18 of 61 DOCUMENTS

2008
Volume 6

[2008] 6 MLJ xiv; [2008] 6 MLJA 142008 6 MLJ xiv; 2008 6 MLJA 14

2008Article: AL-BAI BITHAMAN AJIL - ITS CONSISTENCY WITH THE RELIGION OF ISLAM: WITH SPECIAL REFERENCE TO ARAB-MALAYSIAN FINANCE BHD V TAMAN IHSAN JAYA SDN BHD & ORS AND OTHER CASES

Ashgar Ali Ali Mohamed LLB(Hons), MCL (IIUM), LLM (Hons)(NZ), PhD (Business Law)Ahmad Ibrahim Kulliyyah of LawsInternational Islamic University Malaysia

[*14]

INTRODUCTION

Islam is not merely a religion but a complete way of life. It encompasses a legal, social and moral order aimed at construing the entire fabric of human life and culture in the light of values and principles revealed by Allah (SWT) for our guidance. Its decrees and rules are to ensure prosperity and peace on earth and in the hereafter. n1 Shariah or Islamic law is applicable in all aspects of life and this includes the economic and financial aspects. Banking is an important financial and social institution which has contributed greatly to the development and growth of the modern industrial society. The Islamic banking, which is a system of banking that complies with the Shariah, is legal and permissible in Islam based on the *hadith* of the Prophet SAW. Abu Al-Minhal narrated that he asked Prophet SAW about money exchange. He replied, If it is from hand to hand, there is no harm in it; otherwise it is not permissible . n2 Having stated the above, this article will consider the recent High Court s decision in *Arab-Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors and Other cases*. In the above case, Abdul Wahab Patail J had considered the legality of the BBA facility in the context of the phrase Islam and the religion of Islam in the Federal Constitution, the Islamic Banking Act 1983 and the Banking and Financial Institutions Act 1989. [*15]

Prohibion of Riba and the Emergence of Islamic Banking Business

Prohibition of riba

A substantial part of the operation of the conventional banking and financial system is not in line with the Shariah principles because they charge interest on all lending contracts. Muslims are prohibited from taking or giving interest (*riba*) regardless of the purpose for which such loans are made and regardless of the rates at which interest is charged.

The prohibition of *riba* is mentioned in four different sections in the Qur an, namely, *Surah Al-Rum*, verse 39; *Surah Al-Nisa*, verses 160-161; *Surah Ali-Imran*, verse 130 and *Surah Al-Baqarah*, verses 275-281. The first verse emphasises that interest deprives wealth from God s blessings. The second condemns it, placing interest with wrongful appropriation of property belonging to others. In the third reference, it instructs Muslims to stay clear of interest for the sake of their own welfare and the fourth establishes a clear distinction between interest and trade, urging Muslims to take only the principal sum and to forgo even this sum if the borrower is unable to repay.

The prohibition of interest is also referred to in no uncertain terms in the *hadith*. The Prophet Mohammed SAW condemned not only those who take interest but also those who give interest and those who record or witness the transaction. From Jabir: The Prophet SAW cursed the receiver and the payer of interest, the one who records it and the two witnesses to the transaction and said: They are all alike (in guilt) . n3 Again, from Abu Said al Khudri: The Prophet SAW said: Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, salt for salt - like for like, and hand-for-hand. Whoever pays more or takes more has indulged in r*iba*. The taker and the giver are alike . n4

The rational of the prohibition is that it creates selfishness, miserliness, greed and malevolence. n5 The very act of lending money [*16] on the basis of *riba* reflects the fact that the lender only cares for the principal, and *riba* on it that has to be paid by the borrower under all circumstances. Yusuf al-Qaradawi aptly stated: in a society in which interest is lawful, the strong benefit from the suffering of the weak. As a result, the rich become richer and the poor poorer, creating social-economic classes in the society separated by wide gulfs. Naturally this generates envy and hatred among the poor towards the rich, and contempt and callousness among the rich toward the poor. Conflicts arise, the social-economic fabric is rent, revolutions are born, and social order is threatened. Recent history amply illustrates the dangers to the peace and stability of nations inherent in interest-based economies. n6

In *Malayan Banking Bhd v Ya kup bin Oje & Anor*, n7 Hamid Sultan Abu Backer JC stated:
Islamic law of commercial transactions is fundamentally rooted on the premise of total eradication of *riba* and *gharar* (uncertainty). It is seen as a coherent system designed to cater to human welfare to achieve maximum benefit. The law of commercial transaction balances the moral and material needs of society to achieve social-economic justice. The very objective of the Shariah is to promote the welfare of the people, which lies in safeguarding their faith, life, intellect, posterity and property.

In *Mahmood ur Rahman Faisal v Secretary Ministry of Law*, n8 the Federal Syariah Court of Pakistan held that interest charged in loans and given on deposits by banks falls within the definition of *riba* and that it makes no difference whether the loan is taken for consumption purposes or for productive purposes, ie, for trade, commerce and industry and thus, made an order that all banks in Pakistan adopt Islamic principles in eliminating all elements of *riba* from their operation. On appeal, the Shariah Appellate Bench of the Supreme Court of Pakistan delivered its judgment in December 1999 upholding the decision of the trial court banning interest in all its forms and by whatever name it may be called.

