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JUDICIAL OVERREACH: THE ILLEGALITY OF NON-COMMERCIAL, PRIVATE LOANS IN MAINLAND TANZANIA'S COURTS

*Baraka Francisco Kanyabuhinya**

Abstract

This research examines a legal contradiction emerging in Mainland Tanzania regarding informal lending. While it is common practice for individuals to obtain loans from private lenders and friends, repaying principal with interest; recent judicial decisions have imposed a strict regulatory framework. Courts have ruled that lending at interest is lawful only for entities formally registered and licenced as financial or microfinance entities by the Bank of Tanzania, thereby declaring all interest-bearing transactions by informal lenders illegal. This prohibition, ostensibly for consumer protection, persists alongside the widespread continuation of the very informal lending practices it seeks to suppress. The overbroad nature of this judicial interpretation, unfairly harms the lender and unjustly rewards the borrower. This approach severely undermines the principle of freedom of contract by arbitrarily restricting the ability of consenting parties to negotiate terms, including interest. Furthermore, it is inherently anti-competitive, as it unjustifiably eliminates a vast segment of informal credit providers from the market, thereby reducing consumer choice and access to credit. The research is motivated by a contrasting judicial perspective from Uganda and Nigeria, which affirmed that insisting on interest-free friendly loans would defeat common sense and the doctrine of freedom of

* Lecturer at the University of Dar es Salaam School of Law. He may be contacted at kanyabuhinya@yahoo.co.uk

contract. Consequently, the Tanzanian judicial position requires re-examination, for a law should never be wielded as a tool to effectuate or condone inequitable outcomes. A borrower who has benefitted from a loan transaction should not be allowed to plead that the contract underlying the transaction was illegal, in order to escape from his obligations to repay the loan.

Keywords: *loan on interest, freedom of contract, competition, informal lending, private lenders, microfinance.*

1. Introduction

The regulatory environment governing credit provision by informal money lenders; in Tanzania, imposes undue constraints on contractual freedom and market competition. This is evidenced by the legal treatment of informal financial services providers-individuals and unincorporated lenders who extend loans and charge interest without registration, licensing, or authorization from the Bank of Tanzania (BoT). It is estimated that such providers serve approximately 10.6 million Tanzanian adults, indicating a significant market demand that formal institutions fail to meet.[1]

A detrimental consequence of this framework is the judicial invalidation of informal loan agreements. When borrowers default, they frequently invoke the lender's non-compliance with regulatory statutes to have the contracts declared illegal, void, and

[1] Majenga A.K, et al, Promoting Rural Entrepreneurship in Tanzania Through Empowering Voluntary Financial Saving Groups, in the African Journal of Applied Research, Vol. 10, No. 1 (2024), pp. 275-294 Available at http://www.ajaronline.com http://doi.org/10.26437/ajar.30.06.2024.17

unenforceable.[2] Prevailing jurisprudence has often accepted this reasoning, resulting in the denial of recovery even of the principal loan amount to private lenders. This outcome not only rewards opportunistic default but also fundamentally undermines the principle of *pacta sunt servanda* (agreements must be kept) in commercial dealings.

The regulatory burden creating this imbalance is twofold. First, the Business Licencing Act provides that no person may carry on any business without a valid license for such business.[3] Second, formal microfinance undertakings, in tier 2 (which comprises of non-deposit taking microfinance service providers such as individual money lenders) are regulated by the Microfinance Act of 2018. The regulatory prohibitions established by these Acts are notably stringent. Individuals, or persons in a non-professional lending capacity, may encounter substantial difficulty in complying with these provisions when extending a loan bearing interest to a relative. Moreover, the regulation made under the Microfinance Act, defines an "individual money lender" as a person licenced to undertake microfinance business of lending money in accordance with the provisions of the Act.[4] The regulations, further stresses that in case of individual money lender, he must register a business name as a sole proprietor under the Business Licensing Act.[5]

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2 See the case of Grofin Africa Fund Limited vs. H. Furniture and Electronics Limited and Four Others PC Civ. Appeal No. 13 of 2003, TZHC 3630 and Grofin Africa Fund Limited vs. H. Furniture and Electronics Limited and Four Others Commercial Cause No.81 of 2017 (High Court, Commercial Division at Dar es Salaam).

3 Business Licensing Act Cap 101 R.E. 2023, s.4.

4 Microfinance (Non-Deposit Taking Micro Finance Service Provider) Regulations, GN No. 679 of 2019, regulation No. 2.

5 Ibid, regulation 4(b).

The applicable regulatory framework further imposes compliance requirements that are characteristically burdensome, such that a private individual engaged in occasional lending to friends or relatives would likely be disinclined to subject themselves to the associated regulatory regime.

1.1 Burdensome Compliance Requirements

The Microfinance Act and the accompanying Non-Deposit Taking Microfinance Service Provider Regulations impose formal and procedural compliance requirements that restrict the ability of individual moneylenders to transact with close friends and relatives. The overall effect of this regulatory framework is to burden informal financial transactions, thereby marginalizing the informal lending sector.

The Microfinance Act establishes a regulatory framework for the formalization and operation of private lending businesses by individuals. Among its provisions, it requires every licensed microfinance service provider to maintain a designated place of business, with a proper address, from which its microfinance operations are to be conducted.[6] A microfinance service provider operating under the Act must also comply with the prescribed minimum capital requirements. The regulations stipulate that a Tier 2 microfinance service provider shall commence operations with, and at all times maintain, a minimum capital of twenty million shillings, or such higher amount as the Bank of Tanzania (BOT) may prescribe.[7]

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6 The Microfinance Act, s. 6(1)

7 Microfinance (Non-Deposit Taking Micro Finance Service Provider) Regulations, GN No. 679 of 2019, regulation No. 46(1).

