

**INTERNATIONAL SALE OF GOODS REGIMES: THE MAKING AND  
EXPECTED ARRIVAL OF A *SHARI'AH* COMPLIANT MODEL LAW**

**SHARIFAH SAEEDAH SYED MOHAMED**

**THESIS SUBMITTED IN FULFILMENT OF THE REQUIREMENTS FOR THE  
DEGREE OF DOCTOR OF PHILOSOPHY**

**FACULTY OF LAW  
UNIVERSITY OF MALAYA  
KUALA LUMPUR**

**2013**

UNIVERSITY OF MALAYA

**ORIGINAL LITERARY WORK DECLARATION**

Name of Candidate: Sharifah Saeedah bt. Syed Mohamed

Registration No: LHA 080002

Name of Degree: Doctor of Philosophy

Title of Thesis: International Sale of Goods Regimes: The Making and Expected Arrival of a *Shari'ah* Compliant Model Law

Field of Study: International Trade Law

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## ABSTRACT

The study of international trade law involving an international sale of goods typically comprises of at least four documents. They are the contract of sale, the contract of carriage, the contract of insurance, and the financing arrangements with banks or financial institutions to facilitate payment for the goods purchased. The key features of international trade are, *inter alia*, to render certainty in the parties' rights and obligations by ensuring that the law is consistent and predictable; to provide sufficient flexibility to the parties' needs to do business by permitting the recognition of trade customs and usages and also to recognise the international dimension of commerce by the application of specialised rules of conflict of laws, the admission of practices and rules of international organisations aiding the interpretation and application of commercial law. Multilateral treaties play an important role in international trade law where they regulate trade between the contracting states in a general way. International contracts of sale under the conventional system have largely been entered into or made under uniform rules such as the United Nations Convention on Contracts for the International Sale of Goods 1980 (CISG) and complemented by standard commercial terms such as the INCOTERMS. Despite the emergence and increasing significance of *shari'ah* compliant transactions in recent decades, particularly involving Islamic banking and finance and also *takaful* (Islamic insurance) globally, the development and usage of Islamic law in the arena of international contracts of sale of goods have surprisingly been very sluggish or almost non-existent till to date. In other words, there are currently no uniform laws based on the *shari'ah* principles regulating the international contracts for the sale of goods. The writer sees this gap or voidness in the law from the *shari'ah* perspective as a great opportunity for Islamic scholars to explore the prospects and viability of creating a *shari'ah* compliant law applicable to international sale of goods in the future as Islamic commercial law has a friendly and liberal face imbued with basic discipline and prospects which distinguishes it from conventional commercial law propagated by the West. The writer holds firmly to the hypothesis that it is only a matter of time that this body of Islamic law will come into being and it will slowly and eventually over a period of time operate as an alternative and competing regime alongside the hitherto established conventional international sale of goods law referred to above. In the circumstances, the writer initiates and spearheads this research in search of the prospective *shari'ah* law with the sincere hope that others will follow suit shortly. A study of the CISG and INCOTERMS 2010 with a bias towards CISG is inevitable as the starting point and, the prospective *shari'ah* principles applicable to international contracts for the sale of goods under the *shari'ah* will be shaped and formulated. This research focuses on examining and analysing the obligations and rights of sellers and buyers in international contracts of sale of goods both from the conventional and Islamic perspectives, making comparisons between the two systems and also exploring the prospects and viability of a new model uniform law based on *shari'ah* principles once the Islamic contract law on international sale of goods has gained wide acceptance, recognition and application.

## ABSTRAK

Kajian undang-undang perdagangan antarabangsa yang melibatkan jualan barangan antarabangsa biasanya terdiri daripada sekurang-kurangnya empat dokumen, iaitu kontrak jualan, kontrak pengangkutan, kontrak insurans, dan pengaturan pembiayaan dengan bank atau institusi kewangan untuk memudahkan pembayaran bagi barang-barang yang dibeli. Ciri-ciri utama perdagangan antarabangsa, antara lain, untuk memberi kepastian kepada hak dan kewajiban pihak-pihak terbabit dengan memastikan bahawa undang-undang adalah konsisten dan boleh diramal; untuk memberi fleksibiliti yang mencukupi keperluan pihak terbabit dalam perniagaan dengan membenarkan pengiktirafan perdagangan yang digunakan secara lazimnya, dan juga untuk mengiktiraf dimensi perdagangan antarabangsa dengan melaksanakan peraturan khusus konflik undang-undang, kemasukan amalan dan peraturan organisasi antarabangsa membantu tafsiran dan aplikasi undang-undang komersil. Perjanjian pelbagai hala memainkan peranan yang penting dalam undang-undang perdagangan antarabangsa dimana ianya mengawal selia kontrak perdagangan antara negara-negara secara umum. Kontrak jualan antarabangsa di bawah sistem konvensional sebahagian besarnya telah dibuat di bawah peraturan seragam seperti United Nations Convention on Contracts for the International Sale of Goods 1980 (CISG) dan dilengkapi dengan terma komersial seperti INCOTERMS. Walaupun terdapatnya kemunculan dan peningkatan kepentingan transaksi patuh syariah sejak beberapa dekad kebelakangan ini, terutamanya yang melibatkan perbankan dan kewangan Islam dan juga takaful di peringkat global, pembangunan dan penggunaan undang-undang Islam untuk kontrak jualan barangan di arena antarabangsa adalah terlalu lembab atau hampir tidak wujud sehingga kini. Dalam erti kata lain, pada masa ini, tiada undang-undang seragam yang berdasarkan prinsip-prinsip syariah yang mengawal selia kontrak jualan barangan antarabangsa. Penulis melihat jurang atau kekosongan dalam undang-undang dari perspektif syariah sebagai peluang besar kepada para ilmuan Islam untuk meneroka prospek dan daya maju mewujudkan undang-undang yang mematuhi syariah yang boleh digunakan untuk jualan barangan antarabangsa pada masa hadapan sebagai undang-undang komersial Islam yang mempunyai wajah yang mesra dan liberal yang disemai dengan disiplin yang asas dan prospek yang membezakannya dari undang-undang komersial konvensional yang disebarluaskan oleh pihak Barat. Penulis memegang teguh kepada hipotesis bahawa ia hanya menunggu masa yang sesuai untuk undang-undang komersial Islam bagi kontrak jualan barangan antarabangsa diterima dan digunakan pada masa hadapan secara perlahan-lahan dan akhirnya beroperasi sebagai alternatif dan bersaing kepada kontrak jualan antarabangsa di bawah sistem konvensional yang disebut di atas. Justeru itu, penulis memulakan dan menerajui penyelidikan ini dengan harapan ikhlas bahawa orang lain akan turut menyusul kemudiannya. Sebagai titik permulaan, kajian terhadap CISG dan Incoterms 2010 dengan perhatian yang lebih kepada CISG tidak dapat dielakkan, dan prinsip-prinsip syariah yang bakal digunakan untuk kontrak jualan barangan antarabangsa di bawah syariah akan dibentuk dan digubal. Kajian ini memberi tumpuan kepada memeriksa dan menganalisis kewajiban dan hak penjual dan pembeli dalam kontrak penjualan barangan antarabangsa dari kedua-dua perspektif konvensional dan Islam, membuat perbandingan antara kedua-dua sistem, dan juga meneroka prospek dan daya maju model baru undang-undang seragam yang berasaskan kepada prinsip-prinsip syariah apabila undang-undang kontrak Islam jualan barangan antarabangsa mendapat penerimaan luas, pengiktirafan dan digunakan.

## ACKNOWLEDGMENTS

First and foremost, I am thankful to Allah The Almighty, through whom all things are possible, by His abundant grace and mercy.

I would like to express my gratitude to my employer, Universiti Teknologi MARA (UiTM), the Ministry of Higher Education for the scholarship which makes it possible for me to pursue my Ph.D and also to University of Malaya (UM) for sponsoring my Research Associateship at the School of Law, School of Oriental and African Studies, University of London (SOAS). My appreciation is also extended to the immediate former Dean of the Law Faculty UiTM, Associate Professor Datin Dr Musrifah Sapardi and the current Dean, Associate Professor Datin Paduka Saudah Sulaiman, for their unending support.

I would also like to record my indebtedness to my supervisors, Associate Professor Dr Gan Ching Chuan and Associate Professor Dr Mohd Khalil Ruslan for their patience, guidance and encouragement. My special thanks also go to Professor Mashood Baderin, Professor Matthew Craven, Mr Ian D Edge and especially to Mr Nicholas H D Foster of SOAS for their kind assistance during my tenure as a Research Associate at SOAS. I would also like to express my gratitude to Professor Vivienne Bath and Dr Camilla Baasch Andersen who have unselfishly shared their knowledge and expertise for this research.

I am also eternally grateful to my parents, siblings and other family members for their unconditional support, assistance and prayers, without which the completion of this dissertation would not be possible. I am also thankful to my colleague, Associate Professor Dr Irwin Ooi for mooted the idea for this research and also to my dear friends Rohani, Noraziah, Norliza, Hariati, Rozlinda and Mazlifah for their encouragement. Not forgetting Sarah and Nazli for their constant support. I also extend my appreciation to all the staff of the Tan Sri Professor Ahmad Ibrahim Law Library (UM) for their assistance.

To my dear husband, Kamal Aryf, thank you for your patience, tolerance and sacrifices and for being my pillar of strength during one of the most difficult journeys of my life. And to my beloved children, Dania, Ryyan and Eilham, thank you for understanding what mama had to go through.

I would also like to thank everyone who has contributed to the successful realisation of my dissertation and my apologies to those whom I cannot personally name here. Finally, I dedicate this work in memory of my dear friend, Norlaily Osman (1973-2013).

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## TABLE OF ABBREVIATIONS

### Common Abbreviations

c.f. – compare  
e.g. – (*exempligratia*) for example  
et. al. – (*et alia*) and others  
etc. – and so fourth  
i.e. – that is  
id. – (*idem*) the same below  
ibid. – (*ibidem*) in the same place  
pbuh – peace be upon him  
Vol. - volume

### Periodical Legal Journals

AJCL; Am. J. Comp. L. – American Journal of Comparative Law  
ALQ – Arab Law Quarterly  
Am. J. Int'l L. – American Journal of International Law  
ABLR - Australian Business Law Review  
Brook. J. Int'l L. – Brooklyn Journal of International Law  
Chi. J. Int'l L. – Chicago Journal of International Law  
Cornell Int'l L.J. – Cornell International Law Journal  
E.B.L.R. - European Business Law Review  
Ga.J.Int'l. & Comp.L. - Georgia Journal of International and Comparative Law  
International Islamic University Malaysia Law Journal - IIUM Law Journal  
Institut Kefahaman Islam Malaysia Law Journal - IKIM Law Journal  
InDret - revista per a analisi del dret (Journal in the Analysis of Law)  
Int'l Law. – International Lawyer  
Islamic & Comp. L,Q. – Islamic and Comparative Law Quarterly  
J.B.L. – Journal of Business Law  
J.L. & Com. – Journal of Law and Commerce  
J.L. & Religion – Journal of Law and Religion  
J Islam & Comp - Journal of Islamic and Comparative Law  
JWT - Journal of World Trade  
Minnesota Journal of Global Trade - Minn. J. Global Trade  
Ohio St. L.J. - Ohio State Law Journal  
Pace Int'l L. Rev. – Pace International Law Review  
ShLR – Shariah Law Reports  
SJLS - Singapore Journal of Legal Studies  
Tul. L. Rev. – Tulane Law Review  
Victoria U. Wellington L. Rev. – Victoria University of Wellington Law Review

## **Law Reports**

AC - Appeal Cases

All ER - All England Law Reports

Cal Rptr - California Reporter (USA)

E.D.La. - District Court for the Eastern District of Louisiana (USA)

FCR - Federal Court Reports (Aus.)