Emergence of Islamic Banking Business

Since, *riba* is strictly forbidden in Islam, Muslims have opted for the Islamic banking products and services. The Islamic banks provide an [*17] interest-free banking system and their business is operated parallel with the framework of Islamic requirements and Shariah principles. There are currently 36 banks in Malaysia - 22 conventional banks n9 and 14 Islamic banks established pursuant to the Islamic Banking Act 1983. n10 The Islamic banks above include foreign financial institutions carrying the international Islamic banking business in Malaysia. n11 Apart from the above, the Central Bank of Malaysia has, since 1993 allowed the existing commercial banks to offer Islamic banking products and services n12 on a parallel basis with their conventional [*18] banking services. n13 The conventional banks are authorised to offer exactly the same products and services that comprise the Islamic bank business. n14

In *Arab-Malaysian Merchant Bank Bhd v Silver Concept Sdn Bhd*, n15 Suriyadi Halim Omar J stated:

The Islamic banking system, currently co-existing with the civil banking system in Malaysia, is the extraction of the essence of Islamic Jurisprudence or Shariah, sourcing from the *al-Quran* and *Al-Sunnah/ahadith* and is here to stay. These two sources are the only God sanctioned sources in Islam. Despite all the unknown fears, bits and pieces have been picked up and pieced together, and finally seeing a wholesome and identifiable Islamic banking system moulded from these two sublime sources. It saw statutory reality with the promulgation of the Islamic Banking Act 1983, primarily to provide for the setting up and licensing of Islamic banks, falling within the jurisdiction of the civil law and applying the civil court procedures (*BIMB v Adnan bin Omar* [1994] 3 AMR 2291; *Tinta Press Sdn Bhd v Bank Islam Malaysia Bhd* [1987] 2 MLJ 192; *Dato Haji Nik Mahmud v Bank Islam Malaysia Bhd* [1998] 3 MLJ 393). [*19]

All transactions of an Islamic bank, including the products and services offered by it, will have to be first approved by its Shariah advisory body, established under s 3 of the Islamic Banking Act 1983. The commercial banks offering Islamic banking products and services on a parallel basis with their conventional banking services are also required to establish a Shariah advisory committee. The establishment of a Shariah advisory committee is important to serve as a check and balance to ensure that the management and operations of the Islamic banking institutions do no deviate from the Islamic principles in the formulation of their policies. n16

Opting for Islamic Banking Facility: Whether Parties Allowed to Contend the Hardship of the Scheme Compared to Conventional Banking

Having stated the above, a pertinent question that arises from this is whether the parties who have selected the Islamic banking facility of their choice based on freewill, from those available in the market, can be allowed to argue for example, that the Islamic banking scheme is more burdensome than the conventional banking one ? In *BIMB v Adnan bin Omar*, n17 it was held that the parties were bound by the terms of the contract and they were estopped from raising such arguments. In other words, the parties were debarred from repudiating their liability under the contract, save on grounds of undue pressure, coercion or misrepresentation, among others.

Again, in *Bank Kerjasama Rakyat Malaysia Bhd v PSC Naval Dockyard Sdn Bhd*, n18 Rohana Yusuf J stated:

fulfilment of a promise in Islam is a religious demand. In Chapter 5 Verse 1, the *Quran* declares that: *O you who believe! Fulfill all your obligations*. A covenant is a solemn undertaking or engagement between man and his obligations to God, between man and his soul and between the individual and his fellow men which covers the entire area of a man s moral and social responsibilities. In Chapter 17 Verse 34, the importance of fulfilling of one"s promise is again stressed when the Verse states: *And fulfill (every) engagement, for every engagement will be enquired into (on the day of reckoning)*. These verses show that a contract in Islamic Jurisprudence is [*20] not a mere binding legal relation but is based on certain moral and religious principles.

However, in *Malayan Banking Bhd v Ya"kup Oje & Anor*, n19 Hamid Sultan Abu Backer JC stated:

If a contract between the contracting parties becomes an instrument of injustice, a judge cannot ignore the unfairness and insist on strict adherence to the letter of the contract. Hence, a judge is empowered to set aside a contract when the fact discloses gross unfairness on one of the parties as the Islamic system is a just and equitable system that promotes close relationship between the banks and the customers based on co-operation and the equitable sharing of risks and rewards.

Islamic Banking Matters: Within Jurisdiction of Civil Courts

It must be noted that since banking and its related matters are enumerated in the Federal List, therefore, the appropriate court to deal with the Islamic banking disputes is the civil court and not the Shariah Court. Banking, finance and insurance are matters enumerated in the Federal List, items 7 and 8 respectively. The ascertainment of whether a particular product of banking, finance and insurance (or *takaful*) is Shariah-compliant or not falls within item

4(k) and is a federal matter . n20

In *Bank Islam Malaysia Bhd v Adnan bin Omar & Ors*, n21 a case involving a suit filed by Bank Islam for the recovery of money owing pursuant to a guarantee, the defendant raised the preliminary objection that as the plaintiff was an Islamic bank, therefore, by virtue of art 121(1A) of the Federal Constitution, the civil court had no jurisdiction to hear the case. It was counter-argued that since the plaintiff was a corporate body, it did not have a religion, and as such, it was not within the jurisdiction of the Shariah courts. The High Court dismissed the preliminary objection. It was stated, inter alia, that: (a) Shariah courts can only decide cases that fall under the State List. The above list excludes any case relating to commercial laws such as Islamic banking; and (b) Shariah courts can only decide a case when all the parties are Muslims. Since BIMB is a corporate entity created by statute, it does not prescribe to any religion, and as such, it is not within the jurisdiction of the Shariah courts. [*21]

Again, in *Bank Kerjasama Malaysia Bhd v EMCEE Corp Sdn Bhd*, n22 the Court of Appeal held that although the appellant granted the respondent a loan facility of RM20m under the Islamic banking principle of *Al-Bai Bithaman Ajil*, that did not mean that the law applicable in this application was different from the law that was applicable if the facility were given under conventional banking. The charge in this case was a charge under the National Land Code. The remedy available and sought was a remedy provided by the National Land Code. The procedure was provided by the Code and the Rules of the High Court 1980. The court adjudicating it was the High Court. So, it was the same law that was applicable, the same order that would be, if made, and the same principles that should be applied in deciding the application. It may be noted however, that certain provisions of the substantive and procedural laws are in conflict with Islamic law. n23 For example, in foreclosure proceedings under O 83 r 3(3) of the Rules of the High Court 1980, the applicant is required to state, in the affidavit in support of the application, the principal amount due and the interest accrued up to date.