Moreover, the Bank of Tanzania, as regulator, is mandated to issue licences to qualified microfinance service providers in accordance with the Microfinance Act.[8] No person shall carry on any microfinance business unless duly licensed under the provisions of the said Act.[9] Any microfinance service provider that violates the licensing requirements of the Microfinance Act shall be liable, on conviction, to a fine of not less than twenty million shillings and not exceeding one hundred million shillings, or to imprisonment for a term of not less than two years and not exceeding five years, or to both.[10]

This cumulative licensing requirement functions as a prohibitive barrier to entry for small-scale informal individual lenders. By rendering a vast segment of *de facto* credit transactions legally unenforceable, the regime stifles competition within the financial sector. It protects the formal banking oligopoly and eliminates a crucial source of credit for a large population excluded from formal banking services. Ultimately, the regulations prioritize administrative compliance over the reality of market needs, disproportionately penalize providers rather than regulate the activity, and severely restrict the freedom of competent parties to enter into binding credit contracts. This represents a significant and damaging overreach that hampers both contractual autonomy and a competitive credit market.

8 The Microfinance Act, s. 16(1).
9 Ibid.
10 Id, s.16(2)(a).

2. Problem Statement

It must be observed that certain unscrupulous individuals are exploiting the aforementioned licensing and business formality requirement. They deliberately seek loans from unlicensed and unregistered entities, only to assert the defense of illegality and unenforceability when sued for repayment. This conduct operates to the detriment of the lenders, who are thereby deprived of their lawful dues. Such a state of affairs, if unaddressed, inequitably favours borrowers and prejudices lenders, resulting in the unjust enrichment of the former. Moreover, this result undermines the doctrine of freedom of contract. It provides an unwarranted technical defence to parties who willingly entered loan agreements to address immediate financial necessities and needs which could not await the protracted process of formal institutional lending. Moreover, the prohibition excludes informal lenders from the financial marketplace, thereby restricting consumer choice and stifling competition. Consequently, notwithstanding the existing legal prohibition, the persistence of these transactions indicates a clear demand and underscores the necessity for appropriate legal reform.

It is significant to observe that banking and formal financial services are not universally accessible across Mainland Tanzania, with rural regions being particularly underserved. As of May 2023, there were only 47 licensed banks operating in Mainland Tanzania.[11] The majority of these institutions are concentrated in urban centres, township headquarters, and regional or district

11 See List of Banks in Tanzania, available at List of all the Banks in Tanzania & CEOs Names - December 2023 Update (tanzaniainvest.com) (accessed on 24th July 2023).

administrative capitals, thereby leaving rural populations with minimal access to formal credit. This service vacuum necessitates the recognition of interest-bearing loan transactions between private persons, even where such persons are not registered or licensed as banks or financial institutions.

Furthermore, the spirit of competition law advocates for a plurality of market participants to safeguard consumer rights, including the right to choose, fair pricing, and value for money in financial services. A blanket prohibition on lending by unregistered persons constitutes an undue restriction on market entry, which is inherently anti-competitive. Consequently, this paper is grounded in the legal proposition that the provision of financial services-specifically, the practice of granting interest-bearing loans-should be permissible between private parties. This approach honours the fundamental doctrine of freedom of contract. Moreover, sanctioning such private lending would stimulate and enhance competition within the financial sector.

Also, the distinction must be drawn between the *business* of moneylending and the occasional act of lending money. An incident or occasional individual money lender is not doing the business of money lending to be subjected to the regulatory framework outlined above.

3. METHODOLOGY

This research adopts a qualitative, doctrinal methodology to conduct an in-depth legal analysis of the contradictions inherent in Tanzania's regulation of informal lending. Doctrinal research involves the systematic study of legal principles, case law, statutes, and scholarly commentary to identify, critique, and propose solutions for legal inconsistencies. This approach is well-suited for interrogating the conceptual and jurisprudential conflicts at the heart of this study. The primary mode of inquiry is a critical analysis of secondary legal sources. This includes: A comprehensive review of Tanzanian statutory law, particularly the Business Licencing Act, Microfinance Act and regulations, the Law of Contract Act, and relevant subsidiary legislation; a detailed examination of key judicial precedents from Tanzanian courts, especially recent High Court and Court of Appeal rulings that have invalidated private loan agreements for regulatory non-compliance. Finally, this research employs a benchmarking methodology to evaluate Tanzania's regulatory approach to informal lending. It establishes the well-reasoned legal standards from the Ugandan case of *Stephen Khesmodel Omony v. Denis Michael Olara* and the Nigerian case of *Uzoukwu v. Idika* as benchmarks for principled judicial reasoning. The analysis then assesses the Tanzanian position against these benchmarks to highlight where its restrictive approach may be arbitrary or conceptually unsound.

The research design is precedent-centric and grounded in case study analysis. Rather than broad empirical surveying, the study focuses on a curated selection of landmark judgments as its primary units of analysis.

3.1 Analysis of Existing Jurisprudence

The jurisprudence of Mainland Tanzania recognizes a prevalent practice whereby numerous entities that are neither licensed microfinances nor holders of valid business licenses nonetheless engage in the business of providing financial services, primarily in the form of extending loans and charging interest. These financial undertakings typically operate under contracts executed pursuant to the principle of freedom of contract. While such agreements may contain all the essential elements for contractual validity, they are susceptible to being deemed illegal and unenforceable for failure to comply with mandatory legal prerequisites, which require an entity to be licensed by the Bank of Tanzania and to possess a valid business license.

Tanzanian courts have consistently held that the business of granting loans and charging interest requires registration and licensing as a financial institution. However, the prevalence of numerous cases involving informal private individuals acting as lenders-despite their lack of formal status, suggests that an absolute prohibition of the practice may be an ineffective remedy for the underlying mischief. Judicial precedent in Tanzania reveals a consistent and notable trend wherein a borrower, having received and benefited from funds advanced under a loan agreement, is subsequently permitted to raise the defence of illegality (*ex turpi causa*); to invalidate the underlying contract and thereby evade their obligation to repay. This doctrine, which permits a party to avoid an illegal contract despite having materially benefited from it, creates a direct tension between two established principles: that a court will not assist a party whose claim arises from an illegal act, and the equitable principle that prevents unjust enrichment.