K.B. - King's Bench

Lloyd's Rep - Lloyd's List Law Reports

NJW - Neue Juristische Wochenschrift (Germany)

Q.B.D. - Queen's Bench Division

QB - Queen's Bench

WLR - Weekly Law Reports

## **International Conventions, Organisations and Commercial Terms**

CIF - Cost, Insurance and Freight

CISG - The United Nations Convention on Contracts for the International Sale of Goods

CLOUT - Case Law on UNCITRAL Texts

EC - European Communities

FOB - Free on Board

FOSFA - Federation of Oils, Seeds and Fats Association

GAFTA - Grain and Feed Trade Association

GIFF - Global Islamic Finance Forum

ICC - International Chamber of Commerce

INCOTERMS - The International Commercial Terms

KLRCA - Kuala Lumpur Regional Centre for Arbitration

OHADA - Organisation for the Harmonisation of Business Law in Africa

UCC - Uniform Commercial Code

UCP - Uniform Customs and Practice for Documentary Credits

ULF - Uniform Law on the Formation of Contracts for the International Sale of Goods

ULIS - Uniform Law on the International Sale of Goods

UNCITRAL - United Nations Commission on International Trade Law

UNIDROIT - International Institute for the Unification of Private Law



# CHAPTER ONE

## INTRODUCTION

### 1.1 Background of Research

International trade is the exchange of capital, goods and services across international borders or territories. In most countries, such trade represents a significant share of gross domestic product (GDP). While international trade has been present throughout much of history, a prominent example being the Silk Road,<sup>1</sup> its economic, social and political importance has been on the rise in recent centuries. Industrialisation, advanced transportation, globalisation, multinational corporations, and outsourcing are all having a major impact on the international trade system. Increasing international trade is crucial to the continuance of globalisation. Without international trade, nations would be limited to the goods and services produced within their own borders.<sup>2</sup>

International trade is comprised of, amongst others, the contract of sale, carriage, insurance and finance. This dissertation however, focuses only on the aspect of sale. International contracts of sale under the secular system has been regulated by several uniform rules, one of the most notable models being the United Nations Convention on Contracts for the International Sale of Goods 1980, widely known as the CISG.<sup>3</sup> Sale contracts entered using the CISG is customarily supplemented by the Incoterms rules<sup>4</sup> to further define the respective obligations of the contracting parties.

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<sup>1</sup> Boulnois, Luce, *Silk Road: Monks, Warriors & Merchants*, (Hong Kong: Odyssey Books, 2005), 66.

<sup>2</sup> Retrieved on 18<sup>th</sup> January 2013 from <[http://en.wikipedia.org/wiki/international\\_trade](http://en.wikipedia.org/wiki/international_trade)>. This definition from *wikipedia* is used as it gives a more comprehensive description of international trade compared to other academic references.

<sup>3</sup> The United Nations Convention on Contracts for the International Sale of Goods (CISG) is a treaty offering a uniform international sales law which was signed in Vienna in 1980 and became effective on 1<sup>st</sup> January 1988. As of 24<sup>th</sup> February 2012, it had been ratified by 78 countries and currently accounts for three-quarters of all world trade. Retrieved on 12 November 2012 from <<http://www.cisg.law.pace.edu/cisg/countries/cntries.html>>

<sup>4</sup> The “Incoterms” is abbreviation of “International commercial terms” formulated by the International Chamber of Commerce (ICC). They are primarily intended for international sales and the trade terms used typically identify the roles of the contracting parties with

Of late, the world has shown a growing fascination in *shari'ah*<sup>5</sup> compliant business transactions, such as banking and insurance, due to the *shari'ah's* stability and principled governance while being flexible at the same time. However, the progress and usage of *shari'ah* principles in the area of international sale of goods has, to some extent, been sluggish or almost absent. There are no model contracts or a set of universally applicable international rules and regulations to govern and regulate international contracts of sale founded on the *shari'ah* principles. It is the absence of a *shari'ah* compliant uniform rules in the field of international sale of goods that this dissertation addresses.

As regions of the world once separated by continents and vast oceans are now growing closer by a dramatic rise in the level of international business transactions, the law can no longer remain static but has to keep up with the changes. In this day and age where the *shari'ah* has gained a strong foothold in the commercial world, the international business society ought to be given an option to conduct trade either in the conventional manner or derived from the *shari'ah* principles.

This dissertation will, as far as practicable, investigate the rights and obligations of sellers and buyers in international contracts of sale, the remedies available to the contracting parties, the strengths and weaknesses of the conventional uniform international sale of goods regime, and possibly exploring the prospect of introducing a *shari'ah* compliant uniform model sales law to be employed in international business in the near future. In particular, references will be made to the United Nations Convention on Contracts for the International Sale of Goods (the CISG), the Incoterms rules 2010, the principles of contract

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respect to carriage of the goods from seller to buyer; export, import and security-related clearance and the division of costs and risks between the parties. Ramberg, Jan. ICC Guide to Incoterms 2010,(Paris: ICC Publications, 2011), 16.

<sup>5</sup> The *shari'ah* literally means the road to the watering place, the straight path to be followed. It can be described as the sum total of Islamic teaching and system, which was revealed to Prophet Muhammad (pbuh) recorded in the *Qur'an* as well as deducible from the Prophet's divinely guided lifestyle called the *sunnah*. Mohamad Akram Laldin. Introduction to *Shari'ah & Islamic Jurisprudence* (2<sup>nd</sup> ed.), (Kuala Lumpur: CERT Publications Sdn. Bhd., 2008), 3

of sale under the *shari'ah* principles derived from the Holy Qur'an, authentic *hadiths*,<sup>6</sup> views on several aspects of sale from the four major schools of Islamic thought namely, the Hanafi, Maliki, Shafi'i and Hanbali and select Islamic Civil and/or Commercial Codes as a basis for the proposal for the introduction of a *shari'ah* compliant model law for the international sale of goods.

## **1.2 Statement**

International contracts of sale under the conventional system are governed by well settled laws such as contract law and the law in relation to sale of goods. Its implementation is in the mode of uniform rules, standard form contracts and other regulations under international conventions. However, currently,<sup>7</sup> there are no uniform rules in international contracts of sale founded on the *shari'ah* principles. This absence of a uniform *shari'ah* compliant set of rules in the area of international sale of goods has to be addressed to reflect the recognition of the significance of the *shari'ah* in world commerce in the interest of providing options to the international business community in conducting their trade.

## **1.3 Basic Premise**

In the sphere of international commercial law, it is a matter of time before the business community, regionally initially, and internationally subsequently and eventually, will adopt a *shari'ah* compliant uniform international sale of goods law owing to its potential

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<sup>6</sup> A *hadith* is the sayings and teachings of Prophet Muhammad (pbuh), the second source of information (after the Qur'an) for Muslims concerning the right way to live. Ruqaiyyah Waris Maqsood, A Basic Dictionary of Islam, (New Delhi: Goodwork Books, 2008), 81

<sup>7</sup> Correct at the time of writing this dissertation.

attractiveness and viability in terms of its principled governance, flexibility and liberalism as opposed to its much criticised and infamous political and religious Islam.<sup>8</sup>

#### **1.4 Research Objective**

The primary and noble objective of this academic exercise is to initially, in the short run, postulate to the international business community a workable *shari'ah* compliant contract for the international sale of goods which is at least competitive enough, if not better, to rival or compete with the conventional international sale of goods contract based on the CISG and Incoterms, and eventually, in the long run, an internationally recognised *shari'ah* regime on the international sale of goods.

#### **1.5 Research Questions**

1. What are the main obligations of the contracting parties in an international sale contract?
2. What are the requirements of a contract of sale from the *shari'ah* perspective?
3. Can a *shari'ah* compliant model law be transposed as a viable alternative to the conventional international model law on sale of goods?

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<sup>8</sup> Islamic Banking and Finance and also Islamic Insurance (Takaful) have already gained a strong foothold in the field of commerce and are fast developing as competitive commercial products. It is, therefore, inevitable that a *shari'ah* compliant uniform international sale of goods law will make its appearance in the field of international commerce and commercial law. What is uncertain at the moment is the timing of its arrival. It is therefore pleaded that serious efforts must now commence on the part of Islamic scholars to network and spearhead research and serious initiatives towards achieving the eventual goal of creating that body of uniform law and nurturing and developing it until it is competitive and sustainable. It is confident that this noble goal is achievable.

## 1.6 Literature Review

The writer of this dissertation gratefully acknowledges the labour of the individuals who have written books, articles, comments and other scholarly materials in the area of international sale of goods and have paved the way for further research on the subject.

### 1.6.1 The CISG Database

A wealth of materials on matters relating to the CISG can be accessed from this award winning database <<http://www.cisg.law.pace.edu/>>. This database has an extensive collection of materials pertaining to the CISG which includes, *inter alia*, the history of CISG, list of Contracting States, scholarly writings and case law with regard to every individual Article of the CISG. Despite the plethora of materials available in this website, only a handful of the articles written made reference to the relation between the CISG and the *shari'ah* principles on sale of goods.

Fatima Akaddaf, in her article “*Application of the United Nations Convention on Contracts for the International Sale of Goods (CISG) to Arab Islamic Countries: Is the CISG Compatible with Islamic Law Principles?*” (2001)<sup>9</sup> merely gave an overview of the CISG and the *shari'ah* while briefly mentioning the possible intricacies of applying Articles 38,<sup>10</sup> 39<sup>11</sup> and 40<sup>12</sup> in developing Arab countries. The writer also mentioned the application of Article 78<sup>13</sup> and made a comparison between the provision of interest under the CISG and the prohibition of interest under the *shari'ah*. The only similarity between the CISG and the *shari'ah* the writer managed to raise is the notion of good faith, which forms the basis

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<sup>9</sup> 13 Pace Int'l L. Rev. 1 (2001). Available online at <<http://digitalcommons.pace.edu/pilr/vol13/iss1/1>> and also at <<http://www.cisg.law.pace.edu/cisg/biblio/akaddaf.html>>

<sup>10</sup> Article 38 deals with the time for examination of the goods by the buyer.

<sup>11</sup> Article 39 provides for notice on lack of conformity of the goods.

<sup>12</sup> Article 40 relates to seller's knowledge of non-conformity of the goods.

<sup>13</sup> Article 78 concerns the provision of interest on sum under the CISG.

of sales and trade in Islamic law, and referred to in Article 7(1) of the CISG. This article focused more on the influence of Western commercial law in Islamic countries, in particular Islamic countries which are signatories to the CISG, as opposed to promoting the *shari'ah* as an alternative to the prevailing conventional sale of goods law.

T.S. Twibell in his article "*Implementation of the United Nations Convention on Contracts for the International Sale of Goods (CISG) under Shari'a Law: Will Article 78 of the CISG be Enforced When the Forum is an Islamic State*" (1997)<sup>14</sup> contended that although Islamic countries who are signatories to the Convention such as Egypt, Syria and Iraq have accepted Article 78 without reservation, the issue of interest in Article 78 itself is very brief and vague as there is no mention of the rate of interest, when interest starts to run or whether it is simple or compounded interest. Since there is no reported arbitral or court decision has addressed this issue and the question has been raised particularly when some Islamic countries' domestic laws do not recognise interest, this particular area of law needs to be further explored.

Finally, Hossam A. El-Saghir, in his article "*The Interpretation of the CISG in the Arab World*" (2008)<sup>15</sup> discussed in general the principles of interpretation of the CISG, the obstacles to the uniform application of the CISG in the Arab world, the influence of national law on the interpretation of the CISG in Arab countries and also briefly the influence of the CISG on the domestic law of Egypt. Again, there is no mention of a proposal for the introduction of a *shari'ah* compliant international sale of goods law.

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<sup>14</sup> Available online at <<http://www.cisg.law.pace.edu/cisg/biblio/twibell.html>>

<sup>15</sup> Available online at <<http://www.cisg.law.pace.edu/cisg/biblio/el-saghir.html>>

### **1.6.2 The Incoterms Rules 2010**

The Incoterms rules 2010 essentially are rules primarily intended for international sales and the trade terms used such as the CIF (Carriage Insurance Freight) and FOB (Free on Board) typically identify the roles of the contracting parties with respect to carriage of the goods from seller to buyer; export, import and security-related clearance and the division of costs and risks between the parties. There are eleven (11) rules altogether in the Incoterms rules 2010. The Incoterms rules customarily supplement sales contract entered into under the CISG.

### **1.6.3 The Qur'an, *Hadiths* and Select Literature from the Hanafi, Maliki, Shafi'i and Hanbali Schools of Thought**

Contracts of sale have long been recognised under the *shari'ah*, the primary sources being the Holy Qur'an, *hadiths* of the Prophet Muhammad (pbuh) and select writings of scholars of the Hanafi, Maliki, Shafi'i and Hanbali *sunni* schools of thought.<sup>16</sup> Among the verses of the Qur'an relevant to the subject matter of this dissertation are select verses from *surah Al-Baqarah*, *Al-Maidah* and *An-Nisaa*. For instance, Allah has decreed in *surah Al-Baqarah* that "... but Allah hath permitted trade and forbidden usury..." (*Al-Baqarah:175*) as the basis for allowing sales and trade in Islam. Select *hadiths*, mostly from the translation of *Bukhari*, *Muslim* and *Malik's Muwatta* in allowing trade, forbidding *riba* (usury) and *gharar* (speculation) and also select writings of scholars from the abovementioned four schools of Islamic thought, where relevant, are also referred to in this dissertation.

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<sup>16</sup> This dissertation will only discuss the opinions of the said four schools of thought as they are the major schools recognised under the *shari'ah*.