Competency of civil court judges in dealing with Islamic law matters was noted by YA Hamid Sultan JC in *Yong Fuat Meng v Chin Yoon Kew*. n24 It will be a dereliction of my duty as a judge of the High Court of His Majesty to support any proposition that knowledge of Islamic principles and law lies with the Islamic courts or Islamic jurists only, since the religion of Islam is a universal religion. In consequence, the principles, practice and its jurisprudence are easily understandable by any literate person provided he ventures into reading the text and materials on the subject matter. And all His Majesty s judges are equally competent to deal with the matter. This statement is well evidenced by various scholarly texts written on Islamic Jurisprudence by non-Muslims, and various judgments by the Privy Council, etc with the bench consisting of non-Muslims, (see BR Verma s *Islamic Law - Personal*, (6th Ed) 1991). The scholarly texts such as the *Hedaya* and various judgments have been well received by the Muslim community ... it must also be emphasised here that it [*22] is wrong to assume that essentially Islamic jurists or lawyers trained purely in the secular law can confront issues relating to Islam as it needs a fair appreciation of the Federal Constitution and the related principles, since the dominant foundation of the public s right is encapsulated in the Federal Constitution. When the issue is only in relation to simply the personal law of the Muslims and which is not in any way related to the validity of any of the provisions of Shariah state ordinance and/or direct interest of non-Muslims, it is trite that the right forum under the Federal Constitution is the Shariah Court . n25

Al-Bai Bithaman Ajil (BBA) Financing Scheme

The BBA scheme is an Islamic financing facility for the purchase of a residential property on a deferred payment which is based on the Shariah concept. The Islamic banking institution earns a profit by purchasing the asset and subsequently selling it back to the customer at a mark-up price on a deferred payment basis. Under the above scheme, usually the purchaser would purchase the property from the vendor and would have paid the deposit or part of the price. To complete the purchase of the property, the purchaser would normally apply for a loan. To obtain the BBA facility, the purchaser is required to sell the said property to the bank for the balance sum under a bank s property purchase agreement (PPA). The bank would then sell the same property to the purchaser under a bank s property sale agreement

(PSA). n26 The bank s selling price of the property would include the bank s profit margin as agreed to by the parties and its repayment is *vide* monthly instalments of a specified sum over a certain period. As a security, the purchaser is required to execute a charge or an assignment of the property to the bank. Having said the above, in recent years, the Islamic financing facility under the concept of *Al-Bai Bithaman Ajil* (BBA) has attracted numerous judicial considerations.

Premature Determination of the BBA Scheme: Whether the Bank May Claim the Full Sale Price of the Property

In the event the borrower prematurely terminates the scheme, the question arises as to whether the bank is entitled to claim from the borrower the full sale price of the property less what had been paid. In other words, if a person who had obtained the BBA financing [*23] scheme prematurely determines the contract, can he be made liable to pay an amount far higher that what he would have been liable to pay had he opted for the conventional loan with interest?

In *Affin Bank Bhd v Zulkifli bin Abdullah*, n27 it was held that the profit margin charged over the unexpired part of the loan tenure was contrary to common sense and logic. Abdul Wahab Patail J delivering the judgment of the court stated:

> The profit margin that continued to be charged on the unexpired part of the tenure cannot be actual profit. It was clearly unearned profit. It contradicted the principle of *Al-Bai Bithaman Ajil* as to the profit margin that the provider was entitled to. Obviously, if the profit had not been earned it was not profit, and should not be claimed under the *Al-Bai Bithaman Ajil* facility.

Again, in *Malayan Banking Bhd v Marilyn Ho Siok Lin*, n28 it was held that it would not be equitable to allow the bank to recover the sale price as defined in the instrument when the tenure of the facility was determined prematurely.

More recently, in *Malayan Banking Bhd v Ya kup bin Oje & Anor*, n29 Hamid Sultan Abu Backer JC stated:

> Islamic Administration of justice will never permit traders or venture capitalists to strip the loin cloth of the borrowers. This is one of the major distinctions from the secular system. Under the secular system, contracts can be framed reducing all risks and earn a profit by way of interest. Under the Syariah Administration of justice, such legal trick and scholarly arguments to perpetuate injustice will not be entertained.

The learned judge added:

> The fixing of profit or definite returns in terms of percentage as opposed to sharing of profits in Shariah banking activities are more akin to *riba* than trade. It must be emphasised that the basic and most important characteristic of Islamic financing is that it does not deal with fixed interest rate or pre-determined profits. It is based on a profit and loss sharing contract. In crux, it is equity-based financing. In other words, Shariah banking principles invite banks to be venture capitalists rather than lenders.

As from the above, in the event the BBA contract was prematurely determined upon default by the borrower, the bank is not entitled to claim the full sale price less what had been paid by the borrower. [*24] Therefore, just and equitable rebate must be considered taking into account the prevailing market force. The learned judge added:

> Courts have to ensure that nobody exploits the public by dubious methods and propagates justification through formulas and concepts with which the public is not well acquainted currently. It is the constitutional obligation of the courts to ensure that at all material times, justice prevails in the right perspective, both for Islamic Banks as well as customers. In this respect, the courts must not reduce the status of Shariah banks to charitable institutions but ensure and respect that they are trading institutions entitled to earn profits out of their investment and only in exceptional circumstance such as where there is default to adjust their profits according to the facts and justice of the case as required under the Shariah principles and practice. n30

Arab-Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors and Other cases: A Review

