

# Lodhi 5 Properties Investments CC v FirstRand Bank Limited [2015] 3 All SA 32 (SCA) and the Enforcement of Islamic Banking Law in South Africa



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## Abstract

On 22 May 2015, the Supreme Court of Appeal (SCA) handed down a judgment in the matter of *Lodhi 5 Properties Investments CC v FirstRand Bank Limited* [2015] 3 All SA 32 (SCA). This judgement considered whether the prohibition against the charging of interest on a loan in terms of Islamic law (Sharia law) may be a defence for a claim for mora interest in terms of a loan agreement. This note critically discusses the judgment in the light of the approach adopted by the SCA with regard to addressing a dispute arising from a contract that has Islamic law as a governing law. As this is the first case to come before the SCA in South Africa, this note critically analyses how the court discussed the principles of Islamic law as applicable to the dispute between the parties. In particular, it questions the court's assertion that a claim for mora interest has nothing to do with and is not affected by the Sharia law's prohibition against payment of interest on a loan debt. It also looks at the SCA's approach (as a common law court) with regard to the enforcement of the principles of Islamic banking law. The judgment raises important issues regarding the enforceability of Islamic finance law and therefore merits discussion in the context of the continuing growth and expansion of Islamic banking and finance law in South Africa.

## Keywords

Islamic law; mora interest; *riba*; *Hiyal*; profit-and-loss sharing; Sharia; Islam.

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## 1 Introduction

An increase in the number of Muslims worldwide has been observed for many decades. It signals the need for the non-Islamic world to take cognisance of Islamic law (also known as Sharia law) and practices. This has created a demand for pertinent financial transactions and services to comply with Islamic law. As a result, conflicts of law often arise where the principles of Islamic law are incorporated into the terms of financial agreements concluded in a secular context. Judicial officers in non-Muslim jurisdictions face challenges in terms of how to apply and enforce agreements incorporating these principles. This is particularly so with regard to disputes brought before secular courts in common law (and civil law) jurisdictions such as South Africa, where these courts are often called to interpret and apply, or at least to take cognisance of Islamic law. In 2015 the Supreme Court of Appeal (SCA) was faced with a problem of this kind in *Lodhi 5 Properties Investments CC v FirstRand Bank Limited*.<sup>1</sup> This case illustrates the challenges that secular courts encounter when they are confronted with the interpretation and application of uncodified Sharia law, which has been the subject of various scholarly interpretations. It also illustrates the challenges encountered by common law courts with no expertise to interpret and enforce transactions which are subject to Sharia law. This lack of expertise is evident in the abovementioned case, as the courts - both the High Court<sup>2</sup> (HC) and the SCA - did not address several issues which called for the interpretation of the relevant Islamic finance principles, and thus left more questions unanswered than those that were successfully addressed. The case raises important issues regarding the enforceability of Islamic finance law and merits discussion in the light of the continuing growth and expansion of Islamic banking and finance law in South Africa. The purpose of this case note is to critically analyse the decision in *Lodhi 5 SCA* in order to determine whether or not the court correctly applied the relevant principles of Sharia law with regard to the prohibition on the charging of *riba* interest. While the focus of this note is on the decision of the SCA, reference is made to the decision in the HC in order to illustrate the general approach of South African courts to the interpretation and enforcement of Islamic finance law. The discussion of the case note begins with a brief explication of the fundamental principles of

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<sup>1</sup> *Lodhi 5 Properties Investments CC v First Rand Bank Limited* 2015 3 All SA 32 (SCA) (hereinafter "*Lodhi SCA*").

<sup>2</sup> *FirstRand Bank Ltd v Lodhi 5 Properties Investment CC* 2013 3 SA 212 (GNP) (hereinafter "*Lodhi HC*").

Islamic banking law in order to establish the concepts applicable to the case under discussion. This is followed by a description of the facts of the case and the decisions of the HC and, most importantly, the SCA. A critical analysis of the SCA decision follows thereafter, and then concluding remarks are made on the decision of the SCA.

## 2 Fundamental principles of Islamic banking law

Islamic law is a legal system which is derived primarily from the *Quran* (the Muslim holy book) and the *Sunnah* (examples of the practices of Prophet Mohammed).<sup>3</sup> In terms of Islamic law conduct is either permitted (*halaal*) or strictly prohibited (*haram*).<sup>4</sup> The question as to whether something is permitted or prohibited is not a simple one, however. Engaging in the following financial practices is prohibited in terms of Islamic law: *gharar* (indulging in risk or uncertainty), *maysir* (gambling), unjustified enrichment, and *riba* (charging interest, or usury).<sup>5</sup> The focus of this note will be on *riba*, which forms the basis for distinguishing Islamic finance from its conventional counterpart.

### 2.1 *Riba and the charging of interest on loans*

Islamic law generally regards the charging of interest on loans as oppressive and exploitative, and it is therefore prohibited.<sup>6</sup> Similar prohibitions on usurious interest exist in conventional banking, with the result that the distinction between interest and *riba* is sometimes blurred. Unlike the limited prohibition on the charging of interest found in the Bible,<sup>7</sup> the *Quran* expresses the prohibition against *riba* emphatically in four verses.<sup>8</sup> For instance, the *Quran* is translated as saying: "O ye who believe! devour not *Riba* doubled and multiplied".<sup>9</sup> However, it does not define what the term *riba* actually means. *Riba* literally means simply "increase, addition, expansion or growth",<sup>10</sup> but in the context of financial transactions it means much more than that. Terms such as "effortless gain" and "profit which is given without giving anything in exchange" come to mind.<sup>11</sup> Sharia law prohibits *riba* in the sense of the accumulation of wealth that is not a product

<sup>3</sup> Okon 2012 *AJSMS* 106.

<sup>4</sup> Visser *Islamic Finance* 16.

<sup>5</sup> Garner 2013 *LJLC* 72; Razak 2015 *EJIF* 7.

<sup>6</sup> Sauer "Metaphysics and Economy" 154; Alrifai *Islamic Finance* 117.

<sup>7</sup> New International Version Deuteronomy 23:19 and Nehemiah 5:10-11.

<sup>8</sup> Ali *Holy Qur'ān: Translation*, Surah Al-Rum 30:39, Surah An-Nisaa 4:161, Surah Al-i-'Imran 3:130, Surah Al-Baqarah 2:275.

<sup>9</sup> Ali 1987 <http://www.streathammosque.org/uploads/quran/english-quran-yusuf-ali.pdf>.

<sup>10</sup> Chapra 1984 *HI* 5.