#### 1.6.4 Textbooks

Textbooks that have been published pertaining to the CISG are aplenty but in researching materials for this dissertation, this writer mostly referred to books authored by Michael Bridge *The International Sale of Goods, Law and Practice (2<sup>nd</sup> ed.)*<sup>17</sup>, Peter Huber and Alastair Mullis *The CISG, A New Textbook for Students and Practitioners*<sup>18</sup> and also by Jason Chuah *Law of International Trade: Cross-Border Commercial Transactions (4<sup>th</sup> ed.)*<sup>19</sup>. As for Islamic jurisprudence and contracts based on the *shari'ah* principles, this writer found Susan E. Rayner's book *The Theory of Contracts in Islamic Law: A Comparative Analysis With Particular Reference To The Modern Legislation In Kuwait, Bahrain and the United Arab Emirates*<sup>20</sup> and also Mohammad Hashim Kamali, *Principles of Islamic Jurisprudence*,<sup>21</sup> Mohamad Akram Laldin, *Introduction to Shari'ah & Islamic Jurisprudence (2<sup>nd</sup> ed.)*,<sup>22</sup> and Mohd Ma'sum Billah, *Shari'ah Standard of Business Contract*,<sup>23</sup> particularly helpful.

#### 1.6.5 Legislation

Since this dissertation proposes for the introduction of a *shari'ah* compliant model law in the area of international sale of goods, the legislation referred to as a basis for such formulation in the future are The Mejelle, Being An English Translation of *Majallah el-*

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<sup>17</sup> New York: Oxford University Press (2007).

<sup>18</sup> Munich: Sellier European Law Publishers (2007).

<sup>19</sup> London: Thompson Reuters (2009).

<sup>20</sup> London: Graham & Trotman (1991). Unfortunately, this is the only book penned by the author pertaining to contract under the *shari'ah* as there are no other books published after this title.

<sup>21</sup> Malaysia: Ilmiah Publishers (2007)

<sup>22</sup> Kuala Lumpur: CERT Publications Sdn. Bhd. (2008)

<sup>23</sup> Kuala Lumpur: A.S. Noordeen (2006)

*Ahkam-I-Adliya*, A Complete Code of Islamic Civil Law;<sup>24</sup> The Civil Code of Egypt;<sup>25</sup> The Civil Code of Iran;<sup>26</sup> and also the Lebanon Code of Obligations and Contracts.<sup>27</sup>

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<sup>24</sup> Turkey has enacted a new Turkish Code of Obligations which came into force on July 1 2012 and is largely based on the Swiss Obligations Law. However, this writer maintains reference to The Mejlle as its provisions were formulated based on the *shari'ah* principles primarily based on the Hanafi school of thought.

<sup>25</sup> Egypt is a signatory to the CISG. Although Egypt has enacted a New Commercial Code namely Law No. 17 for the year 1997 which came into force on October 1, 1999, this writer specifically made reference to the former Civil Code as a sample legislation due to the following reasons:

(1) The former Civil Code reflects the intention of the original drafters of the Code as it provides for the *shari'ah* to have a role in its enforcement and interpretation. Article 1 of the Code provides that "In the absence of any applicable legislation, the judge shall decide according to the custom and failing the custom, according to the principles of Islamic Law. In the absence of these principles, the judge shall have recourse to natural law and the rules of equity."

(2) The New Commercial Code, instead of upholding the principles of *shari'ah*, has to a certain extent, been influenced by the CISG. Hossam A. El-Saghir, in his article "*The Interpretation of the CISG in the Arab World*" (*op. cit.*) provided several examples of the CISG's influence in the New Code, amongst others:

(i) Article 2 of the New Commercial Code corresponds with Article 6 of the CISG. Both give superiority to parties' agreement. This is the first time that the Egyptian Legislature expressly incorporates party autonomy in the Commercial Code. Thus, contracting parties have extensive latitude to structure their deals in a way that enables them to protect their interests. Party autonomy is thus a principle that equally applies to all transactions regulated by the Code, including commercial sales. According to Article 2 of the Commercial Code, the provisions of the Code only apply as default rules. They only apply absent parties' agreement on the issue. Parties can derogate from the provisions of the Commercial Code. They can alter, or exclude some or all of the Code's provisions. Public policy is the only limitation to party autonomy. If the parties' agreement violates public policy provisions, their agreement will be set aside.

(ii) Open Price Contract - The introduction of open price contracts is another manifestation of the impact that the CISG had on the regulation of commercial sales contracts. Prior to the adoption of the New Commercial Code, the Civil Code governed all sales contracts. The Civil Code requires for the sale contract to be validly concluded that the parties agree on the price either expressly or impliedly. It is well settled that the absence of parties' agreement about the price or about the means for price determination renders the contract invalid. The absence of parties' agreement about the price, either expressly or implicitly, is therefore fatal for a contract's validity. However, the promulgation of the New Commercial Code, and the introduction of the commercial/non-commercial sales contracts distinction has resulted in a reform. For the first time, the legislature allowed for the conclusion of a commercial sales contract even if the parties do not agree about the price. In this regard, Article 89 of the Code lays the rules to which resort is to be made when the parties do not agree about the price. The way in which the New Commercial Code deals with situations where the parties fail to agree about the price is significantly influenced by the Article 55 of the CISG. Article 89 of the Commercial Code stipulates that if parties do not agree about the price, either expressly or implicitly, such price will be that charged in previous deals between them. If no previous deals exist, reference is to be made to the market price. Note: Article 55 of the CISG is explained in paragraph 4.5.3 of this dissertation.

(iii) Avoidance for Non-Delivery with "*Nachfrist*" Notice - The New Commercial Code has also regulated contract avoidance in a way that resembles the CISG. The default rule in the Civil Code is that contract avoidance requires a court decision. The party alleging breach has to bring a claim before the competent court. The court has discretion whether to avoid the contract taking into account the degree of breach. In contrast, the former Civil Code does not require for avoiding the contract that the breach must be serious. Article 96 of the New Commercial Code gives buyer in commercial sales contracts the option to avoid the contract without resort to the judiciary. It borrowed the concept of *Nachfrist* notice from Articles 47(1) and 49(1)(b) of the CISG. Accordingly, where the seller fails to perform his obligation to deliver the goods, the buyer is entitled to specify an additional period of time and notify the seller to perform his delivery obligation during this period. Otherwise the contract is *ipso facto* avoided. In all the cases the buyer retains the right to claim damages. Note: The "*Nachfrist*" Notice is explained in paragraph 5.3.2.2 of this dissertation.

This writer is of the opinion that from the three examples provided by the author, the Open Price Contract is arguably the most troubling provision as it entirely goes against the principles of the *shari'ah* where determination of the price is an essential term of the contract, without which the contract is deemed invalid or *fasid*.

<sup>26</sup> One of the main reasons The Civil Code of Iran is chosen as a sample is to show similarities in Islamic commercial transactions between the *sunni* and the *shi'ah* sect.

<sup>27</sup> Lebanon is also a signatory to the CISG.

### **1.6.6 Case Law**

The majority of case law referred to in this dissertation is obtained from the CISG database <<http://www.cisg.law.pace.edu/>> and also from the Unilex database on CISG and UNIDROIT Principles <<http://www.unilex.info/>>.<sup>28</sup> Since the United Kingdom and Malaysia are not signatories to the CISG, most of the cases referred to are European cases or decisions of courts of the United States of America.

### **1.7 Significance of the Research and Contribution to the Body of Knowledge**

The aim of this research is to find the limitations and drawbacks in the rules and regulations pertaining to the rights and obligations of sellers and buyers in international contracts of sale, with the sole focus on the United Nations Convention on Contracts for the International Sale of Goods (the CISG) as a sample for an evaluation against contracts of sale under the *shari'ah* principles. It is humbly submitted that at the end of this study, concrete ideas and suggestions can be put forward towards the formulation of a *shari'ah* compliant model contract initially, and subsequently a model law or uniform rules governing international contracts of sale.

It is again humbly submitted that in this manner, this dissertation will contribute towards the enhancement of international trade law jurisprudence. This dissertation is intended to be a useful guide towards more efficient and transparent international business transactions, uniformity in the law and a better enforcement of the relevant rules and

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<sup>28</sup> The UNILEX database on CISG and UNIDROIT Principles, International Case Law and Bibliography, accessible at <http://www.unilex.info/> is a renowned database of international case law and bibliography on the UNIDROIT Principles of International Commercial Contracts and on the CISG – two of the most important international instruments for the regulation of international commercial transactions. It contains detailed abstracts of the most important cases decided under both instruments by courts and arbitral tribunals worldwide; the full text of each decision in its original language; the complete texts of the UNIDROIT Principles and the CISG; a status report on the state of ratifications of the CISG, including reservations and declarations by States parties to the Convention and a comprehensive bibliography for each instrument.

regulations. This research will further lead to the contribution of new knowledge and ideas in this area of law.

## **1.8 Methodology**

This thesis will engage in doctrinal research in law for the purpose of making a relative study between the conventional and *shari'ah* principles on the rights and obligations of contracting parties in an international contract of sale. This research will also endeavour to identify the basic features in the international conventional model and *shari'ah* principles in addressing and regulating such rights and obligations. The method of study is to appraise and contrast both the conventional and *shari'ah* regimes before ultimately proposing the introduction of a theoretical construct of a *shari'ah* compliant model contract, and eventually a model law, for international contracts of sale.

For the purpose of appraising and contrasting the said regimes, relevant provisions of the United Nations Convention on Contracts for the International Sale of Goods (CISG) and the Incoterms Rules 2010 will be studied and contrasted with the provisions relating to *shari'ah* sale of goods founded in the Holy Qur'an, authentic *hadiths* mostly from the translation of *Bukhari, Muslim* and *Malik's Muwatta* and also select scholarly writings of Muslim jurists from the Hanafi, Maliki, Shafi'i and Hanbali schools of thought. The principles and methodology adopted by these four schools of thought will be briefly explained below.

(i) Hanafi

Of all the four revered Imams who established the above schools of thought, Imam al-Nu'man b. Thabit b. Zuta Abu Hanifah who founded the Hanafi school, is distinguished for its application of the rules of the *shari'ah* to practical matters of human life, making use of reason and logic in this process or broadening the rules by means of analogy (*qiyas*) and equity (*istihsan*). It would be proper to say that the school was a natural result of the changing human civilisation of the time and it was the first to lay foundation of technical legal thought.<sup>29</sup> While the principles formulated by the Imam were strictly in conformity with the *shari'ah*, while giving his opinion, he would also trace out the bases from the sacred principles as contained in the evidences and adopted a method of approach to legal problems in a chronological manner taking guidance from the Qur'an, Traditions of the Prophet (pbuh), *ijma'* (consensus) of the Companions,<sup>30</sup> *qiyas* (analogical deduction), *istihsan* (equity) and also *'urf* (custom).<sup>31</sup>

It goes to the credit of Imam Abu Hanifah that he was the first to formulate the technique of legal evolution in order to codify the law. For accomplishing this, he evolved out a theory of juristic development as the science of law called *usul al-fiqh*, by making use of *qiyas* or analogical reasoning and also *istihsan* or juristic equity. The legal evolution following on the theory of *usul al-fiqh* has made the principles of the Hanafi school most humanitarian of all and most suited for changing society.

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<sup>29</sup> Anwar A. Qadri, *Islamic Jurisprudence in the Modern World*, 2<sup>nd</sup> ed., (Lahore: Sh. Muhammad Ashraf Kashmiri Bazar, 1973), 90. Both *qiyas* and *istihsan* are explained in paragraphs 3.5.2.2 and 3.5.2.3 respectively in Chapter 3 of this dissertation.

<sup>30</sup> A Companion or *Sahabah* is a close friend of the Prophet Muhammad (pbuh). Among the notable Companions are Abu Bakr Siddiq, 'Umar bin Khattab, 'Usman bin Affan and Ali bin Abi Talib.

<sup>31</sup> Anwar A. Qadri, *op. cit.*, 94. *Ijma'* and *'urf* are explained in paragraphs 3.5.2.1 and 3.5.2.5 respectively in Chapter 3 of this dissertation.

By reason of the possibility of its immense technical developments, the Ottoman Empire not only adopted the Hanafi school as its officially recognised school but for the changing society *Majallah el-Ahkam-I-Adliya* (The Mejlle) was drafted from the principles of researches in law books of the Hanafi jurists.<sup>32</sup>

(ii) Maliki

Imam ‘Abdullah Malik ibn Anas b. Malik b. Abi ‘Amir founded the Maliki school of thought leaned towards *hadith* learning, occupies a conspicuous place in the teaching of the *hadith* but also made use of analogical deduction like Imam Abu Hanifah of the Hanafi school. Perhaps somewhat rigid and formal on a number of points as compared with the Hanafi school, the Maliki school had, on the other hand, won immense public applause for having been from the outset a practical and living body of doctrines.<sup>33</sup> While interpreting the *shari’ah*, the Imam relied on the fundamental sources, namely the Qur’an and the *Sunnah*<sup>34</sup> and also the practices of the city (of Medina) and the sayings of the Companions. In the absence of explicit texts, he had recourse to analogy and also to *maslahah mursalah* or public interest.<sup>35</sup>

(iii) Shafi’i

In order to make a choice between reason and authority, Imam Abu ‘Abdullah Muhammad b. Idris b.’Abbas as-Shafi’i al-Matlabi better known as Imam Shafi’i, brought about a balance between traditionalism of the Maliki school and the practicality of the Hanafi

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<sup>32</sup> *Id.* at 95-97

<sup>33</sup> *Id.* at 111-114.