More recently, the BBA scheme was once again considered by the High Court in the following cases *Arab-Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors*; n31 *Bank Islam Malaysia Bhd v Ghazali bin Shamsuddin & Ors*; n32 *Bank Islam Malaysia Bhd v Nordin bin Suboh*; n33 *Bank Islam Malaysia Bhd v Peringkat Raya (M) Sdn Bhd & Anor;* n34 *Bank Islam Malaysia Bhd v Ramli bin Shuhaimi & Anor*; n35 *Bank Islam Malaysia Bhd v Azhar bin Osman*; n36 *Bank Islam Malaysia Bhd v Mohd Razmi bin A Rahman & Anor*; n37 *Bank Islam Malaysia Bhd v Nor Azlina bt Baharom*; n38 *Bank Islam Bhd v Zawawi bin Osman & Anor*; n39 *Bank Islam Bhd v Mohammad Rizal bin Othman & Anor*; n40 *Bank Islam Bhd v Baharom bin Harun & Anor*; n41 *Bank Islam Malaysia Bhd v Nadiah Chai bt Abdullah & Anor* n42 (hereinafter referred to as the *Arab-Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors and other cases*). [*25]

In the above cases, Abdul Wahab Patail J had requested counsel for all the parties to present their submissions collectively. It was so ordered so as to ensure a more comprehensive consideration of the dispute so that a more consistent result would be derived as to the basic principles concerning the Islamic financing facilities. The primary consideration of the court, in the above cases, was concerning the legality of the BBA facility in the context of the religion of Islam in the Federal Constitution, the Islamic Banking Act 1983 and the Banking and Financial Institutions Act 1989.

At this jucture, it would be appropriate to consider the phrase Islam and religion of Islam as provided in the above mentioned statutes. By virtue of art 3 of the Federal Constitution, Islam is the religion of the Federation. Islam therefore has a special position in Malaysia, with the Ruler of a State of the Federation being the head of the religion of Islam in his State and the Yang di-Pertuan Agong being the head of the religion of Islam in the Federal Territories of Kuala Lumpur, Labuan and Putrajaya in addition to being so in his own state and in the states of Malacca, Penang, Sabah and Sarawak. n43

However, the Islamic religion dealt with under art 3 is limited to rituals and ceremonies. n44 In the case of *Fatimah bte Sihi & Ors v Meor Atiqulrahman bin Ishak & Ors (Minors, suing through Syed Ahmad Johari bin Syed Mohd)*, n45 which concerns the rights of Muslim pupils in a school to wear *serban*, the High Court had decided in favour of the pupils, holding inter alia that art 3 of the Federal Constitution should be interpreted to mean that the religion of Islam exceeds rituals and ceremonies, and that the government is given the responsibility to protect and promote Islam as best as it could. However, on appeal, the Court of Appeal overruled the decision of the court below. It stated instead that whether or not the wearing of *serban* forms an integral part of the religion of Islam involves a question of evidence and it was for the respondents to adduce sufficient relevant admissible material to prove that the wearing of *serban* was mandatory in Islam, something which the respondents were unable to do. n46 [*26]

The observation by Suriyadi Halim Omar J in *Arab-Malaysian Merchant Bank Bhd v Silver Concept Sdn Bhd,* n47 regarding the phrase religion of Islam is worth reproducing:

It does not speak of a Malaysian oriented religion of Islam, Islam practised by a particular branch in the Muslim world or *mazhab* or in words to that effect, but simply religion of Islam. That being so it must be in the original format as revealed through Prophet Muhammad ordained by Allah, before the birth of the sectarian groups. The *al-Quran* has clearly injuncted that the only source of guidance is what has been laid down in it, as revealed by Allah through Prophet Muhammad, and the authentic *hadith* (traditions and actions of the prophet; *al-Quran V 5:49; V 7:3; V 59:7*). The *al-Quran* as a source is not a problem, as it has remained unchanged since its revelation, and no Muslim of whatever sect will suggest otherwise. The problem is the *al-Sunnah*. This collection of traditions, sayings and actions has had its fair share of controversy, in the like of their acceptance by branches of followers (sects), generally termed as *mazhabs*. The major ones are the Hanafi, Maliki, Shafie, and Hambali. To some, hereinafter referred to as purists or fundamentalists, a word made respectable by the former Malaysian Prime Minister, to even accede to the *mazhab"s* concept is *per se* blasphemous, as in the eyes of Islam they would have committed sin, for having divided the religion of Islam into different sects (*Al-Quran* 6: 159). Without wanting to stir any hornet"s nest, during the life time of Prophet Muhammad, these *mazhabs* never existed and Islam as propagated by him was the solitary sect. As far as any purist is

concerned only the *mazhab* of Muhammad existed then. The sects that came after him were never revealed through him by the Almighty, and surely if He had wanted it sanctioned He would have revealed it through the prophet. His prophecy of his followers splitting up into seventy-three sects, with only one acceptable group religiously adhering to his sublime teachings, has given further ammunition to these purists. With the procreation of these sects, came the predictable different interpretations of the abovementioned two sources. Certain sects, apart from giving different interpretations have created further discord, by challenging even the very existence and authenticity of some of the *hadiths*. Surely all these differences do not augur well for the ordinary Muslim on the road, especially the non-Arabic speaking Muslim populace. These are only a few of the headaches faced by the legislators and propagators of the Islamic banking system. With Allah at V 5: 3 having said that He had perfected the Islamic religion as chosen by him (*see also Bukhari and Muslim*), and all Muslims must only refer to the *al-Quran* and the *hadith*, it takes a brave and perhaps [*27] suicidal government to codify and create another competitive source of reference for consideration. Perhaps that is the main reason why an Act in the like of the Contracts Act 1950, but catering to Islamic prerequisites has yet to see the daylight of a successful legislation.

As from the above observation, the phrase religion of Islam should be construed with reference to the primary sources of Islamic law namely, the *al-Quran* and the tradition of the Prophet SAW. Further, its interpretation should not be limited with reference to a particular *mazhab*. In *Yong Fuat Meng v Chin Yoon Kew*, n48 Hamid Sultan JC stated:

When reference is made to personal law of a Muslim, it extends only as much as to the original source and the development by application of *ijma* or *qias* etc by various *madhabs*. It does not extend to administrative laws or civil or criminal laws in practice in various Muslims states for the good governance of the country, even though it may have been under the guise of Shariah law.