<sup>11</sup> Alrifai *Islamic Finance* 100.

of labour or equivalent financial value.<sup>12</sup> A consensus among Muslim jurists exists that *riba* has the same literal meaning and import as interest.<sup>13</sup> It is also agreed that it refers to some form of "premium" that must be paid to the creditor, along with the principal amount, as a condition for extending the loan, or for an extension of its maturity.<sup>14</sup> Any positive, fixed, or predetermined interest rate that is tied to the maturity of the loan is considered as *riba* and is therefore prohibited.<sup>15</sup> Muslim scholars, however, have not reached a consensus on the ambit of the prohibition against *riba*. This has sparked a conflict of interpretation between the two main categories of Muslim scholars.<sup>16</sup> A tug-of-war on the ambit of *riba* exists between classical and modern scholars.

The classical Muslim school follows the traditional definition of *riba* as any additional charge for borrowed money.<sup>17</sup> They adopt the technical Arabic meaning of *riba*, which is translated as "an excess" or "increment".<sup>18</sup> In their view, any additional amount charged over and above the capital originally advanced as a loan is simply "an act of renting money at a price called interest" and is therefore prohibited.<sup>19</sup> They refute any argument that strives to make a distinction between simple interest (which is not prohibited) and usurious interest (i.e. an exorbitant amount of interest).<sup>20</sup> According to the classical scholars, any benefit or increase (nominal or real), or any predetermined return on the loan capital advanced is *riba* and therefore prohibited.<sup>21</sup> Consequently, any sum added to the principal from an exchange that is not reciprocated by an equivalent of value in return is *riba*.<sup>22</sup> Their verdict is that the prohibition against interest is absolute, unambiguous and unconditional.<sup>23</sup>

Modern scholars are, so to speak, "attempting to separate the chaff from the grain". The crux of their debate is about whether *riba* means interest or usury.<sup>24</sup> If *riba* is defined as interest, any commercial transaction which requires the repayment of an amount additional to the capital is invalid under

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<sup>12</sup> Sharawy 2001 *GJICL* 161.

<sup>13</sup> Swartz 2012 *AJBM* 10104.

<sup>14</sup> Swartz 2012 *AJBM* 10104.

<sup>15</sup> Iqbal "Financial Engineering" 10.

<sup>16</sup> Thomas "What is Riba" 140.

<sup>17</sup> Visser *Islamic Finance* 100.

<sup>18</sup> Irfan *Heaven's Banker* 60; Ginena and Hamid *Foundations* 40-42.

<sup>19</sup> Abdul-Rahman *Art of RF* 2; Sauer "Metaphysics and Economy" 155.

<sup>20</sup> Chapra 1984 *HI* 5.

<sup>21</sup> Saeed *Islamic Banking* 1.

<sup>22</sup> Sauer "Metaphysics and Economy" 154-155.

<sup>23</sup> Chapra 1984 *HI* 4.

<sup>24</sup> Khalil "Overview of Sharia" 55.

Sharia law. However, if *riba* simply means usury, as long as the rate of interest has not hit some rate which is determined to be exorbitant, it is valid.<sup>25</sup> They begin by questioning a ban on *riba* in the modern-day economy.<sup>26</sup> Their argument is that *riba*, as manifested in the *Quran*, is a very specific form of interest. *Riba* and interest are two different things, and the ban cannot therefore be applied to all forms of interest found in modern economies.<sup>27</sup> They argue that the *Quran* verse quoted above is qualified by its reference to a specific amount of usury.<sup>28</sup> In their view, the words "doubled or multiplied" connote that "interest is classified as *riba* if the principal repayable is double the original amount".<sup>29</sup> What is banned by Sharia law, in their view, is "an unjustified increase" of return on a capital amount.<sup>30</sup> Their view of the ban on *riba* in the *Quran* and *Sunnah* is different from that of the classical scholars. Rather than defining it literally, they look at the rationale for the injunction as a ban on exploitative forms of interest which have the effect of committing economic injustices against the poor, contrary to Sharia law.<sup>31</sup> They support their position by arguing that the ban on *riba* is a ban on usuriously high and excessive interest, which is not equated with interest *per se*.<sup>32</sup> Unlike the classical scholars, in their view the ban on interest is conditional and not absolute.<sup>33</sup> Notwithstanding their different views on *riba*, there is a consensus amongst Muslim scholars that Sharia law prohibits *riba*.<sup>34</sup> They differ only in terms of what qualifies as prohibited *riba*, and not necessarily on whether or not Sharia law prohibits it.<sup>35</sup>

Alongside the prohibition on *riba*, as argued by the classical scholars, Islamic law also prohibits the additional penalty interest imposed on defaulting customers who fail to meet their obligations.<sup>36</sup> Any additional amount claimed after the contract is agreed upon (such as an increase in price, default interest levied for late payment, and an early payment penalty) is also unlawful and prohibited as *riba*.<sup>37</sup> According to contemporary Muslims, however, Sharia law allows a claim for compensation arising from

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<sup>25</sup> Khalil "Overview of Sharia" 55.

<sup>26</sup> Visser *Islamic Finance* 36.

<sup>27</sup> Visser *Islamic Finance* 36.

<sup>28</sup> Irfan *Heaven's Banker* 63.

<sup>29</sup> Irfan *Heaven's Banker* 63.

<sup>30</sup> Irfan *Heaven's Banker* 63.

<sup>31</sup> Irfan *Heaven's Banker* 63.

<sup>32</sup> Visser *Islamic Finance* 38; Sauer "Metaphysics and Economy" 154.

<sup>33</sup> Sauer "Metaphysics and Economy" 155.

<sup>34</sup> Zuhayli "Juridical Meaning of Riba" 27.

<sup>35</sup> Fisho-Oridedi 2009 *CEPMLPAR* 5; Khalil "Overview of Sharia" 55.

<sup>36</sup> Hatta and Samah 2015 *GJAT* 12.

<sup>37</sup> Wahyudi *et al Risk Management* 113.

the actual loss suffered by the financier due to a delay in payment (*ta'widh*), as well as the penalty charges imposed for such a delay, without the need to prove the actual loss (*gharamah*).<sup>38</sup> Such penalties can be charged, provided that the money is given to charity and is not income for the creditor.<sup>39</sup>

## **2.2 Permissible financial products in terms of Sharia law**

If the financial system were based on adherence to the classical position and the prohibition against levying interest on loans, this would raise a simple question: how would lenders be able to yield positive returns from the capital amounts that they advanced, without contravening Islamic law? In particular, are there any *halal* alternatives to the charging of interest on loans? Islamic law provides few modes of financing which serve as a replacement for the prohibitions against *riba*-based financing. The bulk of these modes of financing derive from financial instruments that are "engineered" on the basis of the profit and loss sharing principle (PLS) and asset-based financing, which have become primary characteristics of Islamic banking.<sup>40</sup> To understand what each of these financial instruments actually entails, one needs to understand the PLS principle upon which they are based.