<sup>34</sup> The *sunnah* is explained in paragraph 3.5.1.2 in Chapter 3 of this dissertation.

<sup>35</sup> Anwar A. Qadri, *op. cit.*, 114. *Maslahah mursalah* is explained in paragraph 3.5.2.4 in Chapter 3 of this dissertation.

school and thus a third *sunni* school emerged.<sup>36</sup> The Imam stood unrivalled for his abundant merit and illustrious qualities and has knowledge of all sciences connected with the Qur'an, the *Sunnah*, the sayings of the Companions, their history and the conflicting opinions of the learned and the avowed object of the Imam was to reconcile the *fiqh* (Islamic jurisprudence) and the Traditions (of the Prophet). In addition to accepting the four sources of law, namely the Qur'an, the *Sunnah*, *ijma'* and *qiyas*, he introduced *istislah* or *istishhad* (taking into consideration public good) but rejected *istihsan* and *maslahah* of the Hanafi and Maliki schools respectively. Nevertheless, such methodology is not new but a continuation of the principles inherent in the *shari'ah* principles on points of flexibility and suitability in explanations.<sup>37</sup> However, it is the effort of Imam Shafi'i to reconcile the science of law mechanised by Imam Abu Hanifah and the superb approach towards the *Sunnah* by Imam Malik have been a landmark in the history of Islamic jurisprudence.<sup>38</sup>

(iv) Hanbali

Imam Abu 'Abdullah Ahmad ibn Hanbal is the founder of the fourth *sunni* school. In his research methodology in jurisprudence, he always looked for the *Sunnah* of the Prophet and actions of his Companions. The methodology of the Imam was a complete following of these two principles and they became the basic rule of his school. He laid down principles of the school by adopting the sources of law from the Qur'an, the *Sunnah* and *fatawa* (rulings on a point of Islamic law given by a recognised authority) of the

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<sup>36</sup> *Id.* at 123. Malaysia adheres to the principles of the Shafi'i school.

<sup>37</sup> *Id.* at 126.

<sup>38</sup> *Id.* at 131.

Companions (if they are uncontradicted) as well as sayings of certain Companions, weak traditions<sup>39</sup> and also by *qiyas* (analogy).<sup>40</sup>

The *fiqh* of Imam Ahmad Hanbal was a system raised and enriched under reliance of placed upon the Traditions of the Prophet with an underlying emphasis on the opinions of the Companions. The methodology in legal development adopted by the Imam (especially in the field of transactions) was a reliance upon principles of permissibility in cases where no direct authority was available in the Qur'an and traditional texts or traces in the Companions, and where nothing was found, he made use the exercise of *ijtihad* (to make use of similarities and comparisons).<sup>41</sup> The peculiarity of the Hanbali school is its unanimous approach to the principles in the establishment of religious commandments. It took care of reasons and causes with the motives behind daily life together with their outward manifestations in analysing legal problems which led to a better scope of human transactions under the system.<sup>42</sup>

In addition to the above literature, various aspects of sale of goods from the *shari'ah* perspective will also be examined by studying the relevant provisions of The Mejlle, The Civil Code of Egypt, The Civil Code of Iran and the Lebanon Code of Obligations and Contracts as samples. Although the above Codes have been criticised as having Western influence to them, this writer values their relevancy in relation to this research, firstly, since the extent to which other legal systems influenced Muslim law has long been disputed. This is not least because the Muslim belief that the *shari'ah* is an unprecedented, immutable and comprehensive world order, derived exclusively from the Word of God and

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<sup>39</sup> The Imam accepted weaker Traditions including *hadith mursal* and *daif* by his personal choice. Anwar A. Qadri, *op. cit.*, 141.

<sup>40</sup> Anwar A. Qadri, *op. cit.*, 141.

<sup>41</sup> *Id.* at 140.

<sup>42</sup> *Id.* at 144.

conduct of the Prophet. The influence of the legal scholars on the development of the law is generally admitted but the extent to which they themselves were influenced by other legal cultures causes some variance of opinion among modern authors.<sup>43</sup>

And secondly, the modernists, who include contemporary lawyers such as Subhi Mahmassani and Professor ‘Abd al-Razzak al-Sanhuri<sup>44</sup> contend that Islam and the *shari’ah* are meant to provide viable socio-political institutions which must be adaptable to, and serve the interests of, man in all ages. They point out that since at least three-fifths of the *shari’ah* depends on human reasoning, the *shari’ah* must always be a recognised instrument for man’s development. While the Qur’an and the *Sunnah* are immutable, however, interpretations by human reason are subject to change in proportion to the extent of knowledge and experience which man requires in certain ages. Thus the *shari’ah* must be adaptable or be broken.<sup>45</sup>

Finally, cases pertaining to the rights and obligations the sellers and buyers in relation to international contracts of sale will also be discussed and reviewed. Various legal databases such as the CISG database, the UNILEX database on CISG will also be accessed in search of relevant materials to this research.

## **1.9 Organisation of this Dissertation**

This dissertation is divided into nine chapters, the contents of which are described briefly below.

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<sup>43</sup> Rayner, S E, *The Theory of Contracts in Islamic Law: A Comparative Analysis with particular Reference to the Modern Legislation in Kuwait, Bahrain and the United Arab Emirates*, (Graham & Trotman: London, 1991), 10-11.

<sup>44</sup> Professor Sanhuri is also primarily responsible for drafting the Egyptian Civil Code (1949), the Iraqi Code (1951), the Libyan Code (1953) and the Kuwaiti Codes (of 1960).

<sup>45</sup> Rayner, *op. cit.*, 43-44.

## **Chapter 1**

This chapter briefly explains, amongst others, the background of this research, the research questions and objective, the basic premise of this dissertation, literature review, sources of the research on which it is based and the limitations of the research.

## **Chapter 2**

The current conventional practices in international trade, with specific reference to the United Nations Convention on Contracts for the International Sale of Goods (the CISG) and the Incoterms rules 2010 will be examined in this chapter. Relevant Articles of the CISG will be discussed where relevant. The role of the Incoterms rules in general and the Incoterms rules 2010 in particular in supplementing the CISG will be explained. Several strengths and weaknesses of the CISG will also be highlighted in this chapter.

## **Chapter 3**

This chapter will focus on the definition and components of the *shari'ah*, the types of rulings and also sources of the *shari'ah*. This chapter will further explain on the Islamic principles of contract and Islamic nominate contracts with particular reference to the contract of sale.

## **Chapter 4**

This chapter will examine the obligations of sellers and buyers in a sale contract, both under the CISG and also under the *shari'ah*. Relevant Articles of the CISG with regard to the seller's and buyer's obligations will be examined in contrast with similar obligations under the *shari'ah*.

## **Chapter 5**

Remedies available to the seller and buyer in a sale contract both under the CISG and from the *shari'ah* perspective will be examined in this chapter. Once again, relevant Articles of

the CISG with regard to such remedies will be studied whilst remedies under the *shari'ah* is divided into those under the modern legislation and remedies made available by *fiqh* (Islamic jurisprudence).

## **Chapter 6**

This chapter will try to undertake a rather contentious discussion on the issue of interest, also known as *riba* or usury under the *shari'ah*. Whilst Article 78 of the CISG allows for the imposition of interest on late payment, *riba* is prohibited in all *shari'ah* commercial transactions, such prohibition being derived from Qura'nic injunctions and also from authentic *hadiths*. A debate has been raised on the issue of Islamic countries signatories to the CISG which have adopted the said Article without reservation but it seems that there has yet to be closure on this matter. Alternatively, this research will seek to propose that all international sale of goods contracts be free of *riba* in the near future.

## **Chapter 7**

This chapter will attempt to propose a theoretical construct of a new model law for the international sale of goods. The adaptability of the *mu'amalat* (Islamic commercial transactions) will be explained together with the need to avoid *gharar* (uncertainty or speculation) in contracts of sale. The ills of capitalism and speculation in the secular free market will also be mentioned whilst the suggested outcome will be the arrival of a *shari'ah* compliant model law in the international sale of goods arena.

## **Chapter 8**

Instead of the typical theoretical recommendations in the final part of a dissertation, this recommendation chapter is drafted in a form of a draft *shari'ah* compliant model contract which represents the ideas contained in Chapters 3,4,5, 6 and 7 of this dissertation. It is hoped that a *shari'ah* compliant model contract initially and a uniform model law

subsequently will one day be the choice model law in the area of international sale of goods.

## **Chapter 9**

This is the concluding chapter of this dissertation. It will contend that the present conventional rules and regulation pertaining to international sale of goods while workable, exposes certain weaknesses which may be resolved by the introduction of a *shari'ah* compliant model law which is founded on stability, principled governance while being flexible at the same time.

### **1.10 Limitations of the Research**

The conduct of this research in certain instances is limited by research materials written in the Arabic language. This writer however managed to obtain translations of the relevant materials in the English language that although translated from the primary sources, still provides for reliable and valuable literature in completing this dissertation. A further limitation to this research is the difficulty in obtaining the Civil and/or Commercial Codes of Islamic countries, particularly those that are written in English.<sup>46</sup>

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<sup>46</sup> A considerable number of such translated materials and the Civil and/or Commercial Codes of several Islamic countries used as samples in this research were obtained during this writer's tenure as a Research Associate at the School of Law, School of Oriental and African Studies, University of London between October and December 2010. The writer trained as a civil lawyer and this is her first attempt in researching a *shari'ah* related topic.

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## **CHAPTER TWO**

### **CURRENT CONVENTIONAL PRACTICES IN INTERNATIONAL SALE OF GOODS CONTRACTS – WITH SPECIFIC REFERENCE TO THE UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (CISG) AND THE INCOTERMS**

#### **2.1 Introduction**

The study of international trade law can be said to entail the legal relationships between parties who sell and buy goods from each other - the contract of sale; their relationships with persons willing to carry the goods from one place to another - the contract of carriage; the arrangements they have with insurers to protect the goods - the contract of insurance, and any financing agreements with banks or financial institutions to facilitate payment for the goods in question.

The main features of international commercial law are, among others, to ensure certainty in the parties' rights and obligations by ensuring that the law is consistent and predictable; to provide sufficient flexibility to the parties' need to do business by permitting the recognition of trade custom and usage and also to recognise the international dimension of commerce by the application of specialised rules of conflict of laws, the admittance of practice and rules of international organisations as guiding the interpretation and application of commercial law.<sup>1</sup>

Bilateral<sup>2</sup> and multilateral<sup>3</sup> treaties play an important part in international trade law. For instance, a number of bilateral friendship treaties involve states granting each other

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<sup>1</sup> Chuah, J, Law of International Trade: Cross-Border Commercial Transactions, 4<sup>th</sup> ed., (London: Thomson Reuters, 2009), 2-3.  
<sup>2</sup> A treaty is bilateral when it is in force between only two subjects of international law – states or international organisation.

advantages in relation to imports and exports, rights of establishment and free movement of services, trade in general and rights of carriage of goods by sea. Some multilateral treaties regulate trade between the contracting states in a general way. Many multilateral treaties grant trade regulatory powers to particular international organisations such as the United Nations or the World Bank while others seek to unify the law in order to facilitate international trade and financing.<sup>4</sup>

The purpose of some treaties is to liberalise trade between the contracting states whilst other treaties are aimed at economic integration. Another group of treaties further aims at unification of the law where they introduce common substantive rules for legal relationships between private persons and companies. The provisions of a treaty or uniform law become part of the national law of the contracting states concerned. However, treaties and uniform laws are often interpreted differently in each country. Usually, there is no common forum that can give a consistent interpretation on the provisions of those treaties.<sup>5</sup> A sale contract may be governed by different national laws depending on the court seized of the matter and its conflict of laws rules, which gives little legal certainty to the seller and buyer in such contracts. It is upon these premises that early initiatives were taken by UNIDROIT<sup>6</sup> to develop uniform rules in respect of international sales.

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<sup>3</sup> A multilateral treaty is a treaty which is in force between more than two parties or contracting states.

<sup>4</sup> Houtte, H V, *The Law of International Trade*, (London: Sweet & Maxwell, 2002), 2.