The following discussion examines a series of illustrative cases that demarcate the contours and application of this judicial trend within the Tanzanian jurisdiction.

In *David Charles v. Seni Manumbu*, the Court held that charging interest on a loan, in any form as a business transaction; must comply with section 3 of the Business Licensing Act, Cap. 208 R.E. 2023, which states:

> "3(1) No person shall carry on business in Tanzania, whether as principal or agent, unless such person is the holder of a valid business license issued in relation to that business."[12]

A further illustration is found in *Grofin Africa Fund Limited v. H. Furniture and Electronics Limited and Four Others*. In that case, the High Court (Commercial Division) adjudged a comparable loan agreement to be illegal, void, and without legal effect. The Court provided the following justification for its decision.[13] The High Court, Commercial Division had these to reiterate in justifying its holding and it stated:

> First, there is uncertainty, if the plaintiff was dully licensed as a financial institution capable of charging interest on the loan, when advancing it to the 1st defendant, because no proof was provided. A loan advanced with the condition of paying interest thereon implies that the transaction was a business deal, which could only be done by institution such as banks and other recognized financial institutions or any authorized organization. The only institution from which

12 Civil Appeal No. 31 of 2006 (HC of Tanzania, unreported).

13 Commercial Cause No.81 of 2017 (High Court, Commercial Division at Dar es Salaam).

> people borrow money to be repaid with interest are banks and financial institutions which meet conditions imposed by the Banking and Financial Institutions Act, Cap 342 (the Banking and Financial Act).

In *Grofin*, the Court further reasoned that the contract was illegal and void on the principle that a party cannot derive a benefit from its own wrong. This illegality stemmed from the plaintiff's lack of capacity at the time the agreement was formed, as it failed to prove it was a registered bank or financial institution authorized to advance loans and charge interest. The Court also affirmed that a signed agreement alone is insufficient evidence to prove the actual disbursement of a loan.

An identical line of reasoning, resulting in a consistent holding, is evident in *Lameck Magoro Liku v. Emmanuel A. Machiwa.*[14] The learned judge, Kahyoza J., held the contract to be *illegal ab initio*. This finding was grounded in section 7 of the Banking and Financial Institutions Act.[15] The court held that the Act prohibits unlicensed institutions from charging interest on loans. As there was no evidence that the appellant possessed the requisite license to conduct financial business, the court found the plaintiff was not entitled to charge interest on the lent sum. Consequently, the award of interest was set aside.

The principle was again affirmed in *Mauri-Tan Holdings Limited v. A Copy Cat Tanzania Limited and 2 Others.*[16] The court ruled it is evident that lending money at interest is, in essence, a banking activity

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14 (PC Civil Appeal 31 of 2020) [2020] TZHC 3868 (20 November 2020).

15 Cap. 342 R.E. 2019.

16 In The High Court of Tanzania (Commercial Division) At Par Es Salaam, Misc. Commercial Cause No. 33 of 2020

requiring licensure. Consequently, any such unlicensed activity is illegal and unenforceable, as a court cannot uphold an unlawful contract. The court elaborated, stating *inter alia*:

> …the law is very clear that money-lending on interest is only limited to banking business after complying with the elaborate procedure provided for under sections 6-15 of Part III of the Banking and Financial Institution Act, 2006 read together with section 3 of the Business Licensing Act, [Cap 208 R.E. 2023] which prohibits doing business without holding a valid business license.[17]

Consistent with this jurisprudence, the High Court in *Ronjino Matuli v. George Katambi* adjudged an interest-bearing mutual loan made by a non-bank to be void *ab initio*, the consideration being illegal.[18] The court concluded that by engaging in this activity, the lender had illegally purported to act as a bank, a role for which it had no legal authority.

Conversely, in *ULF Nilson v. Dr. Tito Mziray Andrew*, the court clarified that the lack of registration as a money-lender or institution does not, in itself, bar an individual from obtaining security in connection with a loan.[19] Nevertheless, the court re-emphasized that an unregistered person is not, for that reason alone, barred from taking security for a loan. Ultimately, however, the court held it could not sanction the underlying illegal lending business.[20] Consequently, the decision reinforces the principle that

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17 P.16.
18 (PC Civil Appeal 35 of 2020) [2020] TZHC 2289 (31 August 2020)
19 Land Case No.66 of 2007 DSM (unreported).
20 Ibid, at p. 27.

financial lending entities must be duly registered as money lenders for their transactions to possess legal validity.

Moreover, the case of *Gasto Sabas Nyongo v. Bambo Johnson Nyamweru* presents unique material facts.[21] In this matter, the respondent advanced a principal loan of TZS 1,500,000/= to the appellant, repayable within one month with accrued interest of TZS 300,000/= and witness costs of TZS 20,000/=. Consequently, the total sum due was TZS 1,820,000/=. It was common ground that the appellant subsequently defaulted on the agreed repayment. On 27 September 2018-four months after the loan's disbursement, the appellant was compelled to formalize a written loan agreement before the learned advocate, Mr. Silvester Damas Sogomba, which both parties executed. This subsequent agreement recorded the loan amount as TZS 4,530,000/=, purportedly without interest. The issue for determination on appeal was whether the underlying loan transaction was legal and enforceable.