Having stated the above and reverting back to *Arab-Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors and Other cases*, Abdul Wahab Patail J had, on 18 July 2008, delivered the written judgment rejecting the plaintiffs interpretation of the bank s selling price and instead applied the equitable interpretation. It was stated that where the bank had purchased the property directly from its customer and thereafter sold the same to the customer with deferred payment at a higher price in total, it is not a *bona fide* sale but a mere financing transaction. It was further stated that the profit portion of such a BBA facility rendered the facility contrary to the Islamic Banking Act 1983 or the Banking and Financial Institutions Act 1989, as the case may be.

Since the banks action, as in *Arab-Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors and Other cases*, resulted more from a misapprehension, the court held that the plaintiffs were entitled, pursuant to s 66 of the Contracts Act 1950, to the return of the original facility amount they had extended. Further, when granting the order for sale by public auction in respect of the charged property, the learned judge stated: [*28]

Notwithstanding that the properties may, where no title had been issued, have been assigned absolutely to the plaintiffs, by virtue of the fact the assignment was as security, it is equitable that the plaintiffs must seek to obtain a price as close to, if not more than, the market price as possible, and account for the proceeds to the respective defendants.

In arriving at the above conclusion, the court had considered the legality of the BBA financing scheme in the context of the religion of Islam as provided in the Federal Constitution, Islamic Banking Act 1983 and the Banking and Financial Institutions Act 1989. The reasoning of the learned judge is as follows:

(i) [emsp]An Islamic financing scheme must not contain elements not approved by the religion of Islam : The Islamic financing facilities offered to the Muslims must not contain any element not approved by the religion of Islam such as usury or *riba*, which is prohibited for the reasons noted earlier. The above conclusion is consistent with the interpretation of the term Islam and religion of Islam in the Federal Constitution, the Islamic Banking Act 1983 and the Banking and Financial Institutions Act 1989.

In particular, the learned judge stated: It is self evident that if a conventional loan must be avoided because of the prohibition of *riba* or interest, surely the alternative must result in a consequence that is less burdensome than a default

in the conventional loan with prohibited interest. But it is equally evident in this case that the result of what is presented as the application of the *Qur anic* principle is that the defendant become liable, upon default at any time, to an amount that is 2.2 times the facility he obtained. It could hardly have been intended by the terse words in the *Surah al-Baqarah* that an Islamic financing facility should result in consequences far more onerous than the conventional loan with *riba* that is prohibited and unequivocally condemned ... The *Qur an* could hardly have intended that its followers, faithfully and trustingly seeking an Islamic compliant facility, should be delivered to those who offer what appears to be perfectly Islamic compliant facilities, but upon a default, had an interpretation applied that imposes a far more onerous liability than the conventional loan with interest. It is difficult to conceive that the religion of Islam intended to discourage its followers from the conventional loan with interest, condemn lenders for such loans, and deliver its followers into the hands of banks and financiers who under sale agreements with deferred payments, exact upon default, payments far exceeding the liability upon default of a conventional loan with interest. One cannot say that the religion of Islam is so much more concerned with form than substance as would sustain the bank s interpretation of selling price .

(ii) [emsp]The legality of BBA facility: Is not determined with reference to a particular *mazhab*: The determination whether the BBA facility is Islamic or otherwise should not be restricted with reference to a particular *mazhab* alone. The terms Islam and religion of Islam are [*29] therefore not confined to any *mazhab* of the religion. The Islamic financing facilities are presented as Islamic to Muslims of all *mazhabs*. The facilities do not say they are offered only to Muslims of a certain *mazhab*, for example *Syafi e*. If a facility is to be offered as Islamic to Muslims generally, regardless of the *mazhab*, then the test to be applied by a civil court must logically be that there is no element not approved by the religion of Islam under the interpretation of any of the recognised *mazhabs*. That it is acceptable to one *mazhab* is not sufficient to say it is acceptable in the religion of Islam when it is not accepted by the other *mazhabs* .

The learned judge added that since Islamic financial matters are within the jurisdiction of the civil courts, the civil court functions strictly as a civil court. It remains for all purposes a civil court. It does not become a Shariah Court. Nor does it proceed to apply Islamic law according to the interpretations and beliefs of any particular *mazhab* as it might if it were a Shariah Court. The civil court s function is to render a judicially considered decision on the particular facts of the specific case before it according to law .

(iii) [emsp]It is substance and not form that matters. It was stated that the court is required to examine and make a finding of fact in the case before it to determine whether or not the Islamic financing facility which was passed on to the public as Islamic contains any element which was not approved by the religion of Islam, for example, whether the loan facility incorporated *riba* or usury, whether fixed or variable. Transactional schemes that purport to be Islamic must be viewed as a whole rather than, by closing one eye ... what matters in discerning the true nature of contracts and transactions is the substance and not the words and structure . The learned judge added: In this regard, the civil court is not so much concerned with Islamic law *per se*, as with findings as to the elements of the religion of Islam where they arise. The civil court is concerned with the fact of those elements, and not the economic, social, religious and other justifications or rationale of the elements, for example, the prohibition and condemnation of *riba* in the religion of Islam.