<sup>5</sup> *Ibid.*

<sup>6</sup> International Institute for the Unification of Private Law. It is an independent intergovernmental organisation with its seat in Rome. Its purpose is to study the needs and methods for modernising, harmonising and co-ordinating private and in particular commercial law as between States and groups of States. Set up in 1926 as an auxiliary organ of the League of Nations, the Institute was, following the demise of the League, re-established in 1940 on the basis of a multilateral agreement which is the UNIDROIT Statute. Membership of UNIDROIT is restricted to States acceding to the UNIDROIT Statute. It has currently 63 members drawn from the five continents which represent a variety of different legal, economic and political systems as well as different cultural backgrounds. Retrieved February 5, 2010 from UNIDROIT's official website (English version) <<http://www.unidroit.org/dynasite.cfm>>.

## **2.2 International Sale Contracts – The United Nations Convention on Contracts for the International Sale of Goods (CISG)**

### **2.2.1 Background of CISG**

Earlier attempts by UNIDROIT at introducing uniform laws on international sale of goods resulted in the formation of two Conventions, which are the predecessors to CISG, namely, the Uniform Law on the International Sale of Goods (ULIS) and the Uniform Law on the Formation of Contracts for the International Sale of Goods (ULF).<sup>7</sup> While ULIS set forth the basic obligations of parties to sales contracts such as delivery of the goods, their conformity with the contract, payment of the price, excuse for non-performance, remedies for breach and risk of loss, ULF on the other hand prescribes rules on offer and acceptance, revocation of offers, counter-offers and related questions.<sup>8</sup> However, the intention that both the Conventions should receive wide recognition did not gain momentum. It was claimed that many provisions of the Conventions were too complicated and the scope of application was too wide.<sup>9</sup> Apart from the technical shortcomings, it was further claimed that the failure of the Conventions can be attributed to the late involvement of the United States and also the non-involvement of developing and socialist countries in the process.<sup>10</sup> Only nine countries ever ratified the Conventions<sup>11</sup> but five countries subsequently withdrew when they adopted the CISG.<sup>12</sup> The lack of success of the Hague Conventions eventually led to an UNCITRAL (United Nations Commission on International Trade Law) study group in 1968 to examine the changes necessary to make uniform sales law more suitable

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<sup>7</sup> The Conventions were conceptualised at a diplomatic conference held at The Hague in April 1964 and are commonly referred to as the Hague Conventions. These Conventions came into force in 1972.

<sup>8</sup> Honnold, J, “The 1964 Hague Conventions and Uniform Laws on the International Sale of Goods”, *The American Journal of Comparative Law*, Vol. 13, No. 3 (Summer 1964), 451-453.

<sup>9</sup> Houtte, *op. cit.*, 145.

<sup>10</sup> Bridge, M, *The International Sale of Goods, Law and Practice*, 2nd ed., (New York: Oxford University Press, 2007), 510

<sup>11</sup> The United Kingdom, Belgium, West Germany (as it then was), Italy, Luxembourg, the Netherlands, San Marino, Israel and Gambia.

<sup>12</sup> Houtte, *op. cit.*, 146. The five countries are Belgium, West Germany (as it then was), Italy, Luxembourg and the Netherlands. See also Article 99 of CISG.

and appealing to the international communities. Thus, a proposal drafted by representatives of 14 countries came to fruition in 1978 which ultimately resulted in the birth of CISG.<sup>13</sup>

The CISG was signed in Vienna in 1980 and became effective on 1 January 1988 with the objective of the development of international trade on the basis of equality and mutual benefit. Another of its objectives is to promote friendly relations among the Contracting States. One of the aims of CISG is to adopt uniform rules which govern contracts for the international sale of goods taking into account the different social, economic and legal systems which would contribute to the removal of legal barriers and to promote development of international trade. As at 24 February 2012, UNCITRAL reports that 78 States have adopted the CISG.<sup>14</sup> Currently, the CISG accounts for over three-quarters of all world trade.<sup>15</sup>

## **2.2.2 Sphere of Application**

### **2.2.2.1 Applicability of CISG**

The CISG, by virtue of Article 1(1)<sup>16</sup> applies to contracts of sale of goods between parties whose places of business are in different States when the States are Contracting States<sup>17</sup> or when the rules of private international law lead to the application of the law of a Contracting State.<sup>18</sup> Common to Articles 1(1)(a) and 1(1)(b) is the requirement that the

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<sup>13</sup> *Ibid.*

<sup>14</sup> Retrieved on 12 November 2012 from <<http://www.cisg.law.pace.edu/cisg/countries/cntries.html>>. The Contracting States are Albania, Argentina, Armenia, Australia, Austria, Belarus, Belgium, Benin, Bosnia-Herzegovina, Bulgaria, Burundi, Canada, Chile, China, Colombia, Croatia, Cuba, Cyprus, Czech Republic, Denmark, Dominican Republic, Ecuador, Egypt, El Salvador, Estonia, Finland, France, Gabon, Georgia, Germany, Greece, Guinea, Honduras, Hungary, Iceland, Iraq, Israel, Italy, Japan, South Korea, Kyrgystan, Latvia, Lebanon, Losotho, Liberia, Lithuania, Luxembourg, Macadonia, Mauritania, Mexico, Moldova, Mongolia, Montenegro, Netherlands, New Zealand, Norway, Paraguay, Peru, Poland, Romania, Russian Federation, Saint Vincent & Grenadines, Serbia, Singapore, Slovakia, Slovenia, South Korea, Spain, Sweden, Switzerland, Syria, Turkey, Uganda, Ukraine, United States, Uruguay, Uzbekistan and Zambia. Malaysia and the United Kingdom are not signatories to the CISG. The number of signatory countries represents 40.63 % of the 192 total member countries of the United Nations.

<sup>15</sup> Retrieved on 12 November 2012 from <<http://www.cisg.law.pace.edu/cisg/cisgintro.html>>.

<sup>16</sup> All articles referred to herein are articles of the CISG unless otherwise stated.

<sup>17</sup> Article 1(1)(a).

<sup>18</sup> Article 1(1)(b).

sale contract in question has an international character namely, it is a sale between parties whose place of business are in ‘different States’. Limiting sales rules to international transactions was necessary because these rules are embodied in a Convention designed for universal adoption.<sup>19</sup> This requirement is always necessary but in itself is an insufficient condition for the application of the Convention<sup>20</sup> by virtue of the Article 1(1) rule.<sup>21</sup> If a party has more than one place of business, reference has to be made to Article 10, which is where the place of business has the closest relationship to the contract and its performance.<sup>22</sup> If, in a given situation, the different States in which the parties reside are CISG Contracting States, then the CISG applies by virtue of Article 1(1)(a).<sup>23</sup> A Contracting State that applies the CISG in accordance with Article 1(1)(a) is applying it as part of its national law.<sup>24</sup> Article 1(1)(b) becomes relevant when the criterion in Article 1(1)(a) is not met, that is, when one or both parties to the contract do not reside in any of the CISG Contracting States.<sup>25</sup> Unlike Article 1(1)(a), this provision is conventionally taken to be a rule of private international law. Unfortunately, Article 1 does not say whose rules of private international law would trigger the application of the CISG but it is suggested that they can only be those of the forum State. Furthermore, the forum State must be a Contracting State if it is to be bound to apply the CISG.<sup>26</sup> This ambiguity in the wordings of Article 1(1)(b) would almost always causes difficulty in deciding the

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19 Honnold, J O, “Uniform Law for International Sales under the 1980 United Nations Convention”, (1999, 3rd ed). Retrieved 7 May 2010 from <<http://www.cisg.law.pace.edu/cisg/biblio/honnold.html>>.

20 The words Convention and the CISG are used interchangeably in this chapter.

21 Lookofsky, J, “The 1980 United Nations Convention on Contracts for the International Sale of Goods, Sphere of Application, Article 1” (2004). Retrieved February 24, 2010 from <<http://www.cisg.law.pace.edu/cisg/biblio/1001.html>>.

22 Article 10: For the purpose of this Convention:

(a) if a party has more than one place of business, the place of business is that which has the closest relationship to the contract and its performance, having regard to the circumstances known to or contemplated by the parties at any time before the conclusion of the contract;

(b) if a party does not have a place of business, reference is to be made to his habitual residence.

23 Honnold, *op. cit.*

24 For example, New Zealand incorporates the CISG into its national law as the Sale of Goods (United Nations Convention) Act 1994 (NZ).

25 Honnold, *op. cit.*

26 Bridge, *op. cit.*, 514.

applicability of the CISG in an international sale of goods contract when the courts have to resort to the rules of private international law to resolve the matter.

As this rule proved to be controversial, the Convention allows some latitude to Contracting States to exclude the application of Article 1(1)(b) under Article 95 of the Convention.<sup>27</sup> If, for example, a seller in the United States sells to a buyer in a non-Contracting State, Article 95 means that the US courts are not bound to apply the Convention rules even if the relevant rules of private international law lead to the application of US law (i.e. the law of a CISG Contracting State). In this situation, if the relevant conflict-of-laws rule points to the seller's law, an American court would apply domestic American law, that is, the Uniform Commercial Code (UCC) as enacted in the American state concerned.<sup>28</sup> As an illustration to this line of reasoning, the Federal District Court for Southern District of Florida, United States in *Impuls I.D. Internacional, S.L. v. Psion-Teklogix*<sup>29</sup> found that the contract in question was not governed by CISG as the distribution contract had been concluded with a manufacturer with its place of business in England, a non-contracting State, and under Article 1(1)(a), the CISG would therefore not apply. Further, although Article 1(1)(b) allows for the application of the CISG when a party is not a contracting State, the United States, by virtue of the Article 95 reservation has successfully excluded the application of CISG in this case.<sup>30</sup> Even though the defendant subsequently became a party to the distribution contract and was from a contracting State (Canada), the court held

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27 Article 95: Any State may declare at the time of the deposit of its instrument of ratification, acceptance, approval or accession that it will not be bound by subparagraph (1)(b) of article 1 of this Convention. Currently, countries which have invoked the Article 95 reservation are the United States of America, China, the Czech Republic, Singapore, St Vincent and the Grenadines and Slovakia. Canada made an Article 95 reservation with respect to British Columbia upon its accession to the CISG on 23 April 1991 but subsequently withdrew the declaration on 31 July 1992. Retrieved 14 November 2012 from <<http://unilex.info/dynasite.cfm?dssid=2376&dsmid=13351&x=1>>.

28 Lookofsky, J, "The 1980 United Nations Convention on Contracts for the International Sale of Goods, Article 95, 'Private International Law' and Article 1(1)(b)", (2000). Retrieved 5 March 2010 from <<http://www.cisg.law.pace.edu/cisg/biblio/loo95.html>>.

29 Decided on 22 November 2002. Retrieved 5 March 2010 from <<http://cisgw3.law.pace.edu/cases/021122u1.html>>. Since Malaysia and even the United Kingdom are not signatories to the CISG, cases referred to in this chapter are United States of America's or European cases.

30 *Ibid.*

that it was the place of business of the original parties to the contract that governed whether or not the CISG would apply. The fact that the defendant became a party to the contract was to be disregarded as it was not known to the parties at any time before or at the conclusion of the contract.<sup>31</sup>

#### **2.2.2.2 Excluding the CISG**

Although the decision in *Impuls* has clearly addressed the issues governing Article 1 and Article 95, the CISG still has an element of fluidity since the contracting parties are allowed to derogate from or vary the effect of all the provisions of the Convention (other than Article 12).<sup>32</sup> It is common knowledge that even where all the CISG's requirements of applicability, namely, international, substantive, temporal and personal/territorial, are met, the CISG does not necessarily apply. In order to decide whether the CISG is applicable, it must also be looked into whether the Convention has been excluded by the parties.<sup>33</sup> It can therefore be observed that Article 6 embodies a vigorous affirmation of the principle of party autonomy. As far as party autonomy is concerned, it can be indicated that Article 6 refers to two different states of affairs. One is where the Convention's application is excluded and the other is where the parties derogate from or modify the effects of the provisions of the CISG on a substantive level.<sup>34</sup> These two circumstances differ from each other in that the former does, according to the CISG, *per se* does not encounter any restrictions, whereas the latter is limited as there are provisions the parties are not allowed to derogate from.<sup>35</sup> Where, for instance, at least one of the parties to the contract governed

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<sup>31</sup> *Ibid.* Article 1(2) states that 'The fact that the parties have their places of business in different States is to be disregarded whenever this fact does not appear either from the contract or from any dealings between, or from information disclosed by, the parties at any time before or at the conclusion of the contract.'

<sup>32</sup> Article 6: 'The parties may exclude the application of the Convention or, subject to Article 12, derogate from or vary the effect of any of its provisions.'