In determining the appeal, the High Court found the business to be unlawful. It reasoned that the loan agreement constituted a business transaction, as the respondent had advanced TZS 1,500,000/= as capital with an expected profit of TZS 300,000/= per month. Within three months, this capital had purportedly grown to a sum in the millions, as previously stated. On this basis, the court concluded the transaction was commercial in nature and consequently declared it illegal in its entirety, stating:

> The Respondent herein had no business license to that effect and therefore was doing illegal transactions. He was actually contravening the Banking and Financial Institutions Act,

21 PC Civ. Appeal No. 13 of 2003, TZHC 3630.

> Cap. 242 R.E. 2002 in which only Banks and Financial Institutions can run business in the nature of financial transactions like lending money on interest basis. That law under section 4(1) & (2) restricts business in the nature of financial transactions to Banks and Financial Institutions subject to the application and grant of license to that effect under Section 6 of the Act. The Procedures on how to apply and grant of the license are provided for under section 7 of the said Law. In the circumstances, the respondent was violating the law by carrying on business without being registered for and licensed as such. He cannot be allowed to benefit from illegal businesses.

The case of *Gasto* merits careful analysis due to its significant legal implications. It illustrates the prevalent reality of private financial arrangements among individuals. Despite statutory prohibitions on private, interest-bearing loans, the public continues to engage in such transactions knowingly. Professional experience indicates that informal lenders and their clients have developed strategies to circumvent these stringent legal barriers. The prevailing legal guidance from legal practitioners is to draft contracts that incorporate interest into a single, consolidated principal sum. This is done with the understanding that, should a borrower default, the issue of interest, which would render the contract illegal is unlikely to surface in subsequent disputes.

It is also significant that in *Gasto*, the court grounded its final determination in core principles of contract law, drawing predominantly on the Law of Contract Act,[22] which provides that

[22] Cap 345 R.E 2019

any contract founded upon unlawful consideration or with an unlawful object is void. The court, citing the Law of Contract Act, observed *inter alia* under section 23(2):

> "...in each of the cases referred to in subsection (1), the consideration or object of an agreement is said to be unlawful; and every agreement of which the object or consideration is unlawful is void. No suit shall be brought for the recovery of any money paid or thing delivered or for compensation for anything done under any such agreement."[23]

The *Gasto* case introduces a further jurisprudential principle: disputes founded upon an inherently unlawful subject matter, as in this instance, are inadmissible before a court of law. This flows directly from the text of section 23(1) of the Law of Contract Act, which stipulates that "…no suit shall be brought for the recovery of any money paid or thing delivered or for compensation for anything done, under any such agreement." In essence, claims arising from illegal transactions are barred from judicial consideration. The court articulated this principle, stating *inter alia*:

> "It was wrong therefore for the court to receive and register such a suit which was based on an illegal transaction." Beyond rendering the transaction void, engaging in such unlicensed lending is also proscribed as a criminal offence under the Banking and Financial Institutions Act.[24]

Cementing on this, the case of *Gasto* reiterated the criminal consequences of this kind of conduct. It stated that, "The acts of

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23 At p.5.
24 Act No. 5 of 2006.

the respondent to carry on such illegal business of lending money on interest basis is not only illegal but also criminally punishable under section 4(3) of the Banking and Financial Institutions Act."[25]

All of the aforementioned cases reaffirm that under Tanzanian law, an individual who is not formally registered and licensed as a microfinance institution or business entity may not enter into a loan contract and charge interest, even where both parties have freely consented to such terms. This restriction consequently undermines the doctrine of freedom of contract and limits the consumer's right to choose a source for obtaining loan facilities.

4. RATIONALE FOR THE REGULATION OF MICROFINANCE INSTITUTIONS AND PRIVATE LENDERS

Academic literature in this field widely supports the necessity of minimum and prudential regulations. Such oversight is essential to supervise financial service providers and deter opportunistic behaviour, which may arise from the temptation to assume excessive risk in pursuit of higher profit. Indeed, the commercial imperative to maximize returns can manifest in the imposition of substantial interest rates. Within this context, regulation serves the critical function of preventing microfinance institutions and private lenders from extracting excessive profits through usurious interest charges imposed on consumers (borrowers).

A further fundamental objective of regulation is consumer protection within the financial services sector. Regulatory

25 Ibid, the old and repealed Act reads mutatis mutandis under section 4(3).

frameworks are designed to safeguard vulnerable consumers. In the absence of such protection, consumers are exposed to predatory lending practices, including exorbitant interest rates and unfair treatment by unscrupulous lenders seeking profits that can exceed 100 percent of the principal loan amount.

In more severe cases, lenders have appropriated borrowers' valuable assets-including motor vehicles and real property. In certain instances, victims have reported these arrangements to the anti-corruption bureau, which has intervened to facilitate the recovery of the seized property. [26]

A preliminary point of distinction in regulatory scholarship is the critical separation of microfinance and private lending entities into deposit-taking and non-deposit-taking models. The deposit-taking model attracts rigorous prudential regulation, a level of oversight not ordinarily applied to its non-deposit-taking counterpart. As Ridder articulates this principle:

> In order to protect their clients and to prevent risks to the financial system, Microfinances need to be thoroughly regulated and supervised by the government. MFIs that do

[26] See Massengo Hezron, Assessment of the Impact of Personal Loans to Primary School Teachers in Tanzania: A case study of Mvomero District Council; Morogoro Region (Dissertation for Award of Master of Business Administration, 2013) at p. 39, stating that challenges facing borrowers included; dishonest behavior (teachers accessing personal loans from more than one financial institution); lack of transparency on interest rates and other pertinent details in the exorbitant lending procedures among the financial institutions; steep interest rates which virtually change arbitrarily from time to time; tightening collection conditions for individual borrowers; psychological discomfort as others did not receive any payment at the end of the month; lack of knowledge to utilize well the loan as planned; absenteeism at work as the result of debts hence, not fulfilling their responsibilities; changing jobs as to escape debts; poor payment (due to low salaries teachers receive); and inflation rates.