### **2.2.1 PLS-based Islamic financial instruments**

The PLS principle stems from the promotion of profit from trade and productive investments under the Sharia law.<sup>41</sup> This principle generally means that the lender must share in the profits and losses arising out of the project for which the money was lent.<sup>42</sup> What is objectionable in terms of the prohibition against *riba*, as previously indicated, is not the payment of profit, but a pre-determined rate of return that is not the result of the profits and losses incurred by either party to a financial transaction.<sup>43</sup> This principle helps to draw a distinction between a prohibited *riba* and a legitimate return on investment. It recognises the use of an expected rate of return which is based on the risk that may arise from the operation of a financial transaction.<sup>44</sup> To implement this principle and be Sharia compliant, some forms of financial arrangements have been developed which are consistent

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<sup>38</sup> Wahyudi *et al Risk Management* 113.

<sup>39</sup> Baele, Farooq and Ongena 2012 <https://core.ac.uk/download/pdf/6654624.pdf>.

<sup>40</sup> Siddiqui "Islamic Banking" 74.

<sup>41</sup> Mirakor and Zaidi "Profit-and-Loss Sharing" 51.

<sup>42</sup> Kettell *Islamic Finance* 5.

<sup>43</sup> Mirakor and Zaidi "Profit-and-Loss Sharing" 51.

<sup>44</sup> Iqbal "Financial Engineering" 10.

with encouraging trade and profit. What is evident from the literature is that all parties to a financial transaction need not share in both profit and loss. In certain transactions, one party (mostly the financier) may fully shoulder the risk of loss.<sup>45</sup> As correctly stated, "[the] underlying idea is that Quran ... prohibits *riba* but applauds trade and profit, which is not frowned upon".<sup>46</sup> As a result, there are numerous financial instruments that have been accepted as Sharia-compliant and which have become the core of Islamic finance today. The relevant permissible Islamic banking products are discussed below.

The most recognised equity-based Islamic financial instruments, based on the PLS principle, are the *mudarabah* (trust financing) and *musharakah* (partnership financing).<sup>47</sup> Both are based on the idea of partnership: a passive partnership in the case of *mudarabah* and an active one in the case of *musharakah*.<sup>48</sup> *Mudarabah* is defined as a type of partnership where one party - a financier or a bank - supplies the capital, while the other party provides the expertise, management and labour.<sup>49</sup> It is called "trust financing" because the financier entrusts his or her finance or investment to another party.<sup>50</sup> If the project results in profit, they share it in pre-determined proportions. If it results in a loss, the entire loss is borne solely by the financier, and the entrepreneur gains no benefit out of his or her effort.<sup>51</sup> *Musharakah*, unlike *mudarabah*, is purely a partnership financial instrument. It refers to a partnership agreement between two or more parties, in which the partners contribute either capital or labour in order to carry out a joint venture.<sup>52</sup> Unlike *mudarabah*, both parties contribute the capital and both have management rights in the project.<sup>53</sup> In a *musharakah*, both parties share in the profit according to a pre-agreed formula. Losses, however, are shared strictly according to their respective contributions to the partnership.<sup>54</sup> Although partnership based on the PLS principle is highly recommended under the Sharia law, it is not always easy to find partners to create a joint venture, in order to obtain financing.

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<sup>45</sup> Visser *Islamic Finance* 53.

<sup>46</sup> Visser *Islamic Finance* 66.

<sup>47</sup> Hassan, Kayed and Oseni *Introduction* 104.

<sup>48</sup> Hassan, Kayed and Oseni *Introduction* 104.

<sup>49</sup> Hussain *Islamic Banking* 245.

<sup>50</sup> Alrifai *Islamic Finance* 125.

<sup>51</sup> Fakir and Tkiouat 2016 *IJEFI* 221; Hassan, Kayed and Oseni *Introduction* 105.

<sup>52</sup> Morapi *Islamic Banking in South Africa* 7.

<sup>53</sup> Qasaymeh 2011 *CILSA* 281.

<sup>54</sup> Kettell *Islamic Finance* 25.

Islamic law also recognises another financing instrument called *murabaha* (cost plus). *Murabaha* is debt-like, asset-based financing, in terms of which a customer requests the financial institution to purchase an asset for him or her and then sells it to the customer at an agreed price.<sup>55</sup> In terms of this agreement, the financial institution buys a product or asset at the request of the buyer in the market at its own cost<sup>56</sup> and for its own account.<sup>57</sup> The financial institution takes legal possession of the asset and later sells it to the buyer at cost plus a mark-up.<sup>58</sup> By taking possession of the financed property, the financial institution bears the risk during the period between purchasing the property and reselling it to the customer.<sup>59</sup> One of the key features of *murabaha*, which distinguishes it from a conventional loan, is that one cannot receive cash as a subject of the agreement.<sup>60</sup> In a *murabaha* transaction, the agreed sale price of the asset consists of the amount of financing and a predetermined profit margin.<sup>61</sup> This mark-up profit is generally not regarded as interest, simply because the financial institution is not giving a loan to the customer, but selling the goods to the customer at a profit.<sup>62</sup> At first glance, financing in terms of *murabaha* looks like a conventional loan, admitting the prohibited interest as cost plus profit through the back door. In support of this position, it is argued that the credit price charged by a financial institution, which includes a pre-specified profit margin, is parallel to a prohibited *riba* with similar characteristics to the one charged in conventional financing.<sup>63</sup> The reason for its acceptability, however, is that it has an "asset-for-money" character rather than a prohibited "money-for-money" character. In terms of *murabaha*, the financial institution does not lend the borrower money and ask for the money over time plus a profit in addition to the loan capital.<sup>64</sup> By buying the asset and then reselling it at a higher price, the financial institution takes a risk associated with the possibility of a sudden fall in price, which could see the buyer refusing to accept the asset at the agreed higher price.<sup>65</sup> It is acting as a seller rather than a moneylender.<sup>66</sup> The additional profit is not associated with the lending of money but with the buying and selling of the

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<sup>55</sup> Hanif 2011 *JBSS* 174; Hassan, Kayed and Oseni *Introduction* 82.

<sup>56</sup> Irfan *Heaven's Banker* 135.

<sup>57</sup> Visser *Islamic Finance* 66.

<sup>58</sup> Hussain *Islamic Banking* 245.

<sup>59</sup> El-Gamal "Paradox" 294.

<sup>60</sup> Hanif 2011 *JBSS* 170.

<sup>61</sup> Hussain *Islamic Banking* 245.

<sup>62</sup> Jalil 2010 *JBSS* 226.

<sup>63</sup> El-Gamal "Paradox" 292.

<sup>64</sup> Alrifai *Islamic Finance* 128.

<sup>65</sup> Alrifai *Islamic Finance* 128.