When determining whether an order for sale should be granted, the court must ensure, as in this case, that the balance sum claimed by the plaintiffs were not contrary to the religion of Islam. A party applying for an order of sale pursuant to s 256 of the National Land Code must fulfil all the requirements set by O 83 of the Rules of the High Court 1980. Order 83 requires that where money or possession is claimed, the plaintiff must show by affidavit the circumstances under which the right arose and show [*30] the amount of advance, amount of repayment, amount of instalments in arrears as at date of summons and date of affidavit, and amount remaining. Thus, while applications for orders for sale are in respect of ad rem rights, O 83 requires the in personam part of the action to be dealt with also, for it would be clear injustice if the ad rem rights were allowed when there is such an error on the in personam part of the action that there was no foundation for an order for sale. In recognising that an order for sale is in respect of an ad rem right while the debt is an in personam right, the common error has been in viewing the proceeding before the court as being exclusively under s 256 of the National Land Code 1965 and overlooking the fact that the application, governed under O 83, involves addressing the in personam claim also. Similarly in Islamic financing cases .

(iv) [emsp]There is a distinction between profit upon a sale and interest on a loan. According to the learned judge, the distinction between a sale and a loan must be maintained both in its form and substance. While the religion of Islam allows deriving profit upon a sale, interest upon a loan is however, prohibited. The application of the notion that it is the interest in a loan that is *riba* to the verses quoted above in the *Surah al-Baqarah* results in the interpretation that a profit upon a sale is allowed, but interest upon a loan is prohibited in the religion of Islam. But since both profit and interest are increases, maintenance of the distinction between a sale and a loan is therefore essential. On a first glance it can be observed that the profit on a sale is upon the goods sold, while the profit upon a loan is for the time the borrower is allowed the use of the lender s money .

Having said the above, the court went on to consider the core issue, namely whether the BBA facility was a bona fide sale (whether the bank was a genuine seller) or a mere pretence sale. The distinction is maintained both in form and in substance so as to ensure that the profit derived from these transactions does not involve any element not approved by the religion of Islam. Since the argument concerning BBA scheme is related to a sale transaction, the learned judge had considered and/or referred to the earlier decisions relating to the BBA scheme in cases such as *Bank Islam Malaysia Bhd v Adnan Omar*, n49 *Affin Bank v Zulkifli Abdullah*, n50 *Dato Hj Nik Mahmud Daud v Bank Islam Malaysia Bhd*, n51 *Bank* [*31] *Islam Malaysia Bhd v Pasaraya Peladang Sdn Bhd*, n52 *Malayan Banking Bhd v Marilyn Ho Siok Lin*, n53 and *Malayan Banking Bhd v Ya kup Oje & Anor*. n54 In the above cases, the customers who had sought and obtained the BBA facility ended up, when they defaulted not longer thereafter, with liabilities far higher than what they would have been liable to in a conventional loan with interest.

In relation to the above, the learned judge stated: The *Qur an* could hardly have intended that its followers, faithfully and trustingly seeking an Islamic compliant facility, should be delivered to those who offer what appears to be perfectly Islamic compliant facilities, but upon a default, had an interpretation applied that imposes a far more onerous liability than the conventional loan with interest. It is difficult to conceive that the religion of Islam intended to discourage its followers from the conventional loan with interest, condemn lenders for such loans, and deliver its followers into the hands of banks and financiers who under sale agreements with deferred payments, exact upon default, payments far exceeding the liability upon default of a conventional loan with interest. One cannot say that the religion of Islam is so much more concerned with form than substance as would sustain the bank s interpretation of selling price ... If interest is no more than an increase, expressed as a sum or rate, for the facility of a loan, profit upon a sale is the increase upon the sale. The sum of the seller s cost and his profit is the selling price. The selling price is ordinarily paid upon delivery. If the payment is to be made later, the seller in effect is extending a credit, in other words, a loan, of that selling price. If there is no increase of the selling price as a consequence of granting time to make payment, it is a benevolent loan (*qard al-hasan*) ... bearing in mind that deferred payment of the selling price is a credit or a loan, permissible only because no *riba* is charged, any profit claimed or charged by the seller from deferred payment by adding to the cost above a profit for himself for the time given to make full payment, that profit arising from the giving of time to make payment is interest, is *riba* and the very element prohibited in the religion of Islam. ... In employing the *Al-Bai Bithaman Ajil* concept in a bank s *Al-Bai Bithaman Ajil* scheme, care must be taken to keep the transaction as a bona fide sale. It is too easy to structure a loan as a joint venture or a sale, and it is always only too human to be tempted and to succumb to such structuring in order to make profit. ... A novation agreement was required for the client to relinquish his [*32] contract with the vendor. The bank took over all obligations of the purchase from the vendor. Then the bank as the owner proceeded to sell to its customer. ... If the *Al-Bai Bithaman Ajil* transaction of the past were said to maintain only a pretence of a sale transaction between the bank and the customer, the *Al-Bai Bithaman Ajil* in the current cases abandoned all pretence. It usually happens when pretence is resorted to, that in time, when the reason for the pretence is lost that pretence is abandoned. That, however, neither justifies nor corrects the problem that it must not be a pretence in the first place, but that the novation was what it was intended to be, to make the bank a genuine seller... The court accepts that where the bank is the owner or had become the owner under a novation agreement, the sale to the customer is a bona fide sale, and the selling price is as interpreted in *Affin Bank v Zulkifli Abdullah*. Thus, where the bank was the owner of the property, by a direct purchase from the vendor or by a novation from its customer, and then sold the property to the customer, the plaintiffs interpretation of the bank s selling price is rejected and the court applies the equitable interpretation. This court holds that where the bank purchased directly from its customer and sold back to

the customer with deferred payment at a higher price in total, the sale is not a bona fide sale, but a financing transaction, and the profit portion of such an *Al-Bai Bithaman Ajil* facility rendered the facility contrary to the Islamic Banking Act 1983 or the Banking and Financial Institutions Act 1989 as the case may be .