> not take deposits from their clients are generally less regulated than MFIs that do take voluntary deposits.[27]

A further rationale advanced for the regulation of private lenders and microfinance entities is the characterization of their operations as income-generating activities, thereby establishing a taxable base. Consequently, governmental intervention is purportedly justified as a means of revenue generation. It is acknowledged that the business of private lending, particularly when involving the charging of interest, yields profits which are legitimately subject to taxation. However, this work contends that the potential for tax avoidance or evasion does not, in itself, operate to invalidate transactions freely entered into between private parties.

Notwithstanding the foregoing rationales, it remains imperative that prudential regulatory mechanisms and specifically, self-regulation through the instrument of contract-be recognized as a lawful modality for conducting loan transactions among unregistered and unlicensed persons. This is because the imposition of mandatory business licencing and central bank authorisation not only effectively proscribes contracts formed by free consent, but also constitutes an impediment to financial sector development. The establishment of stringent prerequisites further serves to diminish the number of participants in financial markets, as such regulatory requirements function as barriers to entry, thereby inhibiting competition.

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[27] Ridder M, Microfinance in Tanzania: Are the interest rates that MFIs charge excessive and too high for the poor? April 2010, available at Microsoft Word - Ridder.M. de. BSc.doc (businessinsightz.org), Accessed on 25th July 2022.

5. REGULATION AND PROHIBITION IN THE CONTEXT OF FREEDOM OF CONTRACT

A cornerstone and inviolable principle of contract law is the doctrine of freedom of contract. This doctrine enshrines the right of parties to enter into binding agreements and to autonomously determine their terms, free from arbitrary or unreasonable statutory constraints. This fundamental liberty finds explicit constitutional protection in instruments such as the Contract Clause of Article I, Section 10 of the United States Constitution.[28] Acknowledging the imperative to safeguard the liberty of contract, Chrenkoff, citing Sir George Jessel MR, states *inter alia*:

> If there is one thing which more than another public policy requires, it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by courts of justice.[29]

In reinforcing the critical importance of zealously safeguarding the doctrine of freedom of contract, Chrenkoff further invokes the words of Lord Bramwell, stating *inter alia*:

> I am for my part prepared to hold, not that an agreement between two people which has been voluntarily entered into by them cannot be unreasonable, but the fact that it has been voluntarily entered into by them is the strongest possible

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28 Merriam-Webster Dictionary, Freedom of Contract, available at www.merriam-webster.com/legal/freedom%20of%20contract (Accessed on 28th July, 2022).

29 Chrenkoff A, Freedom of Contract, A New Look at the History and Future of the Idea, Available at www.austlii.edu.au/au/journals/AUJlLegPhil/1996/1.pdf (Accessed on 29th July, 2022).

> proof that it is a reasonable agreement, and that I should require the strongest possible evidence, or something more even than a possibility, to show me that was an unreasonable agreement.[30]

The freedom of contract is the most fundamental principle that must be protected by the state at all costs save for conducts that amounts to criminal offences. In some countries, notably the United States of America (USA) the doctrine is prescribed in the Constitution. The contract clause, found in Article I, section 10 of the Constitution, prohibits the states from impairing the obligations of contracts.[31] In *Craigmiles v. Giles*,[32] the Sixth Circuit held that a law that allowed only licensed funeral directors to sell caskets violated the due process clause.[33] The case of Craigmiles is very analogous to the prerequisite imposed on microfinance and private lenders-requiring them to be licenced to advance loans and charge an interest.

Chitty's Law of Contracts also reaffirms that the doctrine of freedom of contract as reflected in the sanctity of contracts; is still a cardinal principle of English law because it suits the needs of a commercial community.[34] English law is consistently reluctant to admit excuses for non-performance where there is no incapacity, no fraud (actual or constructive) or misrepresentation, and no principle of public policy prohibiting enforcement.[35]

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30 Ibid.

31 Bernstein D.E, Freedom of Contract, Available at http://ssrn.com/abstract_id=1239749 (Accessed on 29th July 2022).

32 312 F.3d 220 (6th Cir. 2002).

33 Ibid, at p.11

34 Chitty's Law of Contracts, Volume I, (24 ed), at page 5

35 Ibid.

The doctrine of freedom of contract is also well-established and applicable in Tanzania.[36] Tanzania operates under a common law system which recognizes the fundamental principle of freedom of contract. A body of decided cases affirms that statutory regulations should not, by default, invalidate an agreement concluded between free and consenting adults. In this context, the facts in *Simon Kichele Chacha v. Aveline L. Kilawe* are not materially distinguishable from the Tanzanian jurisprudence cited above.[37] The appellant entered into a loan agreement with the respondent, under which he provided a loan of TZS 2,600,000. The agreement was executed in the presence of the Ward Executive Officer. It stipulated that the loan was to be repaid within three months, with an added interest of 30% should the respondent default on repayment within the agreed period. The appellant subsequently repaid a portion of the loan, namely TZS 400,000, leaving an outstanding principal balance of TZS 2,200,000.00, plus the contractual interest of 30%.

A dispute arose from this arrangement. On appeal, the appellant's defence was predicated on the contention that the respondent lacked a valid license to extend a loan with interest, thereby rendering the contract illegal and void *ab initio*. Conversely, the respondent argued that the agreement constituted a purely contractual matter, and not a regulated financial transaction, as had been found and held by the two lower courts.

In its reasoned judgment, the Court of Appeal, invoking the doctrine of freedom of contract, underscored the settled principle that parties are bound by the agreements they freely enter into; as

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36 Freedom and liberty to contract is not a Constitutional right in Tanzania.

37 Civil Appeal No. 31 of 2014 (Unreported).

a cardinal rule of contract law which upholds the sanctity of contract. The court fortified its reasoning by citing, *inter alia*, the authority of *Abualy Alibhai Azizi v. Bhatia Brothers Ltd.*

> The principle of sanctity of contract is consistently reluctant to admit excuses for non-performance where there is no incapacity, no fraud (actual or constructive) or misrepresentation, and no principle of public policy prohibiting enforcement.