<sup>33</sup> Ferrari, F, "Remarks on the UNCITRAL's Digest's Comments on Article 6 CISG", (2005). Retrieved 26 April 2010 from <<http://cisgw3.law.pace.edu/cisg/biblio/ferrari13.html>>

<sup>34</sup> *Ibid.*

<sup>35</sup> *Ibid.*

by the CISG has its place of business in a State that has made a reservation under Article 96, the parties may not derogate from or vary the effect of Article 12.<sup>36</sup> In those instances, in accordance with Article 12, any provision ‘that allows a contract of sale or its modification or termination by agreement or any offer, acceptance or other indication of intention to be made in any form other than in writing does not apply’.<sup>37</sup>

Excluding the application of the CISG in relation to the sale contract must be done expressly, as was decided by the Supreme Court of France in a recent case of *Societe Anthon GmbH & Co. v SA Tonnellerie Ludonnaise*<sup>38</sup>. The Court held that express exclusion of the CISG will be denied if the pleadings referred to both CISG and the domestic law and the parties had not expressly excluded CISG’s application. In this case, although the seller in its pleading had cited the provisions of both the French Civil Code and the CISG, the Court was of the opinion that the CISG applied on account of the international character of the contract and the fact that the parties had not excluded CISG’s application.<sup>39</sup> Express exclusion of the CISG can also be made in important standard form contracts such as the standard contracts of the Federation of Oils, Seeds and Fats Association (FOSFA) and the Grain and Feed Trade Association (GAFTA).<sup>40</sup>

Whilst express exclusion of the CISG is usually a rather straightforward scenario, it is the implied exclusion of the Convention that occasionally poses problems of interpretation for

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<sup>36</sup> *Ibid.*

<sup>37</sup> Article 12 *in toto* reads as follows: ‘Any provision of article 11, article 29 or Part II of this Convention that allows a contract of sale or its modification or termination by agreement or any offer, acceptance or other indication of intention to be made in any form than in writing does not apply where any party has his place of business in a Contracting State which has made a declaration under Article 96 of this Convention. The parties may not derogate from or vary the effect of this article.’ Article 96 states that ‘A Contracting State whose legislation requires contracts of sale to be concluded in or evidenced by writing may at any time make a declaration in accordance with article 12 that any provision of article 11, article 29 or Part II of this Convention, that allows a contract of sale or its modification or termination by agreement or any offer, acceptance, or other indication of intention to be made in any form than in writing, does not apply where any part has his place of business in that State.’ Article 11 allows for a contract of sale not be concluded or evidenced in writing whereas Article 29 explains that a contract may be modified or terminated by agreement of the parties. Part II of the Convention deals with formation of contracts under the CISG.

<sup>38</sup> Decided on 3 November 2009. Retrieved 30 April 2010 from <<http://www.unilex.info/case.cfm?id=1491>>.

<sup>39</sup> *Ibid.*

<sup>40</sup> Houtte, *op. cit.*, 148. Usually, the exclusion clause will essentially state that “The following shall not apply to this contract: (a) the Uniform law on sales ..... ; (b) the United Nations Convention on Contracts for the International Sale of Goods .....

the courts. In a recently decided Austrian case,<sup>41</sup> the Supreme Court of Austria decided that a choice of law clause in favour of a Contracting State amounts to an implied exclusion of CISG where the parties' intention to opt out of the Convention is clearly established. In the court's view, the parties' intention to exclude the Convention could be inferred from the fact that both the parties had referred only to provisions of Austrian law in their pleadings and that the choice of law clause in the seller's standard terms referred to Austrian law as the one exclusively governing the contract.<sup>42</sup> However, an implied exclusion of the CISG which is vague and imprecise is considered invalid as was decided in an Italian case of *Ostroznik Savo v La Faraona soc. Coop. a r.l.*<sup>43</sup>. The *Tribunale di Padova* (the Court of Padua) was of the opinion that although there was a clause in the contract stating, *inter alia*, that the contract was to be governed by the "laws and regulations of the International Chamber of Commerce Paris, France" it did not amount to an implied exclusion of the CISG as in accordance with the applicable conflict of law rules, parties are free to choose the governing law of their contract but in so doing they must opt for a particular domestic law. Consequently in this case, even such incorporation into the contract must be excluded since the reference to the "laws and regulations of the International Chamber of Commerce of Paris, France" was too vague so as to permit a precise identification of any specific rule.<sup>44</sup>

Apart from excluding the application of the CISG, the parties, under Article 6, could also derogate from or modify the effects of the provisions of the CISG. In other words, the parties can still retain their autonomy and may accept the CISG in part and derogate from

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<sup>41</sup> It is quite common that not all CISG related cases reported state the parties' names. The number for this particular case is 8 Ob 125/08b decided on 2 April 2009. Retrieved 30 April 2010 from <<http://www.unilex.info/case.cfm?id=1474>>.

<sup>42</sup> *Ibid.*

<sup>43</sup> Decided on 11 January 2005. Retrieved 30 April 2010 from <<http://www.unilex.info/case.cfm?id=1005>>.

<sup>44</sup> *Ibid.*

other CISG provisions if they so wish.<sup>45</sup> In a decided case from Netherlands<sup>46</sup>, the Arnhem Court decided that the parties were bound by the seller's standard terms as the buyer had signed and returned the invoice to which the terms were attached without any complaint. In the court's opinion, the seller's standard terms derogated from the CISG as they provided for any notice of lack of conformity to be given within five working days after delivery.<sup>47</sup> However, there are limits to the party's autonomy in exercising their rights to derogate from the provisions of CISG. In a case decided by the Austrian Supreme Court,<sup>48</sup> the court stated that even though the buyer, according to Article 49(1) of the CISG, has the right to avoid the contract under certain circumstances, the parties can agree to derogate from this provision and restrict the buyer's rights and these changes must be valid according to the applicable domestic law. Nevertheless, even if the changes are valid according to the rules of the applicable domestic law, such rules must not contradict the fundamental principles of CISG.<sup>49</sup>

These court decisions are undoubtedly helpful in interpreting CISG articles but unlike the European Communities (EC) or the Organisation for the Harmonisation of Business Law in Africa (OHADA), the CISG member states have no common supreme court to interpret its uniform or harmonised law and this may be regarded as a major handicap of the CISG. However, it has been argued that there are other means to safeguard CISG's uniformity.<sup>50</sup>

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<sup>45</sup> Except in a situation where Article 12 applies. See note 36, *supra*.

<sup>46</sup> Case number 172920/HA ZA 1908-1228 decided on 11 February 2009. Retrieved on 30 April 2010 from <<http://www.unilex.info/case.cfm?id=1439>>.

<sup>47</sup> *Ibid*. There is no corresponding provision in CISG. Article 39(1) merely state that 'The buyer loses the right to rely on a lack of conformity of the goods if he does not give notice to the seller specifying the nature of the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it' without specifying any time frame for the buyer to do so.

<sup>48</sup> Case number 8 Ob 22/00v decided on 7 September 2000. Retrieved on 30 April 2010 from <<http://www.unilex.info/case.cfm?id=473>>.

<sup>49</sup> *Ibid*.

<sup>50</sup> Schwenzler I and Pascal Hachem, P, "The CISG – Successes and Pitfalls", (2009). Retrieved 4 September 2009 from <<http://www.cisg.law.pace.edu/cisg/biblio/schwenzer-hachem.html>>.

It is now common ground that uniform law has to be interpreted autonomously and its international character is to be taken into account. In this respect, it has been argued that the comparative legal method has been proven most adequate and successful. Part of this method involves giving due consideration to foreign court decisions and arbitral awards which are becoming more important on the international front. Whatever the situation in a domestic legal system may be, there can be no doubt that foreign decisions do not have a binding effect upon the national courts but their potential persuasive authority is widely and justly recognised today.<sup>51</sup> Apart from the above, the accessibility and availability of foreign legal materials as well as the CISG Advisory Council's opinions and guidelines for uniform interpretation of the Convention in crucial areas of possibly diverging approaches proves to be helpful in aiding the uniform interpretation of the CISG.<sup>52</sup>

### **2.3 The Missing Definitions**

Although CISG is exclusively about sale of goods contracts, it is rather perplexing that it does not define 'sale', 'goods' or 'contract for the sale of goods', Article 2, being an exclusionary provision, excludes certain types of sale where the CISG does not apply.<sup>53</sup> Definition of goods in relation to the Convention has come mostly from scholars in this area, one being "The term 'goods' (merchandises) is usually equated with 'things' (or somewhat less appropriately – 'objects'), and it would seem that the subject of an international sale must be a moveable thing, that is, a thing which can be transferred (from

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<sup>51</sup> *Ibid.*

<sup>52</sup> *Ibid.*

<sup>53</sup> Article 2: 'This Convention does not apply to sales:

(a) of goods bought for personal, family or household use, unless the seller, at any time before or at the conclusion of the contract, neither knew nor ought to have known that the goods were brought for any such use;

(b) by auction;

(c) on execution or otherwise by authority of law;

(d) of stocks, shares, investment securities, negotiable instruments or money;

(e) of ships, vessels, hovercraft or aircraft;

(f) of electricity.'

one place to another) by a carrier or other medium, although not necessarily by a ‘physical’ medium. Clearly, (immovable) real property lies outside the concept of a moveable thing, just as ‘know-how’ and ‘goodwill’ have little or no link with the generally accepted notion of goods”<sup>54</sup>. By goods, reference will generally be made to tangible products, and this is also most likely how the Convention sees it. That is possibly why stocks, shares, investment securities, negotiable instruments and electricity are excluded in Article 2(d) and 2(f) respectively of the Convention. National sales laws do not always classify these items uniformly and in many jurisdictions they may be categorised as intangibles or immovables rather than goods.

It has been suggested that difficulty in characterising an item supports the need for a clear rule rather than a rule excluding an item<sup>55</sup> but it appears this suggestion has yet to materialise. In this day and age of information technology, software is controversial, and there are many distinctions and differentiations advocated, for example whether it is standard or custom-made software, whether software is tangibly embodied in discs or hard drives, or whether it is to be delivered, that is, transmitted electronically for downloading by the recipient, whether the acquired software could be used forever or only temporarily (with a right of renewal).<sup>56</sup> In light of this uncertainty, it has been put forward that software acquired forever and inheritable from the first acquirer to its heirs should be treated as goods and fall under the Convention with appropriate accommodation of its provisions. If, however, the software can only be used only for a certain period of time, and the use can

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<sup>54</sup> A broad definition of ‘goods’ by Lookofsky, J at <<http://www.cisg.law.pace.edu/cisg/text/e-text-01.html#related>>. Retrieved on 13 April 2010.

<sup>55</sup> Winship, P, “The Scope of the Vienna Convention on International Sales Contracts”, (1984). Retrieved 13 April 2010 from <<http://www.cisg.law.pace.edu/cisg/biblio/winship5.html>>.

<sup>56</sup> Schlechtriem, P, “Requirements of Application and Sphere of Applicability of the CISG”, (2005). Retrieved 23 April 2010 from <<http://www.cisg.law.pace.edu/cisg/biblio/slechtriem9.html>>.

be revoked, for example, by an administrator in insolvency, the contract is a licence contract and not governed by the sales law.<sup>57</sup>

The Convention applies to a contract even if the goods, which will eventually be delivered, do not exist at the time of the formation of the contract but are manufactured by the seller.<sup>58</sup> This is called manufactured or produced goods. For purposes of Article 3(1), namely goods that are produced, it will also include extraction of minerals and the growth of crops.<sup>59</sup> Yet the same Article excludes the application of the Convention “if the party who orders the goods undertakes to supply a substantial part of the materials necessary for such manufacture or production”. It seems that this paragraph resolves doubt that the supply of mass-produced articles for a price is a sale whereas the supply of customised or bespoke articles is not.<sup>60</sup>

Sales means the exchange of goods for money<sup>61</sup> but it can be demonstrated that the CISG goes beyond mere sales. Contracts for pure services, labour contracts and other contracts for performance of services are not considered as sales contracts as can be observed in Article 3(2).<sup>62</sup> Article 3(2) mandates its application to mixed contracts, where one party has undertaken not only to deliver the goods but also to provide services. If these different obligations are part of one contract, such as where there is lump sum price for the whole transaction, the mixed contract has to be qualified entirely either as a sale or a service contract, or it has to be split. The CISG has opted to treat it as a unitary contract, being governed by the CISG only if the preponderant part of the transaction is the delivery of

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<sup>57</sup> *Ibid.*

<sup>58</sup> Article 3(1): Contracts for the supply of goods to be manufactured or produced are to be considered sales unless the party who orders the goods undertakes to supply a substantial part of the materials necessary for such manufacture or production.

<sup>59</sup> Bridge, *op. cit.*, 520

<sup>60</sup> *Ibid.*, 517.