Since the deferred payment of the selling price is a credit or a loan, the bank s selling price must not be excessive to the extent of burdening the borrower s as compared to a loan with interest. Where, as in this case, the profit portion of the BBA facility is excessive, it renders the facility contrary to the Islamic Banking Act 1983 or the Banking and Financial Institutions Act 1989. Bearing in mind that deferred payment of the selling price is a credit or a loan, permissible only because no *riba* is charged, any profit claimed or charged by the seller from deferred payment by adding to the cost above a profit for himself for the time given to make full payment, that profit arising from the giving of time to make payment is interest, is *riba* and the very element prohibited in the religion of Islam . It was further stated that the mere fact that the parties had agreed to the selling price does not debar the court from examining the substance of the contract to ascertain whether the terms are consistent with the religion of Islam.

CONCLUSION

The BBA facility offered to Muslims must not be contrary to the religion of Islam and the issue whether the BBA scheme is consistent with the religion of Islam is determined not merely by reading the [*33] property sale agreement independently but by going beyond the words of the agreement to determine the actual facts of the case and the substance of the transaction between the parties. Further, its determination is made with reference to the primary sources of Islamic law namely, the *al-Quran* and *hadith* and not merely with reference to the views of a particular *mazhab* alone. In *Arab-Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors and Other cases*, the court held that where the bank purchased the property directly from its customer and then sold back the same property to the customer with deferred payment at a higher price in total, such a sale is not a *bona fide* sale but a financing transaction. Therefore, where there appears gross unfairness, as in the above case, the courts are entitled to invoke equitable principles so as to eliminate the injustices. n55

As a final remark, it would be worthwhile to reproduce the observation by Suriyadi Halim Omar J in *Arab-Malaysian Merchant Bank Bhd v Silver Concept Sdn Bhd*, n56 and Hamid Sultan JC in *Yong Fuat Meng v Chin Yoon Kew*. n57 In the former case, Suriyadi Halim Omar J stated: so long as the bank genuinely adheres to the very fundamentals of the *al-Quran* and authentic *hadith*, ie the exact demands of the religion of Islam, and the papers on the face of it are in order, that bank may proceed with the relevant banking transaction. Any slip-shod preparatory work by the bank merely makes the rebuttal easier. Whereas in the latter case, Hamid Sultan JC stated that in Islam, equity is a sacrosanct command of Allah, where it: plays a significantly important role in the administration of justice, than the common law. In England one may say, where the law fails equity may save. However, pursuant to various *Quranic* injunctions, it can be safely said in Islam, equity is the fulcrum of justice . [*34]
Return to Text

n 1See *Malayan Banking Bhd v Ya kup bin Oje & Anor* [2007] 6 MLJ 389.

n 2*Sahih Al Bukhari* Vol 3 p 157. See also *Halsbury s Laws of Malaysia* (2006 Reissue) Vol 14 (Family Law & Syariah Law) (Kelana Jaya, LexisNexis, 2006) p 379.

n 3*Muslim, Kitab al-Musaqat.*

n 4*Ibid*.

n 5It may be noted that at common law, parties are bound by the terms in the loan agreement and the borrower must pay the interest that had been agreed upon by them. Any failure, refusal or neglect to repay the

debts including the agreed interest rate may be construed as a fundamental breach of the express term under the loan agreement. For example, in *AEH Capital Sdn Bhd v AM-EL Holdings Sdn Bhd and another appeal* [2008] 4 MLJ 487, the principle of freedom of contract was vigorously applied. In the above case, the interest rate charged for the loan transaction was at the rate of 24.73%pa. This, according to the Court of Appeal, was agreed by the first defendant and therefore it was not excessive nor harsh nor unconscionable .

n 6Yusuf al-Qaradawi, *The Lawful and the Prohibited in Islam (Al-Halal wal Haram fil Islam)* (translated by Kamal El-Helbawy et. al) (Kuala Lumpur: Islamic Book Trust, 2001) 266.

n 7[2007] 6 MLJ 389, p 400.

n 8(1992) FSC 89.

n 9There are 22 conventional banks in Malaysia to date. They are as follows; (1) Affin Bank; (2) Alliance Bank Malaysia; (3) Ambank; (4) Bangkok Bank; (5) Bank of America Malaysia; (6) Bank of China (Malaysia); (7) Bank of Tokyo-Mitsubishi UFJ (Malaysia); (8) CIMB Bank; (9) Citibank; (10) Deutsche Bank (Malaysia); (11) EON Bank; (12) Hong Leong Bank; (13) HSBC Bank Malaysia; (14) JP Morgan Chase Bank; (15) Malayan Banking; (16) OCBC Bank (Malaysia); (17) Public Bank; (18) RHB Bank; (19) Standard Chartered Bank Malaysia; (20) Bank of Nova Scotia; (21) Royal Bank of Scotland; and (22) United Overseas Bank (Malaysia).

n 10The Islamic banks are as follows: (1) Affin Islamic Bank; (2) Alliance Islamic Bank; (3) Al Rajhi Bank; (4) AmIslamic Bank; (5) Asian Finance Bank; (6) Bank Islam Malaysia; (7) Bank Muamalat Malaysia; (8) CIMB Islamic Bank; (9) Hong Leong Islamic Bank; (10) EONCAP Islamic Bank; (11) HSBC Amanah Malaysia Berhad; (12) Kuwait Finance House; (13) Maybank Islamic; and (14) RHB Islamic Bank.

n 11Licences have been issued to foreign financial institutions, under the Islamic Banking Act 1983, to provide the Islamic banking products and services in Malaysia. Some of the international Islamic banks which have been granted licences pursuant to the said Act are: Kuwait Finance House (Malaysia) Bhd which commenced its operations in August 2005; Al Rajhi Banking & Investment Corporation and Asian Finance Bank, which commenced its operations in the late 2006: (see Gan Kim Koon, The Islamic Financial System in Malaysia - Its development and progress .(See http://www.internationalreports.net/asiapacific/malaysia/2007/finance.html).

n 12The commercial banks with Islamic windows are as follows; (1) Citibank; (2) OCBC Bank (Malaysia); (3) Standard Chartered Bank Malaysia; and (4) Public Bank.