The Court of Appeal in *Simon Kichele* proceeded to state that, consistent with the principle of sanctity of contract, it was disinclined to accept the appellant's excuse for non-performance of an agreement he had entered into freely and with full capacity. The pertinent portions of the court's reasoning are reproduced, in part, as follows:

> On our part, we are satisfied that the contract entered between the appellant and the respondent had all attributes of a valid contract. It was not prohibited by the public policy and it is on record that the appellant was not complaining about his consent to the agreement being obtained by coercion, undue influence, fraud or misrepresentation in order to make it voidable in terms of the provisions of section 19 (1) of the Law of Contract Act, Cap. 345 R.E 2002. We therefore wish to emphasis here that since the appellant at the time he concluded Exhibit PI with the respondent was a free agent and he was of sound mind, he must adhere and fulfill the terms and conditions of it.

The *Simon Kichele* decision is doctrinally sound and accurately articulates the legal principles applicable to interest-bearing loan contracts between private, non-commercial parties. As a

pronouncement by the apex court-the Court of Appeal of Tanzania; it is a binding precedent. All subordinate courts, including the High Court, are obliged to follow it pursuant to the doctrine of *stare decisis*.

Furthermore, while a primary justification for the strict regulation of the financial sector is consumer protection-specifically, shielding borrowers from potential exploitation by economically powerful entities, such that interest-bearing loans are often presumed exploitative. This rationale is not wholly consistent with another cardinal principle of contract law: the doctrine of consideration. This principle holds that consideration need only be *sufficient*, not *adequate*. Thus, in contractual relationships, the voluntary exchange of anything of value, provided it is given with free consent, suffices to form a valid and enforceable contract. For instance, a house valued at TZS 30,000,000 may be lawfully sold for TZS 5,000 if the owner freely agrees to those terms. By the same token, a loan advanced with interest payable at a future date constitutes sufficient consideration and is therefore entitled to legal protection.

5.1 Regulation and Prohibition as anti-Competitive

Tanzania has moved toward a liberalized economic model since the 1990s. This shift has resulted in a market characterized by multiple competing entities across various sectors. To govern this competitive landscape, the country has adopted a series of laws and regulations designed to promote and safeguard fair market practices. The most notable of these is the Fair Competition Act, which serves as the cornerstone of Tanzania's modern competition

policy framework.[38] A primary objective of competition law is to foster and maintain a market structure characterized by a plurality of undertakings. A healthy competitive environment is one in which established, dominant firms can coexist with smaller enterprises and new market entrants. Thus, Regulation can have both direct and indirect costs.[39]

In this context, government regulations that impose licensing and authorization requirements can operate to fortify barriers to entry, particularly within financial markets. Such regulatory frameworks may disproportionately burden new entrants, thereby insulating incumbent firms from competitive pressure. This dynamic can entrench or even create dominance for existing undertakings. A position of dominance, once established, carries an inherent risk of subsequent abuse through anti-competitive practices.

Regulation, though potentially instrumental in fostering a competitive market, carries an inherent risk of anti-competitive effect. Without precise calibration, such measures may impose disproportionate burdens on small, micro, and start-up undertakings, thereby suppressing the very competition they are intended to promote. Regulations that establish significant barriers to entry-such as licensing requirements, restrictions limiting business to a specified licensed location, and mandatory minimum capital thresholds (for example, 20 million Tanzanian Shillings); are widely recognized as posing a material risk to effective

38 Act No.8 of 2003.

39 Swedish Agency for Economical and Regional Growth, Regulation and Competition, A Literature Review; Stockholm, March 2017, at p.12.

competition.[40] Backing up this position, the Swedish Agency for Economical and Regional Growth notes:

> Regulation creating barriers to entry can consist of considerable administrative and bureaucratic procedures associated with starting a business, including the length of time it takes; the number and cost of any permits or licenses required; or minimum capital requirements to start a business.[41]

This risk arises because such measures disproportionately affect individuals or entities that engage only in occasional, non-professional lending. A person who provides a loan on a one-off basis, and is not engaged in the business of lending, would likely be unable to bear the substantial compliance costs associated with these stringent regulatory frameworks.

As previously indicated, Tanzania's commercial banking sector is concentrated in a limited number of places, the majority of which operate primarily within urban and municipal centers. Consequently, a significant portion of the rural population remains unbanked and is effectively excluded from accessing formal credit facilities offered by these commercial entities. This observation is corroborated by the scholarly assessment of Hyuha, who notes that the provision of formal credit in Tanzania is not only inadequate in scale but also deficient in its reach.[42] It is frequently characterized

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40 The Microfinance Act of 2018.

41 Swedish Agency for Economical and Regional Growth, Op Cit.

42 Hyuha M. et al, Scope, Structure and Policy Implications of Informal Financial Markets in Tanzania, at p. 3.

by bureaucratic impediments, fails to reliably serve its intended demographic, and exhibits a pronounced urban bias.[43]

Individual private lenders effectively serve to fill the void left by the inaccessibility of formal financial services in rural areas. Consequently, the prohibition of such informal lending transactions not only constitutes a potential restriction on the freedom of contract but also impedes access to essential financial services, particularly credit, for underserved populations.

This dynamic arises from the well-documented reluctance of commercial banks to extend credit to individuals lacking a formal, verifiable income source or conventional collateral. In the typical Tanzanian village context, an ordinary resident without titled land is routinely rendered ineligible for formal institutional loans. Private, informal lenders thus operate as a critical alternative source of credit for a significant portion of the rural populace. Given this function in facilitating financial inclusion, such informal lending arrangements should not be unduly discouraged by rigid or disproportionate legal regulations.