<sup>61</sup> Schlechtriem, *op. cit.*

<sup>62</sup> Article 3(2): ‘This Convention does not apply to contracts in which the preponderant part of the obligations of the party who furnishes the goods consists in the supply of labour or other services.’

goods.<sup>63</sup> However, the interpretation of the abovementioned Article rests on the term ‘preponderant’ and it is argued that this provision was inserted without much thought for its consequences thus raising numerous problems. Firstly, ‘preponderant’ is open to different understandings and secondly and more importantly, it is very uncertain what the consequences would be in a case of a breach of the service obligations under the contract, in particular with regard to the remedies available under the Convention.<sup>64</sup> To conclude, although there is no definition of ‘contract of sale’ in the CISG, one can reconstruct a definition from Articles in the later part of the Convention defining the obligations of the parties. Article 30 requires the seller ‘to deliver the goods, hand over any documents relating to them and transfer the property in the goods’ while Article 53 requires the buyer ‘to pay the price for the goods and take delivery of them.’<sup>65</sup>

#### **2.4 Issues Governed and Excluded by the Convention**

Article 4 provides that the CISG applies only to the substantive law of sale so far as it deals with the rights and obligations of the seller and buyer arising from a contract of sale.<sup>66</sup> From the wordings of Article 4(a), it appears that validity of the contract or any of its provisions is outside the scope of the Convention. The Supreme Court of France in *Societe DIG v Societe Sup*<sup>67</sup> in considering the issue of a late notice of alleged defects of the goods given by the buyer to the seller, decided that the Convention does not deal with the validity of the contract or its clauses but only governs the formation of the sale contract and the rights and obligations deriving thereof.<sup>68</sup> It has also argued that the exclusion of

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<sup>63</sup> Schlechtriem, *op. cit.*

<sup>64</sup> *Ibid.*

<sup>65</sup> *Ibid.* Articles 30 and 53 will be discussed later in Chapter 4 of this dissertation.

<sup>66</sup> Article 4 : This Convention governs only the formation of the contract of sale and the rights and obligations of the seller and the buyer arising from such a contract. In particular, except as otherwise expressly provided in this Convention, it is not concerned with:

(a) The validity of the contract or any of its provisions or of any usage;

(b) the effect which the contract may have on the property in the goods sold.

<sup>67</sup> Decided on 13 February 2007. Retrieved 9 May 2010 from <<http://www.unilex.info/case.cfm?id=1372>>

<sup>68</sup> *Ibid.*

validity will be of particular importance where the contract contains a disclaimer clause restricting or excluding liability for breach of warranty or other obligation imposed on the seller under the Convention and the buyer invokes the doctrine of “fundamental breach” or impeaches the clause on grounds of unconscionability. The author was of the opinion that the exclusion of questions of validity from the reach of CISG is therefore a debilitating if unavoidable weakness.<sup>69</sup>

#### **2.4.1 Extending the Possibilities**

It has always been the traditional view that Article 4(a) is not concerned with the issues of privity of contract between the parties, as can be seen in the case of *KSTP-FM, LLC v Specialised Communications, Inc. And Adtronics Signs, Ltd*<sup>70</sup> where the court held that as the buyer who never contracted with the second defendant therefore lacked contractual privity with the second defendant. Of late, however, emerging alternative views have emerged which seems to suggest the inclusion primary financial losses sustained by the ultimate commercial buyer and that buyer’s possibilities of recourse against a party upstream in the chain of sales contracts, in particular against the manufacturer of the goods, with whom the buyer has no privity of contract under the CISG.<sup>71</sup>

##### **2.4.1.1 Assignment of Claims and Assumption of Debt**

One possibility to extend contractual rights to a third person is the assignment of a contractual claim. The concept of assigning rights to a third party has been known for a long time. Although ancient Roman law as well as medieval Common law initially

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<sup>69</sup> Ziegel, J. (1981). Report to the Uniform Law Conference of Canada on Convention on Contracts for the International Sale of Goods. Retrieved 16 November 2012 from <<http://cisgw3.law.pace.edu/cisg/text/ziegel4.html>>

<sup>70</sup> Decided on 9 March 1999 by the County of Hennepin District Court, Fourth Judicial District, State of Minnesota. Retrieved 9 May 2010 from <<http://www.unilex.info/case.cfm?id=517>>.

<sup>71</sup> Schwenger, I and Schmidt, M, “Extending the CISG to Non-Privity Parties”, (2009). Retrieved 10 May 2010 from <<http://www.cisg.law.pace.edu/cisg/biblio/schwenger-schmidt.html>>.

considered contractual rights as exclusively confined to the original contracting parties, at least by the turn of the eighteenth century Common as well as Civil law countries recognised the possibility of the free assignment of claims.<sup>72</sup>

Whereas by assignment the creditor transfers its rights to a third person, on the proverbial flipside of the coin, the transfer of a debt to a new debtor via the concept of assumption of debt is nowadays similarly acknowledged. In chains of contracts, these two concepts are mostly used in situations which involve a group of companies. For example, a subsidiary company which contracts in its own name with the manufacturer for goods exclusively destined for the use of its parent company. In the event that anything goes wrong with the original contract, the parent company has an interest in asserting the contractual rights in its own name; which can easily be achieved through an assignment of the subsidiary's company's rights under the original contract with the manufacturer. Likewise, an assumption of debt by the parent company will in practice often occur where the subsidiary company is a mere distributor and thus unable to meet remedial claims asserted by its contract partners.<sup>73</sup>

#### **2.4.1.2 Manufacturer's Guarantee or Express Warranty**

Another possibility of extending contractual claims to non-privity parties is by way of issuing a manufacturer's guarantees or express warranties. It is common practice in today's business world that manufacturers not only advertise their products to possess certain qualities, but to also issue written guarantees or warranties intended to induce the public to buy their products and thus to reach the ultimate purchaser. Such guarantees usually warrant the product to be free of any defects in material and workmanship for a certain

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<sup>72</sup> *Ibid.*

<sup>73</sup> *Ibid.*

period of time, while simultaneously limiting the remedies for non-conforming goods to repair and replacement or a refund of the purchase price.

In all legal systems, the manufacturers' guarantees and warranties are governed by their respective contractual regimes. However, the dogmatic justification for categorising such guarantees and warranties as contractual arrangements varies. For the purposes of this argument, it is sufficient to refer to the approaches of the Germanic and U.S. legal systems. According to Germanic legal doctrine, the manufacturer's warranty creates a true contract between the manufacturer and the remote purchaser. This is conceptually explained in three different ways. Either the offer emanates from the manufacturer and is delivered by the seller to the ultimate buyer; or the seller acts as an agent for the manufacturer. Finally, the contract between the manufacturer and its initial buyer may be construed as a third party beneficiary contract with the remote purchaser as a beneficiary.<sup>74</sup>

For nearly half a century, US-American courts have almost unanimously held that the manufacturer can be held liable by the remote purchaser based on the theory of breach of an express warranty notwithstanding the lack of privity of contract. Today, in most states, this result is achieved by relying on the express warranty provision of the Uniform Commercial Code (UCC) (§ 2-313 UCC). The UCC's wording, however, appears to be restricted to the immediate relationship between the seller and the direct buyer. Thus it does not come as a great surprise that the revision of the UCC creates a new provision for such 'pass-through' warranties in the normal chain of distribution. Both Germanic and US-American case laws show that from the beginning of this development not only consumers

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<sup>74</sup> *Ibid.*

but often also commercial buyers were able to claim damages for their commercial losses based on the concepts of manufacturers' guarantees or express warranties.<sup>75</sup>

## **2.4.2 Extended Implied Warranties to the Remote Purchaser**

In addition to allowing express warranties to non-privity parties, many legal systems contemplate the extension of implied warranties to a remote purchaser in a chain of contracts. As with the manufacturers' guarantees and express warranties, the scope of application of these theories is not confined to consumers even though the emphasis is, in general, on consumer protection. Two such examples of these extended implied warranties to the remote purchaser are the *action directe* in the French legal system, the implied warranties under the UCC and also contracts with protective effects.<sup>76</sup>

### **2.4.2.1 Action Directe in the French Legal System**

As long ago as 1820, the French courts recognised the possibility of a contractual claim for damages for breach of warranty (*garantie de vices caches*) by the remote purchaser not only against its immediate seller but also directly (namely *action directe*) against the manufacturer of the goods, the original seller, and every intermediary in the chain of contracts. Warranty claims under a sales contract are treated as being automatically transferred to any downstream buyer as an accessory to the goods sold. Similar concepts to the French *action directe* exist in other European countries, such as in Belgium and Luxemburg.<sup>77</sup>

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<sup>75</sup> In Germany, see Federal Supreme Court, 24 June 1981, (1981) NJW 2248 and in the U.S., see *Randy Knitwear v. American Cyanamid Company*; *Klein v. Asgrow Seed Co.* (1966) 246 Cal App 2d 87, 54 Cal Rptr 609 and *B.B.P. Asso. v. Cessna Aircraft Co.* (1966, Idaho) 420 P2d 134.

<sup>76</sup> Schwenger, I and Schmidt, M, *op. cit.*

<sup>77</sup> *Ibid.*

#### **2.4.2.2 Implied Warranties under the Uniform Commercial Code**

Although still highly debated, the courts in some U.S. states have justified product liability with the theory of breach of an implied warranty. Such liability not only covers personal injury and property damage but may also include economic losses of the ultimate buyer. Concurrently, a growing number of US courts allow non-privity plaintiffs to recover direct and even consequential economic losses.

#### **2.4.2.3 Contracts with Protective Effects**

Contractual solutions were also considered for product liability cases in Germanic legal systems during the 1960s and 1970s. Although most countries ultimately favoured tort solutions, Austria decided to adopt a solution based on a contract with protective effects for third parties. According to this Austrian solution, the first sales contract between the manufacturer and the initial buyer confers contractual rights upon the ultimate purchaser. Recovery of purely economic loss seems not to be permitted under this cause of action, but a commercial buyer may rely on this doctrine to recover losses from property damage.<sup>78</sup>

#### **2.4.3 Applicable Law, Conflict of Laws Rules and Practical Questions**

With regard to the admissibility of direct claims by a sub-purchaser against a manufacturer with whom it does not have privity of contract, it was first shown that the applicability of the CISG to any of the contracts involved does not have any influence on the question of admissibility. To determine the domestic law which decides whether or not such claims are admissible, three categories of claims have to be distinguished, namely, the admissibility of claims arising out of an assignment or an assumption of debts, as a first category, is

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<sup>78</sup> *Ibid.*

determined based on the forum's conflict of laws rules applicable to these concepts. Manufacturers' guarantees or express warranties, as a second category, have to be classified as contractual in nature with the consequence that in the absence of a choice of law clause usually the law of the seat of the manufacturer will be applicable. The third category is formed by claims based on an *action directe*, implied warranty or a contract with protective effects. These claims are tortious in nature and their admissibility is hence determined based on the conflict of laws rules for torts.<sup>79</sup>

For claims based on assignment, assumption of debt, *action directe*, implied warranties or contracts with protective effects, the scope and content of the sub-buyer's claim are exclusively derived from and determined by a claim the manufacturer's first buyer in a chain of contracts might have asserted. If the CISG applies to the first contract in the chain, then it also applies to the claim of the remote purchaser who is further down the line in the chain of contracts. For claims arising out of manufacturers' guarantees or express warranties, the law governing their admissibility also governs their content; even though the relationship between the manufacturer and the ultimate buyer is not a sales contract, the claims are essentially sales claims and therefore also determined by sales law. Hence, the CISG will apply if with respect to the sub-purchaser and the manufacturer the prerequisites for the CISG's territorial sphere of application, that is, Article 1 of the CISG are fulfilled. The manufacturer may of course avoid the application of the CISG by including a choice of law clause in the guarantee or by limiting the guarantee's territorial scope.<sup>80</sup>

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<sup>79</sup> *Ibid.*

<sup>80</sup> Examples include the U.S. *Limited Warranty Summary* for Fujitsu Scanner Products, available at <<http://www.fujitsu.com/downloads/COMP/fcpa/scanners/warranty-summary.pdf>>: 'All statements herein are valid only in the U.S. for U.S. residents [...]'; U.S. *Nokia One-Year Limited Warranty*, available at <<http://www.nokiausa.com/A4410055>>, at no. 3: 'The limited warranty extends only to Consumers who purchase the Product in the United States of America.' and *Apple One (1) Year Limited Warranty*, available at <<http://images.apple.com/legal/warranty/docs/ipodisight.pdf>>: 'This limited warranty is governed by and construed under the laws of the country in which the product purchase took place.'