<sup>66</sup> Alrifai *Islamic Finance* 128.



asset.<sup>67</sup> The acquisition of assets is the key element of *murabaha* which distinguishes it from the normal consumption interest-based loan, which is prohibited under Sharia law.<sup>68</sup>

### 2.2.2 *Wakalah (agency) contracts as an ancillary to PLS contracts*

Each of the above financial products may be offered on its own or with others as hybrid products. One of the permissible contracts recognised as the most frequently accessed form of contract in all major Islamic financial agreements is known as *wakalah* (agency). Literally, *wakalah* means looking after, taking custody, or applying skill on behalf of others.<sup>69</sup> Its operational models are twofold: they consist of pure *wakalah* and a combination of, for instance, *mudarabah* and *wakalah*.<sup>70</sup> In a pure *wakalah*, the agent (*wakil*) is not entitled to a profit in a PLS contract, but to an agreed agency fee based on his or her duties.<sup>71</sup> The principal (*mutawakkil*) bears the risks associated with the transaction. Exceptions are those that arise from the agent's negligence or misconduct.<sup>72</sup> In a combined *mudarabah* and *wakalah*, the agent is entitled to both an agent's fee for the efforts taken in managing the investment project, and to a share of the profit at an agreed ratio, once the investment has realised any such profit.<sup>73</sup> In order to be Sharia compliant, the *wakalah* agreement must not involve any of the prohibited practices, including the prohibition against *riba*. Like other Islamic financial contracts, *wakalah* (pure or combined) may be used as a "legal device" (*hilah*, or *hiyal* in the plural) in order to achieve certain objectives through legal means.<sup>74</sup> Although these objectives may be lawful or unlawful, *hiyal* are mostly used when it would be impossible to attain one's objective without violating the law.<sup>75</sup> In most cases, these legal stratagems are used in Islamic financing to circumvent the prohibition against *riba*, in order to frustrate the objectives of Sharia law.<sup>76</sup> For instance, parties may decide on a loan agreement without a predetermined interest so as to circumvent the prohibition against levying interest, by also entering into an agent agreement with the lender (as the agent), who is entitled to an excessive agency fee. The test for whether or not a particular legal device is lawful

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<sup>67</sup> Alrifai *Islamic Finance* 128.

<sup>68</sup> Abdul-Rahman *Art of RF* 264.

<sup>69</sup> Ayub *Understanding Islamic Finance* 347; Nuhtay and Salman 2013 *IJBSS* 129.

<sup>70</sup> Ab'Aziz *Islamic Banking in Malaysia* 103.

<sup>71</sup> Ab'Aziz *Islamic Banking in Malaysia* 103.

<sup>72</sup> Qaed 2014 *JRHSS* 73.

<sup>73</sup> Hasan "Structured Products" 223.

<sup>74</sup> Horii 2002 *ILS* 313.

<sup>75</sup> Horii 2002 *ILS* 313.

<sup>76</sup> Mansoori 2011 *JIBM* 71.

depends on whether or not the purpose of such a device is simply to overcome the rigidity and inconvenience of any prohibition in terms of the Islamic law.<sup>77</sup> The motive of the parties thus determines the legality or illegality of the contract.<sup>78</sup> The relevant question that must be asked in the context of Islamic banking and finance is "whether the legal device used amounts to a trick or deception in order to open a back door for prohibited *riba*".<sup>79</sup> This note will now discuss the facts of the case and how the SCA dealt with these principles as they arose in the factual disputes between the parties.

### 3 The facts in the *Lodhi SCA* case

The facts in the *Lodhi SCA* case arose from a relationship between the first appellant, Lodhi 5 Properties Investment CC ("Lodhi 5"), and the respondent, FirstRand Bank Limited ("FirstRand"). Lodhi 5 is one entity within the Lodhi Group. Another entity within the group is Lodhi 4 Properties Investments (Pty) Ltd ("Lodhi 4"), the second appellant. The third appellant, Mr Lodhi, is the sole member of Lodhi 5, which conducts the business involving rare and fine art, sporting goods, auctioneering and textile industries.<sup>80</sup> FirstRand offers to its Islamic customers specialised services and products that are compliant with Sharia law, in addition to its conventional banking products.<sup>81</sup> One of the products offered to Islamic customers is called Islamic Finance Residential Property Offering.<sup>82</sup> This involves an agency agreement that allows FirstRand to act as an agent when purchasing property on behalf of its customers in return for a fixed agency fee.<sup>83</sup>

In 2008 FirstRand loaned a sum of R9,6 million to Lodhi 5 in terms of an interest-free loan agreement.<sup>84</sup> The amount was loaned for the purchase of two properties in Kramerville, Johannesburg. This agreement provided that the loan amount would be repayable in 120 monthly instalments of R88 000. The parties also entered into an "Agency and Administration Service Agreement" in terms of which FirstRand acted as Lodhi 5's exclusive agent and purchased the property on the latter's behalf.<sup>85</sup> In return, Lodhi 5 would

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<sup>77</sup> Mansoori 2011 *JIBM* 70.

<sup>78</sup> Rosly and Sanusi 1999 <http://www.kantakji.com/media/8076/o1113.pdf>.

<sup>79</sup> Razak 2015 *EJIF* 7.

<sup>80</sup> *Lodhi SCA* para 2.

<sup>81</sup> *Lodhi SCA* para 3.

<sup>82</sup> *Lodhi SCA* para 3.

<sup>83</sup> *Lodhi SCA* para 3.

<sup>84</sup> *Lodhi SCA* para 3.

<sup>85</sup> *Lodhi SCA* para 6.

pay an additional 8% administration fee to FirstRand, which was also payable in 120 monthly instalments.<sup>86</sup>

As security for its indebtedness, Lodhi 4 and Mr Lodhi also executed a suretyship agreement in FirstRand's favour. In terms of this agreement, Mr Lodhi and Lodhi 4 would be liable to pay FirstRand all amounts owing in the event that Lodhi 5 was unable to perform its obligations under the loan agreement and agency agreement.<sup>87</sup> A covering mortgage bond was also registered over one of the properties in favour of the bank.<sup>88</sup> Lodhi 5 made regular payments in discharge of the loan until September 2009.<sup>89</sup> It later made a payment of R5 million in May 2010 towards the discharge of the loan from the insurance pay-out resulting from a fire which destroyed the building purchased through the loan granted to Lodhi 5.<sup>90</sup> No further payments were made thereafter.

Following these defaults in payment, FirstRand sent letters of demand to the appellants between April and May 2011, requesting them to make payments within 21 days from the dates of these letters, failing which they would be placed in mora and deemed unable to pay their debts.<sup>91</sup> Notwithstanding, none of the appellants responded to these letters. As a result, FirstRand launched an application in the HC to place Lodhi 5 and Lodhi 4 under final winding-up, and for Mr Lodhi to pay the outstanding amount on the loan.<sup>92</sup> FirstRand relied on both the loan agreement and agency agreement alleging that Lodhi 5 had fallen into arrears in terms of both agreements. It alleged that the sums of R3 609 331, 52 and R6 773 242, 73 remained owing as capital in terms of the loan agreement, and the balance of administration fees in terms of the agency agreement, respectively.<sup>93</sup>

## **4 The main issues**

### ***4.1 The issues and the decision in the High Court***

The parties approached the HC in three applications.<sup>94</sup> The first two related applications involved placing Lodhi 4 and Lodhi 5 under final winding-up

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<sup>86</sup> *Lodhi* SCA para 6; *Lodhi* HC para 19.