n 13A licensed institution carrying on Islamic banking business shall not be deemed an Islamic bank because an Islamic bank has the meaning with reference to the Islamic Banking Act 1983. Such banks are merely offering the Islamic banking products and services within their existing conventional banking establishment. For example, in *Wong Kim Soon & 3 Ors v Perwira Affin Bank Bhd & Anor* [2007] 1 LNS 646, where the first defendant, the bank, granted the second defendant, the employer, a financing facility for the purpose of assisting the eligible employee to participate in the TV3 Employee Share Option Scheme. The financing facility offered was under the Islamic Banking Scheme known as *Al-Murabahah* Financing Scheme. In fact, today, the Islamic banking has broadened its appeal well beyond the confines of Muslims. Indeed, nearly one-quarter of all Islamic banking business in Malaysia is being transacted by non-Muslims. See Assif Shameen, Islamic Banks: A Novelty No Longer in *Business Week*, 8 August 2005. (http://www.businessweek.com/magazine/content/05[lowbar]32/b3946141[lowbar]mz035.htm).

n 14Section 124(1) of Banking and Financial Institutions Act 1989 provides: Except as provided in section 33, nothing in this Act or the Islamic Banking Act 1983 shall prohibit or restrict any licensed institution from carrying on Islamic banking business or Islamic financial business, in addition to its existing licensed business,

provided that the licensed institution shall consult the bank before it carries on Islamic banking business or any Islamic financial business.

n 15[2006] 8 CLJ 9 at pp 15-16.

n 16Per Dr Zeti Akhtar Aziz, during address at the conference on the Islamic Financial Services and the Global Regulatory Enviroment, London, United Kingdom on 18 May 2004. The speech is also found in *Islamic Banking and Finance Progress and Prospects Collected Speeches 2000 - 2006* (Kuala Lumpur, Bank Negara Malaysia, 2006) 149.

n 17[1994] 3 CLJ 735.

n 18[2008] 1 CLJ 784.

n 19See fn 1. See also *Affin bank Bhd v Zulkifli bin Abdullah* [2006] 3 MLJ 67; *Malayan Banking Bhd v Marilyn Ho Siok Lin* [2006] 7 MLJ 249.

n 20Per Abdul Hamid Mohamad FCJ in *Latifah bte Mat Zin v Rosmawati bte Sharibun & Anor* [2007] 5 MLJ 101, p 113.

n 21See fn 17.

n 22[2003] 2 MLJ 408. See also *Bank Islam Malaysia Bhd v Pasaraya Peladang Sdn Bhd* [2004] 1 LNS 280; *Malayan Banking Bhd v Marilyn Ho Siok Lin* [2006] 3 CLJ 796.

n 23See *Dato Hj Nik Mahmud bin Daud v Bank Islam Malaysia Bhd* [1996] 4 MLJ 295, HC; on appeal sub nom *Dato Haji Nik Mahmud bin Daud v Bank Islam Malaysia Bhd* [1998] 3 MLJ 393; [1998] 3 CLJ 605, CA.

n 24[2008] 5 MLJ 226.

n 25*Ibid*, at p 252.

n 26See *Dato" Hj Nik Mahmud Daud v Bank Islam Malaysia Bhd* [1998] 3 CLJ 605.

n 27[2006] 3 MLJ 67.

n 28[2006] 7 MLJ 249.

n 29[2007] 6 MLJ 389.

n 30*Ibid*.

n 31Suit No D4-22A-067 of 2003.

n 32Suit No D4-22A-215 of 2004.

n 33Suit No D4-22A-1 of 2004.

n 34Suit No D4-22A-185 of 2005.

n 35Suit No D4-22A-399 of 2005.

n 36OS No D4-22A-395 of 2005.

n 37Writ No D4-22A-166 of 2006.

n 38Writ No D4-22A-167 of 2006.

n 39Writ No D4-22A-178 of 2006.

n 40Suit No D4-22A-192 of 2006.

n 41Writ No D4-22A-203 of 2006.

n 42Writ No D4-22A-204 of 2006.

n 43See *Mohamed Habibullah bin Mahmood v Faridah bte Dato Talib* [1992] 2 MLJ 793, SC.

n 44See *Che Omar bin Che Soh v Public Prosecutor* [1988] 2 MLJ 55, SC; and *Fatimah bte Sihi & Ors v Meor Atiqulrahman bin Ishak & Ors (Minors, suing through Syed Ahmad Johari bin Syed Mohd)* [2005] 2 MLJ 25, CA.

n 45*Ibid*.

n 46*Fatimah bte Sihi & Ors v Meor Atiqulrahman bin Ishak & Ors (Minors, suing through Syed Ahmad Johari bin Syed Mohd)* (see fn 44 above).

n 47See fn 15, at pp 17-18.

n 48See fn 24, at p 249.

n 49See fn 17.

n 50See fn 19.

n 51[1998] 3 CLJ 605.

n 52[2004] 1 LNS 280.

n 53See fn 19.

n 54See fn 1.

n 55For further reading on the application of equitable principles into the BBA facility, see Dr Abdul Rani bin Kamaruddin, *Istihsan as the Basis of Syariah Compliance in Bai Bithaman Ajil End Financing with Special Reference to the Case of Malayan Banking Bhd v Ya Kup bin Oje & Anor* [2007] 6 MLJ 389; Habib Rahman bin Seeni Mohideen, *Affin Bank Bhd v Zulkifli Abdullah* [2006] 3 MLJ i; Mohamed Ismail bin Mohamed Shariff, *The Affin Bank Case: Is Islamic Banking Just Conventional Banking in a Green Garb?* [2006] 3 MLJ cli.

n 56See fn 47, at pp 216-217.

n 57See fn 24, at p 249. See also *Malayan Banking Bhd v Ya kup bin Oje & Anor*, at fn 1.

LOAD-DATE: 11/06/2009