah, such as, “The corporation shall conduct its affairs in compliance with the principles of the glorious Shari‘ah,” or the like. This creates complications and legal uncertainty, in particularly with respect to ultra vires issues. It is, therefore, better practice to make this reference determinable by limiting it to specific rulings of the company’s Shari‘ah Board. This may be achieved by adding to the above-referenced clause: “as determined by the company’s Shari‘ah Board.”
follows from EGBGB, Article 27, which—as compared to Section 1051 of the German Code of Civil Procedure (ZPO)—only allows the choice of a foreign state law. In addition, EGBGB, Article 27, prohibits a cumulative choice of law such that the application of two legal systems to the same contractual provision is not possible. Based on this, it may be assumed that a German court would reject the choice of Islamic law as submitted in the case before the English Court. Despite the reference to Shari`ah principles, the contract would be exclusively interpreted in accordance with German law. Validity and enforceability of contractual rights and obligations would exclusively be governed by German civil law. But that does not leave devout Muslims and other investors who want to conduct their affairs in a Shari`ah-compliant fashion without means to achieve that goal. The focus, however, would be not as much on the choice of law clause as on the specific contractual norm requiring or prohibiting certain conduct in compliance with the Shari`ah. In addition, parties may make the exercise of certain rights and obligations of the agreement subject to approval by a Shari`ah board or other committee in which they have confidence with respect to the application of the Qur`an and the Shari`ah. This has become standard practice in the corporate scenario.

Because under German conflicts rules a choice of Islamic law or the Shari`ah—to the extent it is not codified in state law—is not possible, parties may ensure compliance with Islamic law principles by specific contractual provisions while still relying on a solid and well-interpreted state legal order. Mandatory German law or rules of German public policy that would contradict and—from a German conflict perspective—prevail over the economic rules of the Shari`ah have not come to our attention.60

---

60 By way of example, the prohibition on charging interest or providing for default interest would not contravene principles of fair dealing. See Bürgerliches Gesetzbuch (BGB) (Civil Code) Jan 2, 2002, Bundesgesetzblatt (BGBI) I, as amended, §242. Nor are they against good morals (kein Verstoß gegen die Guten Sitten). See Bürgerliches Gesetzbuch (BGB) (Civil Code) Jan 2, 2002, Bundesgesetzblatt (BGBI) I, as amended, § 138, ¶ 1. They also do not lead to inappropriate detriment for a contractual party. Bürgerliches Gesetzbuch (BGB) (Civil Code) Jan 2, 2002, Bundesgesetzblatt (BGBI) I, as amended, § 307.