<sup>87</sup> *Lodhi* SCA para 3.

<sup>88</sup> *Lodhi* SCA para 3.

<sup>89</sup> *Lodhi* SCA para 4.

<sup>90</sup> *Lodhi* SCA para 4.

<sup>91</sup> *Lodhi* SCA para 5.

<sup>92</sup> *Lodhi* SCA para 6.

<sup>93</sup> *Lodhi* SCA para 6.

<sup>94</sup> *Lodhi* HC para 1.

based on their actual and deemed inability to repay their debtors in terms of the provisions of the old *Companies Act*<sup>95</sup> and the *Close Corporations Act*.<sup>96</sup> The court, per Molefe J, approved these applications on the basis of the alleged failure by these companies to respond to the letters of demand and to make payments in terms thereof. It also looked at their financial statements and concluded that each company's annual income "equat[e]d to just over one month's repayment in terms of the loan agreement", excluding the payment of operating expenses.<sup>97</sup> This was sufficient proof that they were unable to pay their debts.<sup>98</sup> The third application, which is important for the purpose of this discussion, relates to the money judgment against Mr Lodhi. In this regard FirstRand relied on the terms of the suretyship agreement. It argued that in the event that Lodhi 5 was placed under winding-up, Mr Lodhi would have no defence against FirstRand's claim and would be liable to make payment in terms of the suretyship agreement.<sup>99</sup>

The appellants did not deny the existence of a valid agency agreement.<sup>100</sup> However, they denied that any of the fees stipulated in the agreement were due and payable.<sup>101</sup> They raised several defences to support this position. Firstly, they invoked *exceptio non adimpleti contractus* and argued that FirstRand was not entitled to payment, as it did not render its own *quid pro quo*.<sup>102</sup> In particular, they argued that FirstRand had rendered no performance to earn any agency fee. Secondly, and related to the first defence, they invoked an alleged suspensive condition which has the effect of bringing both the loan and the agency agreements into effect upon signature by all parties.<sup>103</sup> They also alleged that a second offer to purchase had to be signed by the appellants and the seller in relation to the purchases of the two properties.<sup>104</sup> As none of these conditions had been fulfilled, they argued that FirstRand was not entitled to any agency fee.<sup>105</sup>

The third defence is important and requires closer examination. According to the appellants, the "fees" claimed by FirstRand under the agency

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<sup>95</sup> *Companies Act* 61 of 1973.

<sup>96</sup> *Close Corporations Act* 69 of 1984.

<sup>97</sup> *Lodhi* HC para 13.

<sup>98</sup> *Lodhi* HC para 28.

<sup>99</sup> *Lodhi* HC para 15.

<sup>100</sup> *Lodhi* HC para 16.

<sup>101</sup> *Lodhi* HC para 16.

<sup>102</sup> *Lodhi* HC para 16.

<sup>103</sup> *Lodhi* HC para 7.

<sup>104</sup> *Lodhi* HC para 22.

<sup>105</sup> *Lodhi* HC para 4.

agreement were "nothing but '*riba*'".<sup>106</sup> As a result, the only amount due and payable was the outstanding capital amount in terms of the loan agreement.<sup>107</sup> The argument with regard to the "*riba*" defence related to a clause in the loan agreement which provided that their transactions should be compliant with Sharia law, particularly the prohibition against the charging of interest.<sup>108</sup> They argued that the agency agreement amounted to the charging of the prohibited *riba*, which rendered it illegitimate. The essence of the argument was that the whole transaction was not Sharia-compliant. The defendants finally argued that FirstRand failed to meet its obligations in accordance with Sharia law, as the agreements were not explained to Mr Lodhi, but were based on the assumption that they would be entered into on the basis of the benefits of profit and risk sharing.<sup>109</sup> The written agreements therefore conflicted with the understanding of Mr Lodhi's "intention of the loan transaction".<sup>110</sup> For reasons that are discussed below, the appellants were unsuccessful in their defence, and therefore appealed to the SCA against both the winding-up and money judgment orders.

#### **4.2 The issues and the decision in the SCA**

The main issues on appeal were crystallised into the following questions: whether or not (a) Lodhi 4 and Lodhi 5 were correctly placed under winding-up; (b) the appeal should succeed partially by the reduction of the amount owed by Mr Lodhi to the outstanding capital amount; and (c) Mr Lodhi was liable to pay interest on such an amount, and if so, from which date. The SCA upheld the HC's ruling on the winding-up question for the same reasons. The discussion will therefore focus on the other questions raised on appeal, as they are relevant to the defences raised in relation to compliance with Sharia law and the prohibition of *riba*.

### **5 The decisions in the High Court and the SCA**

The main factual issue involved in this case was whether or not FirstRand was entitled to the restitution of the money advanced in terms of the loan agreement and, if so, whether or not the appellants were obliged to pay back the capital amount together with any additional amount. Secondly, whether or not it was entitled to any agency fee for the work done under the agency agreement. The issue whether or not any amount was due and

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<sup>106</sup> *Lodhi* HC para 16.

<sup>107</sup> *Lodhi* HC para 16.

<sup>108</sup> *Lodhi* HC para 19 and fn 10.

<sup>109</sup> *Lodhi* HC para 20.

<sup>110</sup> *Lodhi* HC para 21.

payable depended on whether or not the court upheld any of the defences raised by the appellants. In both the HC and the SCA the courts agreed on the winding-up of Lodhi 4 and Lodhi 5.<sup>111</sup> Both courts also ordered Mr Lodhi to pay FirstRand the money that was due and payable, together with interest.<sup>112</sup> However, for reasons that are discussed below, the courts differed on the amounts and reasons for such payments. They also differed in terms of the reasons whether or not these transactions were Sharia compliant.

In order to address the question regarding the reduction of the loan amount and the possible liability for interest, the SCA (as had the HC) had also to address the question as to whether or not the debt claimed was due and payable. The appellants did not deny that a certain amount of the capital sum remained owing under these contracts. Their main contention was that FirstRand had not accelerated the repayment of instalments in terms of the loan agreement.<sup>113</sup> Secondly, they argued that the payment of R5 million from the insurance proceeds amounted to the prepayment of 62 instalments and a year's worth of instalments in advance. Put differently, they were arguing that the payment made from the insurance effectively paid the monthly instalments for many months to come. Therefore, the full amount was not outstanding at the time of the application. Both the HC and the SCA disagreed with the argument pertaining to the acceleration of repayment. Both agreed with the bank's submission that a written notice by FirstRand to the applicants did actually reserve the right to declare all or part of the capital outstanding to be immediately due and payable and was therefore sufficient to accelerate the payment.<sup>114</sup> As the HC correctly held, the "notice did declare that the outstanding balance is due and payable".<sup>115</sup> The only right reserved, the court further held, "was to declare whether part or all the capital outstanding is due and payable".<sup>116</sup> That is, once the letter of demand served to accelerate the payment, it was left to each party to raise the issue as to how much was immediately payable.