6. Drawing Lessons from Uganda and Nigeria

In formulating its regulatory approach, Tanzania may find instructive guidance in the jurisprudence of two landmark cases adjudicated in the neighboring jurisdiction of Uganda and the comparative jurisdiction of Nigeria.[44] Both decisions reaffirms that a borrower who has benefitted from a loan transaction should not be allowed to plead that the contract underlying the transaction

43 Ibid.

44 Both are Commonwealth jurisdictions.

was illegal, in order to escape from his/her obligations to repay the loan.

6.1 The Ugandan Case

The High Court of Uganda, in the case concerning *Stephen Khesmodel Omony and Denis Michael Olara,* delivered a judgment that provides direct judicial support for the legal theory advanced in this paper.[45] In this case, Mr. Olara defaulted on the repayment of the principal and accrued interest owed to Mr. Omony. In a manner consistent with the Tanzanian jurisprudence discussed above; Mr. Olara sought to shield himself from liability by invoking the statutory framework governing formalized money-lending enterprises, thereby attempting to legitimize his default. He further endeavoured to evade his contractual obligation by asserting that Mr. Omony lacked the requisite license to operate as a money lender. In its holding, the Gulu High Court judge, the Honourable George Okello, stated as follows:

> There is no law in Uganda that bars individuals from lending to their acquaintances, friends, or persons belonging to a group, among others and charging interest on a loan, as may be mutually agreed. I, therefore, see nothing wrong with an individual giving credit on friendly terms to persons they choose to give.[46]

The High Court further remarked that the existing statutory framework regulating money-lending businesses does not extinguish the liberty of individuals to procure expedient and

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45 Misc. Application No. 1 of 2022 the High Court of Uganda.

46 Judge Okays interest on loans from friends, Africa Press, available at Judge Okays interest on loans from friends - Uganda (africa-press.net) (Accessed on 7th October, 2023).

accessible loans from acquaintances, for a fee.[47] The Court further reinforced this principle by emphasizing that the judiciary must account for the practical realities of daily life, in which individuals routinely assist friends and family during personal emergencies. [48] The Court further affirmed that courts must remain cognizant of the social realities within Ugandan communities, where it is commonplace for acquaintances or friends to provide financial assistance to one another in order to satisfy urgent personal needs.[49]

In affirming the doctrine of freedom of contract, the High Court of Uganda further held that it would be contrary to both common sense and this fundamental doctrine to suggest that informal loans advanced by friends must be interest-free or provided without security. With respect, such a proposition would constitute a misapprehension of the prevailing legal framework governing lending.

The Court also underscored the pro-competitive rationale for permitting a multiplicity of lenders to operate, rather than unduly restricting the market through regulation. On this point, the Court stated, *inter alia*:

> In my view, to think otherwise, would create an oligopoly situation in Uganda's economy for licensed money lenders, with the adverse consequences of locking out many people from quick access to capital for production.[50] In my considered view, it should only be wrong for a person to

47 Ibid.
48 Id.
49 Id.
50 Id.

> operate or purport to do money-lending business when not registered as a company.[51]

6.2 The Nigerian Case

The case of *Uzoukwu v. Idika* presents pertinent facts and a *ratio decidendi* that are germane to the present discourse.[52] Between 1994 and 1995, the Respondent advanced to the Appellant a total of four separate loans, each subject to an agreed rate of interest.[53] Upon the Appellant's subsequent and unexplained cessation of repayments, the Respondent instituted proceedings before the High Court of Imo State to recover the outstanding principal and accrued interest.

At first instance, counsel for the Appellant contended that the loan agreements contravened Section 4 of the Money Lenders Law, Cap 84, Laws of Eastern Nigeria, which stipulates that any person engaging in the business of money lending must first obtain a license upon payment of the prescribed fees. It was argued that, as a consequence of this statutory breach, the agreements were illegal and therefore unenforceable. The trial judge upheld this contention and accordingly dismissed the Respondent's suit.

The Respondent then appealed to the Court of Appeal. In a majority decision of two to one, that court allowed the appeal and set aside the judgment of the trial court. The Appellant, being dissatisfied, further appealed to the Supreme Court, where he reiterated his argument regarding the illegality and consequent unenforceability of the agreements. The Supreme Court, in a

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51 Id.
52 (2022) 3 NWLR (Pt. 1818) 403.
53 Ibid.

further split decision of three to two, dismissed the appeal and thereby affirmed the ruling of the Court of Appeal. The Supreme Court held, *inter alia*:

> The parties herein had a binding contract not in any way tainted by fraud or illegality. The respondent did not deny that he enjoyed and benefited from the money he took from the appellant. The consideration offered to the appellant by the respondent for the money he received are the agreed interests he should pay, which interest the appellant would have earned had she lodged the money in the bank or invested it. This court will frown at an attempt made by the respondent to deprive the appellant for her principal sum and interests thereon under the misconception that the law that has by its own tenor clearly excluded her, at the same time applies to her. This is to allow the respondent to gloat over his unjust enrichment at the expense of the appellant.[54]

In summary, Chukuma concludes that the Supreme Court's reasoning in *Uzoukwu* is legally sound and represents a correct application of the relevant principles, a decision he fully endorses.[55] The law must not be permitted to serve as an instrument for the perpetration of fraud.[56] A borrower who has derived benefit from a loan transaction should not be entitled to plead the illegality of the underlying contract as a shield to evade his or her obligation to repay the principal sum advanced.[57]

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54 Chukuma, V.0; Friendly Loans With Interest Where the Lender is Unlicensed: A Review of The Supreme Court's Decision in Uzoukwu v Idika (2022) 3 NWLR (Pt.1818) 403 accessed at https://www.linkedin.com/pulse/friendly-loans-interest-where-lender-unlicensed-review-chukwuma/ (Accessed on 8th December, 2025).

55 Ibid.

56 Id.

57 Id.

7. Conclusion and Recommendations

This study has investigated the need to allow individual lenders to lend out money to borrowers and charge an interest in honor of the doctrine of freedom of Contract. The core conclusion is that a single, *ad-hoc* loan made by a private individual to a friend or relative, motivated by sympathy or a personal appeal to meet an emergency or resuscitate a failing business, does not constitute engaging in the business of money lending under any reasonable statutory interpretation. Therefore, such an individual should not be subject to the regulatory compliance and licensing requirements applicable to professional money lenders.