Having decided that the amount was due and payable, the HC had to decide how much was payable. In this regard, it had to decide whether the money payable was only the outstanding capital amount or whether interest on that amount was payable and, if so, from which date. The applicants relied on

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<sup>111</sup> *Lodhi* HC para 24-27; *Lodhi* SCA para 17.

<sup>112</sup> *Lodhi* HC para 38; *Lodhi* SCA para 24.

<sup>113</sup> *Lodhi* SCA para 7.

<sup>114</sup> *Lodhi* SCA para 14; *Lodhi* HC para 23.

<sup>115</sup> *Lodhi* HC para 23.

<sup>116</sup> *Lodhi* HC para 23.

the following defence in this regard. They argued that FirstRand had failed to meet its obligation in terms of Sharia law because neither of the agreements had been explained to Mr Lodhi. As a result, he entered into these agreements with the understanding that they would be based on the sharing of profit, as well as any risk arising from the transactions.<sup>117</sup> Their position was basically that both agreements were generally void for non-compliance with Sharia law. They argued that the bank was not entitled to any interest as the agency fee "amounted to interest in breach of Shari'ah law".<sup>118</sup> Both the HC and the SCA dealt with this issue, but the HC analysed the applicable principles in more detail than the SCA. It dealt both with the issue of Sharia compliance and the issue of the interest that was payable. The HC looked at the fact that Mr Lodhi implemented all the transactions and accepted the benefits (of purchasing the house with the loan money and the extinguishing of existing debts).<sup>119</sup> It also took into account the personality of Mr Lodhi as "an astute businessman".<sup>120</sup> It further questioned Mr Lodhi's failure to explain why he knowingly, and applying Islamic principles, read and signed the agreements without any protest "if they were not Sharia compliant with his religious beliefs".<sup>121</sup> It therefore found his defence to be far-fetched and untenable.<sup>122</sup> This issue was not brought on appeal to the SCA as the parties limited their appeal to the questions of the winding-up and the amount payable.<sup>123</sup>

With regard to the amount that FirstRand was reclaiming, the HC and the SCA approached this issue differently. Having discussed some of the forms of financial transaction which are Sharia-compliant (such as *wakalah*), the HC analysed whether or not the loan agreement was Sharia-compliant.<sup>124</sup> It approached the matter by asking whether or not the loan transaction provided for a shared responsibility for profit and loss between the borrower and the lender.<sup>125</sup> After analysing both the loan and agency transactions, the HC concluded that the loan agreement between the parties was not a profit-sharing agreement.<sup>126</sup> Its reason was that "[t]he only party benefiting from this transaction was the respondents" (as they were in the lower

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<sup>117</sup> *Lodhi* HC para 30.

<sup>118</sup> *Lodhi* SCA para 7.

<sup>119</sup> *Lodhi* HC para 31.

<sup>120</sup> *Lodhi* HC para 31.

<sup>121</sup> *Lodhi* HC para 31.

<sup>122</sup> *Lodhi* HC para 31.

<sup>123</sup> *Lodhi* SCA para 7.

<sup>124</sup> *Lodhi* HC paras 32-35.

<sup>125</sup> *Lodhi* HC para 35.

<sup>126</sup> *Lodhi* HC para 36.

court).<sup>127</sup> It concluded that the transaction was a residential property offered with a fixed agency fee.<sup>128</sup> As a result it held, rather surprisingly, that the loan and agency agreements were Sharia-compliant.<sup>129</sup> It ordered Mr Lodhi to repay FirstRand a cumulative amount of R10 328 574,25 plus interest on the said amount, at the rate of 15.5% per annum calculated from the 18 April until date of the payment.<sup>130</sup>

The SCA also arrived at a similar decision. It ordered Mr Lodhi to repay FirstRand an amount of R2 642 006.95, together with interest thereon at the rate of 15.5% per annum from 15 June 2012 to the date of the appeal.<sup>131</sup> The SCA agreed with FirstRand's position that Mr Lodhi was liable for interest on the reduced sum at the legal rate of 15.5% at the material time. The SCA approached this issue by questioning the nature or the type of interest charged in terms of the agreements between the parties.<sup>132</sup> It held that the interest sought by FirstRand was not based on the enforcement of a contractual undertaking.<sup>133</sup> In the court's view, this interest was based on Lodhi's default in payment.<sup>134</sup> It reasoned that the interest was mora interest intended to compensate the party who suffered a loss as a result of "being deprived of the use of the capital for a period of time".<sup>135</sup> According to the SCA, the interest constituted damage that flowed naturally from the contract itself, due to a failure to perform a contractual obligation within the agreed time.<sup>136</sup> In the SCA's view, this obligation had "nothing to do with and is not affected by the Sharia law's prohibition against payment of interest on a loan debt".<sup>137</sup> It therefore found Mr Lodhi liable to compensate FirstRand for its failure to perform by the due date at a legal rate of interest as prescribed by section 1(2) of the *Prescribed Rates of Interest Act*.<sup>138</sup>

## 6 Critical analysis

The decision in *Lodhi 5* SCA thought to illustrate an eagerness in our courts to adjudicate on matters relating to Islamic law. Islamic banking law is

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<sup>127</sup> *Lodhi* HC para 36.

<sup>128</sup> *Lodhi* HC para 36.

<sup>129</sup> *Lodhi* HC para 36.

<sup>130</sup> *Lodhi* HC para 38.

<sup>131</sup> *Lodhi* SCA para 24.

<sup>132</sup> *Lodhi* SCA para 23.

<sup>133</sup> *Lodhi* SCA para 23.

<sup>134</sup> *Lodhi* SCA para 23.

<sup>135</sup> *Lodhi* SCA para 23.

<sup>136</sup> *Lodhi* SCA para 23.

<sup>137</sup> *Lodhi* SCA para 24.

<sup>138</sup> *Lodhi* SCA para 23.



already part of South African law.<sup>139</sup> The law has, however, yet to be given detailed explication by our courts. This poses a question as to whether our courts, which are grounded in the common law, are willing to adopt and apply the principles of Islamic banking in South African law. The HC in this case has, to a minimal extent, reached its decision by infusing some principles of Islamic banking law into its deliberations. However, it still left unanswered many relevant questions arising from the facts. The parties in this case had agreed that the agreement between them would be governed by Sharia law but they had failed to agree on the specific principles of Sharia law applicable to their agreement. As a result, there were questions that were left for judicial interpretation by the courts.

The first question that the SCA had to address was whether FirstRand was entitled to charge interest in addition to the capital. It is apparent that the parties intended that the agreement should be governed by Sharia law. As the SCA correctly approached the matter, it had to decide on whether or not these transactions were Sharia compliant. This raised the question as to whether or not FirstRand was entitled to anything more than the loan capital in terms of Sharia law. This question pertains to what Sharia law actually permits. The SCA (like the HC) was reluctant to attempt to interpret what the prohibition against *riba* entails. The HC's dismissal of the appellant's claim was based on its acceptance that Mr Lodhi implemented the entire transaction and accepted the benefits without any protest.<sup>140</sup> The court in this regard was able to expose the scope of possible abuses by defaulting debtors, who use the argument of the invalidity of Islamic law to avoid making payments in terms of transactions governed by this law. However, the HC's position that a financial transaction is permissible under Sharia law only if all parties share in the profit and loss in terms of the PLS principle is questionable. As indicated earlier, in certain transactions, loss can be borne fully by only one party.<sup>141</sup> This principle does not entail that profit always be shared among the parties. It simply requires that a financial transaction should have the sharing of profit and loss as its main aim. As a result, the sharing of profit and loss is not in itself the end, but only the means to a Sharia-compliant transaction. With respect, the HC erred by applying the PLS principle as a precondition for compliance with Sharia law. Despite holding that the parties did not share in the profit and loss in terms of the

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<sup>139</sup> *Albaraka Bank Ltd v Halaal Royal Snacks (Pty) Ltd* (SGHC) unreported case number 08400/2010 para 4, Mudarabah and other Islamic finance products are now incorporated into the *Income Tax Act 58 of 1962* in terms of the *Taxation Laws Amendment Act 24 of 2011*.

<sup>140</sup> *Lodhi* HC para 31.

<sup>141</sup> See para 4.2.1 above.

loan agreement, the HC further concluded, surprisingly, that the loan and agency agreements were Sharia-compliant. The question that remains is how these agreements can be thought to be Sharia-compliant if, in the court's view, all parties do not share in the profit and loss.

Likewise, the SCA avoided addressing the main issue before it, which was whether or not Sharia law applied to the transactions. It also did not deal with the question as to whether an additional amount claimed constituted a prohibited *riba*. Arguably, this was a question that required the Court to take the position of either the classical school or the contemporary Muslim school in this regard. Taking the former position would have led to the conclusion that FirstRand was entitled to the advanced capital amount only. The respondent would have been liable for only the outstanding capital amount advanced by the bank. Even taking the contemporary Muslim scholars' approach would not yield a different result. FirstRand did not, as the SCA concluded, claim interest based on the enforcement of a contractual undertaking.<sup>142</sup> The interest claimed was not in the nature of interest agreed upon in a contract, but the claim was based on the default of payment by a debtor. If the claim had been based on the enforcement of a contractual undertaking, the position of contemporary scholars would have been relevant. The court would be called upon to decide whether or not the chaff could be separated from the grain: in other words, whether or not an acceptable amount of additional profit could be separated from the prohibited exorbitant interest. Instead, the court decided the matter by looking at the nature of the interest claimed. It is submitted that the SCA ignored the parties' intention to subject their agreement to Sharia law.

Another question that the SCA left unanswered was whether or not the charging of mora interest in transactions subject to Sharia law is enforceable in South African law. The SCA's view was that the liability of the debtor to compensate the creditor for failure to perform on the due date "has nothing to do with and is not affected by the Sharia law's prohibition against payment of interest on a loan debt".<sup>143</sup> While the rights under common law cannot be denied by the application of Islamic law principles, the defence regarding *riba* was purely on the basis that Sharia law governed the agreement between the parties. Payment of this interest had to be decided in terms of what Sharia law permits. When applying Sharia law, the bank's claim for default interest in this case could not be regarded as either *tawhid* or *gharamah*. There is no indication that the claim for default interest would not

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<sup>142</sup> *Lodhi SCA para 23.*

<sup>143</sup> *Lodhi SCA para 23.*

constitute an additional income to FirstRand, nor is there any indication that the money would be given to charity, as suggested by contemporary Islamic scholars. Therefore the SCA's focus on attempting to establish the type of interest in question was totally unrelated to the parties' intention that the agreement should be governed by Sharia law.

Having decided on the nature of the interest claimed under the loan agreement, the SCA further failed to address the question as to whether or not the fees under the agency agreement constituted *riba*, as claimed. This failure denied the parties an opportunity to address their dispute on this point. In order to rule on this question, the court would first have had to address the defence of *exceptio non adimpleti contractus*. If successful, this defence would allow the appellants to withhold the payment of agency fees until FirstRand had performed in terms of the agency agreement. This defence, however, would still not hold any ground, as FirstRand actually purchased the properties on behalf of the respondents, who subsequently registered a mortgage bond over the properties.<sup>144</sup> If it were accepted that there was a *quid pro quo* on behalf of FirstRand, it would have had to be determined whether or not the payment of the claimed agency fees would have constituted *riba*. This would have been purely a matter of interpretation of the Islamic law. The charging of agency fees is accepted by both classical and modern Muslim scholars, as already indicated.<sup>145</sup> Unless the use of loan and agency agreements (as hybrid *murabaha* and *wakalah*) in this case could be regarded as *hilah* to circumvent the strict prohibition against *riba* under the loan agreement, by charging agency fees in terms of the agency agreement, FirstRand would be entitled to the agency fees once it was established that it had rendered performance in terms of this agreement. In this regard, the appellants would have needed to prove only that the agency agreement was intended to achieve an unlawful objective under the loan agreement, with the intention of circumventing the prohibition against *riba*. In the absence of this proof, the HC and the SCA were therefore correct in concluding that the agency agreement was Sharia-compliant, notwithstanding their failure to analyse the relevant principles in this regard. The agency fee was payable, as FirstRand has performed by buying the property on behalf of the appellants.

The SCA's conclusion that the respondents' obligation to pay default interest had nothing to do with and was not affected by Sharia law's prohibition against the payment of interest also left much to be desired with regard to

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<sup>144</sup> *Lodhi SCA* para 3.

<sup>145</sup> See para 4.1 above. Also see Kusheni and Hayat *Contracts and Deals* 11.

the enforceability of Islamic law by our common law courts. This problem exists mostly in those jurisdictions in which the legal systems are secular, such as the United Kingdom. Common law is still dominant, as judicial officers lack the necessary expertise to address disputes arising in terms of the enforcement of Sharia law.<sup>146</sup> As a result, the courts adopt a dismissive approach to the parties' choice of Sharia law as the governing law for their transactions. Expert views on Islamic law are often ignored in favour of the application of the national law.<sup>147</sup> Contractual disputes are resolved by applying the law of the country in question, disregarding the intention of the parties and the commercial goals of Islamic finance law.<sup>148</sup>

In the UK, for instance, leading cases<sup>149</sup> involving *murabaha* agreements between the financial institutions and their customers provided for a choice of English law or "the principles of the Glorious Sharia" as the governing law. In these cases the UK courts accepted English law as the governing law and therefore ignored the intention of the parties to subject their agreement to Sharia principles. The attitude of English courts towards the enforcement of Islamic banking law is exemplified by Potter<sup>150</sup> as follow:

It was improbable in the extreme, that the parties were truly asking the English court to get into the matters of Islamic religion and orthodoxy.