This work concludes that recent judicial decisions invalidating in for private loan agreements for regulatory non-compliance, while disregarding the principle of freedom of contract, have had detrimental consequences. By elevating statutory licensing requirements above foundational contractual autonomy, this judicial trend has jeopardized a vital credit channel for the economically disadvantaged, who are often excluded from formal institutional lending.

This practice contravenes several established legal principles. First, it undermines the cardinal doctrine of freedom of contract. Second, it conflicts with the related principle that consideration need only be *sufficient*, not *adequate*, thereby invalidating agreements based on the perceived fairness of terms rather than the existence of a bargained-for exchange. Third, it infringes upon the capacity of consenting adults to freely structure their financial affairs.

Moreover, the enforcement of such strict regulatory barriers against informal lenders has significant anti-competitive effects. It

operates to entrench the dominant position of established formal financial entities, while erecting prohibitive barriers to entry for microfinance initiatives and private individuals seeking to provide credit within their communities.

The research also put forward a number of substantive recommendations.

7.1 Recommendations

Following a critical analysis of the impact of legal regulations on microfinance and small-scale lenders, this paper proposes several recommendations for legal reformers and policymakers to enhance the framework for microloans in Tanzania. As previously established, a significant portion of the impoverished and rural population lacks the prerequisites to access formal loans from banks and regulated financial institutions. Consequently, they rely heavily on credit from microfinance entities and private lenders. To address this reality and foster a more equitable and functional credit market, the following measures are suggested:

7.1.1 Honouring the Freedom of Contract Doctrine

It is recommended that the principle of freedom of contract be recognized as a foundational legal tenet that should not be lightly abrogated. As established, this liberty is grounded in constitutional protections and serves as a cornerstone of private autonomy. State intervention to invalidate private agreements should be reserved for circumstances involving serious juridical defects such as fraud, deceit, or duress. Consequently, loan agreements between private lenders and adult borrowers; including those stipulating an interest rate-should not be deemed illegal solely on regulatory grounds,

provided they are entered into with the free and informed consent of all parties.

7.1.2 Deregulation of Non-Commercial, Personal Lending

It is further recommended that private individuals who extend loans to friends or relatives on a non-commercial basis-where the lending is incidental, not systematic, and involves a reasonable, contractually agreed-upon rate of interest; should be exempt from the formal licensing and capital maintenance requirements imposed on professional financial institutions.

Regulatory prerequisites such as a formal license, a designated place of business, and mandated capital thresholds, as stipulated under various business regulatory frameworks, are inappropriate and unduly burdensome for personal and *ad-hoc* transactions. Their application in this context serves as an unnecessary barrier to essential, informal credit without corresponding consumer protection benefits.

7.1.3 Amendment of the Law of Contract Act

It is recommended that the Law of Contract Act be amended, specifically Section 23, which enumerates grounds for declaring contracts unlawful. A *proviso* should be introduced to clarify that a failure to incorporate a formal business entity or to obtain a commercial trading license shall not, in and of itself, constitute a ground for vitiating or rendering a loan contract illegal, provided the contract is otherwise lawful in its substance and formation.

7.1.4 Adherence to Binding Precedent

It is recommended that the High Court and all subordinate courts strictly adhere to the binding precedent established by the Court of

Appeal in the case of *Simon Kichele*. As a decision of the Court of Appeal of Tanzania, it constitutes binding authority upon all lower courts pursuant to the doctrine of *stare decisis*. The reasoning and final determination in *Simon Kichele* correctly apply the law, thereby ensuring judicial consistency and safeguarding the fundamental contractual principle of freedom of contract.

7.1.5 Learning from Uganda and Nigeria

It is recommended that Tanzanian jurisprudence draw guidance from the authoritative decisions of neighboring jurisdictions, such as the Ugandan case of *Stephen Khesmodel Omony v. Denis Michael Olara* and the Nigerian case of *Uzoukwu v. Idika*. These cases affirm that the statutory regulation of formal money-lending businesses should not be interpreted so broadly as to extinguish the fundamental freedom of individuals to obtain expedient credit from relatives or friends who possess adequate financial means. Such reasoned, pro-contractual approaches are instructive for aligning legal interpretation with social and economic realities.

7.1.6 Regulating the Interest rate ceiling

As observed, private lending arrangements can, in some instances, involve interest rates that are prohibitively high and potentially exploitative. To mitigate this risk while preserving access to credit, it is recommended that the law establish a statutory ceiling on permissible interest rates. For example, legislation could prescribe that the total interest charged may not exceed a defined percentage notably not exceeding 5% of the principal sum per annum or per agreed loan period. While such a stipulation necessarily places a limitation on the principle of freedom of contract, it serves a compelling public interest objective: the protection of vulnerable

borrowers from extortionate terms. This measured regulatory intervention balances contractual autonomy with essential consumer safeguards, preventing exploitation without stifling the informal credit market.

7.1.7 Adopt the Common Law Principle of Unjust Enrichment

It is recommended that Tanzanian courts explicitly recognize and apply the common law doctrine of unjust enrichment to protect the legitimate interests of private, informal lenders. This principle should serve as an equitable remedy in cases where a loan contract is technically unenforceable due to licensing formalities, yet the borrower has retained a clear and measurable benefit. Judicial intervention on this basis would prevent the morally and economically untenable outcome where a borrower is permitted to retain loaned capital without obligation, thereby securing a windfall at the lender's expense. The application of this doctrine would provide courts with a vital instrument to mitigate the severe injustice caused by an overly rigid interpretation of licensing statutes, ensuring that fundamental fairness is not sacrificed to formalistic compliance.