The court further characterised the reference to Sharia law as being simply a reference to Islamic religious principles for conducting banking business, rather than to a system of law which could trump the application of English law.<sup>151</sup> In justifying its stance, the court relied heavily on the existence of controversy arising from the existence of various schools of thought regarding the application of Islamic law.<sup>152</sup> Controversial as the approach of the UK courts is, they have made their standpoint on the enforcement of Sharia law quite clear: English law trumps Sharia law in conflict of law matters. The position in South Africa, however, remains unclear. The approach by the HC seems to hold out a "jurisprudential promise" of

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<sup>146</sup> Ginea and Hamid *Foundations* 104.

<sup>147</sup> Yaacob 2011 <http://ifikr.isra.my/documents/10180/16168/19.pdf> 5.

<sup>148</sup> *Beximco Pharmaceuticals Ltd v Shamil Bank of Bahrain EC* 2004 APP LR 01/28.

<sup>149</sup> *Islamic Investment Company of Gulf (Bahamas) Ltd v Symphony Gems NV* 2002 WL 346969 (QB Comm Ct 13 February 2002); *Beximco Pharmaceuticals Ltd v Shamil Bank of Bahrain EC* 2004 APP LR 01/28; *The Investment Dar Company KSCC v Blom Developments Bank SAL* 2009 EWHC 3545 (Ch).

<sup>150</sup> *Beximco Pharmaceuticals Ltd v Shamil Bank of Bahrain EC* 2004 APP LR 01/28 para 41.

<sup>151</sup> *Beximco Pharmaceuticals Ltd v Shamil Bank of Bahrain EC* 2004 APP LR 01/28 para 54.

<sup>152</sup> *Beximco Pharmaceuticals Ltd v Shamil Bank of Bahrain EC* 2004 APP LR 01/28 para 54.

interpreting and enforcing Islamic law. Its pronouncement about the requirements of a PLS principle is an indication that the court is willing to entertain disputes relating to the enforcement of financial transactions governed by Islamic law. However, the decision of the SCA flies in the face of this approach. To reiterate, the judicial officers in *Lodhi SCA* were arguably called upon to enforce the agreements between the parties in accordance with Islamic law, as the parties intended. However, the SCA chose to address the main question as to whether or not the agreements involved a prohibited *riba* outside the scope of the governing clause of the loan agreement between the parties by asking whether or not default interest was payable due to the loss, which is "compensated by an award of mora interest".<sup>153</sup> The SCA was implicitly adopting the English approach of applying the common law applicable to banking law in South Africa, instead of the Islamic law chosen by the parties. Unlike the English courts, the HC and the SCA did not call for experts on Sharia law to advise on the possible solution to this dispute. As the Malaysian Appeal Court correctly pronounced:

... judges in civil court[s] should not take upon themselves to declare whether the matter is in accordance to the Religion of Islam or otherwise as it needs consideration by eminent jurists who are properly qualified in the field of Islamic jurisprudence.<sup>154</sup>

Unless such matters can be referred to available specialised forums, they definitely calls for the opinion of experts who could provide insight into the Islamic principles at play in such cases. One should, however, acknowledge that there are differences in matters of the interpretation of Islamic law amongst Sharia experts. Civil courts should nevertheless be able to take into account different views and opinions and have the power to make a final determination on such matters. Their views are important when they adjudicate on issues that require the interpretation of Islamic law. The SCA in this case should have invited experts in Sharia law to assist with the adjudication of the issues before it. Had the SCA based its decision on the governing law in terms of the agreement between the parties, it would not have been necessary to conclude that Mr Lodhi was liable for default interest. Its failure to apply or pronounce on its position regarding the enforcement and interpretation of the governing law clause in this case leaves open the question as to whether or not parties to financial agreements governed by Islamic law can rely on the courts for the resolution of their disputes. This question that will remain open until another similar

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<sup>153</sup> *Lodhi SCA* para 23.

<sup>154</sup> *Bank Islam Malaysia Berhad v Lim Kok Hoe* 2009 6 MLJ 839 840.

issue comes before our courts, and they are willing to guide us on the enforceability of Islamic banking law. The SCA's reluctance to entertain this question also leaves open other questions regarding the contents of the agreements by the parties in terms of Islamic law. These questions include the following: what the ambit of the *riba* prohibitions is (the question of whether the chaff can be separated from the grain); whether or not hybrid loan and agency agreements are simply unlawful legal devices (*hiyal*) meant to circumvent the strictness of Sharia law; and whether or not the Islamic Finance Residential Property Offering (as provided to the appellants in this case) as well as agency fees charged in terms of an agency agreement are Sharia-compliant under South African law.

## 7 Conclusion

The decision in *Lodhi 5 SCA* provides some lessons to both parties entering into transactions incorporating Sharia law as the governing law, as well as to judicial officers regarding the challenges in terms of enforcing this law. To the former, a simple lesson is the reluctance of our secular courts to accept the application of Islamic finance principles. This reluctance creates challenges with regard to which forum is capable of addressing disputes arising from transactions based on Islamic finance principles. This reluctance is evident in this case, as the court did not address the dispute between the parties in terms of their choice of law. What is evident in this judgement is that the court had no knowledge of what the principles of Sharia law are. The SCA's failure to invite experts in Sharia law to provide guidance on the applicable Islamic law remains a cause for concern, particularly in terms of whether or not parties can in future expect our courts to enforce agreements based on Islamic law. As already indicated, the court failed to take a stand on whether or not it might enforce Islamic law. It could also not address several questions that were posed to it such as the content of a *riba* prohibition, and whether or not agency fees in terms of *wakala* agreements as well as the use of hybrid contracts of *murabaha* and *wakala* (as in this case) are Sharia-compliant. These questions will remain unanswered until another similar case comes before our courts.

South African courts need to clearly indicate whether or not they are willing to enforce and apply Islamic finance law as the governing law of a particular transaction.

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### LIST OF ABBREVIATIONS

AJBM	African Journal of Business Management
AJSMS	American Journal of Social and Management Sciences
CEPMLPAR	The Centre for Energy, Petroleum and Mineral Law and Policy Annual Review
CILSA	Comparative and International Law Journal of South Africa
EJIF	European Journal of Islamic Finance
GJAT	Global Journal Al-Thaqafah
GJICL	Georgia Journal of International and Comparative Law
HC	High Court
HI	Hamdard Islamus
IJBSS	International Journal of Business and Social Science

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IJEFI	International Journal of Economics and Financial Issues
ILS	Islamic Law and Society
JIBM	Journal of Business and Management
JRHSS	Journal of Research in Humanities and Social Sciences
LJLC	Leeds Journal of Law and Criminology
PLS	Profit and Loss Sharing
SCA	Supreme Court of Appeal
UK	United Kingdom