Where the CISG applies to contractual claims of non-privity parties, the following points are to be borne in mind. For claims based on assignment, assumption of debt, *action directe*, implied warranties or contracts with protective effects on the one hand, the sub-purchaser's rights against the manufacturer cannot exceed those which a direct buyer would have. For claims based on express warranties or guarantees, on the other hand, the remote purchaser's claim is independent of any earlier contracts in the chain and must be determined solely based on the relationship between the manufacturer and the sub-purchaser.<sup>81</sup>

Apart from determining the applicability of the CISG to direct claims of the ultimate purchaser against the manufacturer, practical issues that have to be considered are of inspection and notice in accordance with Articles 38 and 39 as well as the foreseeability of loss within the damages provision of Article 74. Again, a distinction should be made between the group of concepts of assignments, *action directe*, implied warranty and contracts with protective effects on the one hand and a guarantee or express warranty on the other hand. In the first group of cases the initial contract not only determines the applicable law but it also defines the scope of the manufacturer's liability. That means if the first buyer has lost its rights by failing to give timely notice of non-conformity, the ultimate buyer, as well, is left without any remedies. Similarly, the type and amount of losses, which the party in breach (that is the manufacturer) foresaw or ought to have foreseen at the time of conclusion of the contract in relation to the first buyer, limit the

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<sup>81</sup> Schwenzler, I and Schmidt, M, *op. cit.*

claim of the ultimate buyer, because the claim of the ultimate purchaser can never exceed the potential claims of the first purchaser.<sup>82</sup>

These considerations do not apply in cases of a guarantee or an express warranty to the ultimate purchaser. In these cases, the ultimate buyer's claim is independent from that of the first buyer. Usually, the guarantee itself will meticulously define the scope and possible remedies arising thereunder as well as the conditions that must be fulfilled for the ultimate purchaser to be able to rely on the guarantee. Any gaps in the guarantee must be filled by resorting to the provisions of the CISG as they would apply if the manufacturer and the remote purchaser were parties to a CISG sales contract. If, in a gap-filling context, the time of the conclusion of the contract is relevant, as is particularly the case in provisions referring to foreseeability, the decisive point in time should be the moment when the goods are leaving the manufacturer's sphere of influence. This is the last point in time for the manufacturer to react to foreseeable circumstances, to estimate its risks and to accordingly shape the express warranty and possibly adjust the price of the goods.<sup>83</sup>

## **2.5 Further Exclusions**

In addition to the above arguments, the exclusion under Article 4(a) also covers a wide range of issues from capacity of persons to enter into a contract to agency, mistakes voiding a contract and in particular, domestic or international regulations prohibiting certain sales, such as embargos or restrictions on the export of goods, for instance, arms, nuclear material and the like. If a state licence is required for certain contracts and it is denied by the competent administrative authorities in a given case, can be categorised as a

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<sup>82</sup> *Ibid.*

<sup>83</sup> *Ibid.*

validity issue governed by domestic law too.<sup>84</sup> But then again, the meaning and scope of ‘validity’ can be an elusive concept. It is not an easy question to determine what falls within the scope of ‘validity’.<sup>85</sup> Issues concerning illegality might in most legal systems be considered as going to validity but the application of national controls on the exclusion and limitation of contractual liability would not be so easy to characterise as pertaining to validity, especially since Article 6 allows the parties to modify or exclude the rights and duties of the contracting parties as laid down in the CISG itself. Different legal systems may define validity in different ways and to different extents and in particular, it is by no means clear that a contract that is unenforceable is invalid. Validity is an expression used in the CISG and, like other expressions used in the Convention, it should attract an autonomous interpretation.<sup>86</sup>

## **2.6 Property in the Goods Sold**

Without formally defining property, the CISG excludes the effect of the contract on the property in the goods sold. Consequently, the CISG also has nothing to say about the requirements that have to be met before the property passes to the buyer or about the time that the property does pass to the buyer.<sup>87</sup> However, the CISG does affirm the seller’s contractual duty to transfer to the buyer certain property rights<sup>88</sup> and it also states that the seller must transfer the property in the goods as required by the contract and the Convention.<sup>89</sup> In a decided case involving a stolen car,<sup>90</sup> the Court of Appeal at Munich,

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<sup>84</sup> Schlechtriem, *op. cit.*

<sup>85</sup> Bridge, *op. cit.*, 526

<sup>86</sup> *Ibid*, 527

<sup>87</sup> *Ibid*, 525

<sup>88</sup> Article 41: ‘The seller must deliver the goods which are free from any right or claim of a third party, unless the buyer agreed to take the goods subject to that right or claim. However, if such right or claim is based on industrial property or other intellectual property, the seller’s obligation is governed by article 42.’

<sup>89</sup> Article 30: ‘The seller must deliver the goods, hand over any documents relating to them and transfer the property in the goods, as required by the Contract and this Convention.’

<sup>90</sup> Case number 7 U 4969/06, decided on 5 March 2008. Retrieved 9 May 2010 from <<http://www.unilex.info/case.cfm?id=1342>>.

Germany held that Article 4(b) of the CISG does not govern the effects of the contract on the property in the goods sold and that, as a consequence, it is a matter governed by domestic law. The Court thus applied German law, which prohibits the acquisition of stolen property even by those who pay for value and in good faith.<sup>91</sup>

Where Article 4(b) is concerned, it has been argued that the drafters of the Convention did not, and could not, draft uniform rules on the transfer of property and whether it takes place *solo concensus*, by mere conclusion of the sales contract, or only at delivery.<sup>92</sup> However, it can be further argued that the exclusion of all property questions extends to security interests as well. Thus, when a contract between an Australian buyer and a German seller contained a title reservation clause amounting to a security interest granted to the seller, the Australian court correctly held that the effects of a retention of title clause which prevents the passing of property, was governed not by the Convention but by the law applicable to property, being, under Australian conflict of law rules, which is German law.<sup>93</sup>

On a different note, a further observation on Article 4 reveals that although there is an abundant of cases where reference to Article 4 is made, most of these decisions merely mention Article 4 in passing and an in-depth analysis of the provision and the notions or concepts used is generally lacking.<sup>94</sup> Unless and until there is a clear and all-encompassing judicial decision on this matter, it appears for now that each case will have to be decided on its own merit.

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<sup>91</sup> *Ibid.*

<sup>92</sup> Schlecthriem, *op. cit.*

<sup>93</sup> *Ibid.* See *Roder Zelt- und Hallenkonstruktionen GmbH v Rosedown Park Pty and Reginald Eustace* (1995) 57 FCR 216, 240 (FCA)

<sup>94</sup> Kröll, S, "Selected Problems Concerning the CISG's Scope of Application", (2005). Retrieved 10 May 2010 from <<http://www.cisg.law.pace.edu/cisg/biblio/kröll.html>>.

## **2.7 Interpretation and Gap-Filling**

### **2.7.1 The Foundation of Article 7**

No codification is ever perfect, and every legal text, therefore needs instruments and concepts that allow adjustments, development and gap-filling to cope with issues not foreseen by its drafters. This is even more so in the case of codifications based on international conventions, for, while a domestic legislator might be willing and competent to enact necessary improvements and reforms, the chances that another United Nations conference can be convened on the CISG, that it will reach results, and that all states that have enacted the Convention will also enact reforms, is almost zero. So there must be safety valves. They are interpretation and gap-filling. The basis is article 7 of the CISG, the formulation of which can now be found in a number of other international conventions, model laws and drafts.<sup>95</sup> Article 7 has also been claimed to be the most important provision of the CISG.<sup>96</sup>

#### **2.7.1.1 Article 7(1) of the CISG**

Article 7(1) of the CISG lays down rules on interpretation of the Convention.<sup>97</sup> Interpretation of an international convention is different from interpretation of domestic legislation, since ambiguities of words and concepts cannot be cleared up by having recourse to other sectors of the same legal system. There are three directives for the interpretation of the Convention to be found in Article 7(1),<sup>98</sup> namely:

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<sup>95</sup> Schlechtriem, *op. cit.*

<sup>96</sup> Bridge, *op. cit.*, 531

<sup>97</sup> Article 7(1): 'In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.'

<sup>98</sup> Schlechtriem, *op. cit.*

(i) Article 7(1) states that, first of all, regard is to be had to the international character of the Convention. This is the principle of autonomous interpretation. The Convention has to be interpreted exclusively on its own terms. In reading and understanding the provisions, concepts and words of the Convention, recourse to the understanding of these words and the like in domestic systems, in particular in the domestic legal system of one's own country<sup>99</sup>, must be avoided. This seems to be self-evident, but experience shows that practitioners and scholars tend to understand words and concepts of the Convention according to their familiar domestic law.<sup>100</sup> In *Genpharm Inc. V Pliva-Lachema A.S., Pliva d.d.*<sup>101</sup> the U.S. District Court, E. D., New York took into account Article 2 of the Uniform Commercial Code (UCC), while bearing in mind the international character of the contract, in interpreting the CISG when provisions in both instruments contain similar language before eventually deciding that the dispute at hand fell within the Court's jurisdiction.<sup>102</sup> At times, it can be seen that resorting to domestic law may be able to assist the courts in interpreting the provisions of the CISG.

(ii) Further, Article 7(1) requires consideration of the need to promote uniformity in the application of the Convention. This, at first sight, looks innocuous, but it is argued that, it is the basis for a kind of international recognition of precedents, that is respecting decisions from all Contracting States, if not fully binding as under a doctrine of *stare decisis*, but as a persuasive authority. There are already examples for this, such as where a United States court thoroughly analysed a decision of the

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<sup>99</sup> On the assumption that that country is a CISG Contracting State.

<sup>100</sup> Schlechtriem, *op. cit.*

<sup>101</sup> Case number 03-CV 2835 (ADS) (JO) decided on 19 March 2005. Retrieved 11 May 2010 from <<http://www.unilex.info/case.cfm?id=1310>>.

<sup>102</sup> *Ibid.*

German Supreme Court, following its basic rule, but distinguished the case at hand from the facts of the German case.<sup>103</sup> This approach, namely, the taking account of foreign courts' judgments, is facilitated by a number of electronic databases offering access to decisions from all contracting states, often translated into English.<sup>104</sup> One combined example of the expediency of using these databases and also on relying on foreign judgements and scholarly writings in aiding the interpretation of the CISG can be found in the case of *Inotex Precision Limited v Horei, Inc. et. al.*<sup>105</sup> where the U.S. District Court, Northern District of Georgia, Atlanta Division referred to a decision of the Supreme Court of France, letters from the Chinese government to the Secretary General of the United Nations, the list of treaties by the International Department of the Hong Kong Department of Justice, articles in the Hong Kong Law Journal and numerous scholarly writings in concluding that Hong Kong is not a Contracting State by virtue of Article 93 of the CISG.<sup>106</sup>

(iii) Thirdly, Article 7(1) mentions the observance of good faith in international trade. This is a much disputed phrase, and, it is further argued, often misunderstood. First of all, it only applies to the interpretation of the Convention, although a great number of legal writers advocate applying it to contractual agreements as well. Secondly, one has to avoid falling prey to preconceptions caused by domestic rules such as the German good faith and fair dealing concept, which became the most important tool for adapting the German Civil Code to new

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<sup>103</sup> Schlechtriem, *op. cit.* See *Medical Marketing v Internazionale Medico Scientifica* 1999 WL 311945 (EDLa)

<sup>104</sup> Examples include Case Law on UNCITRAL Texts (CLOUT) <<http://www.uncitral.org>>; UNILEX <<http://www.unilex.info>> and Pace Law School <<http://www.cisg.law.pace.edu/>>.

<sup>105</sup> Case number 1:09-CV-547-TWT decided on 17 December 2009. Retrieved 12 May 2010 from <<http://www.unilex.info/case.cfm?id=1489>>.

<sup>106</sup> *Ibid.*

challenges. Good faith in international trade, instead, has to be analysed autonomously by taking into account practices, standard forms, value judgments of courts and arbitration tribunals in international cases as forming a body of law merchant beyond the written text of conventions.<sup>107</sup> It has also been contended that in dealing with good faith, Article 7(1) is noteworthy for what it does *not* say. It does not impose on the contracting parties a general duty of good faith and fair dealing in the formation and performance of contracts, which was objected to by certain representatives in the legislative process. Rather, it is a compromise reached after objections were made in some quarters to the introduction of a general duty.<sup>108</sup>

It is further contended that the application of this provision is something of a mystery. One view is that it is as good as the incorporation of a good faith standard in the contract itself. Parties derive their rights and duties from the contract in accordance with the CISG; the CISG is to be interpreted in accordance with good faith and therefore the parties' rights and duties are subject to good faith.<sup>109</sup> It can be fairly predicted that some national courts will interpret this provision more broadly than others and some courts might be prepared to spell out a general duty of good faith from the remaining provisions of CISG pursuant to Article 7(2).<sup>110</sup> However, there may be difficulties of interpretation in this particular scenario. Given that an explicit standard of good faith and fair dealing was rejected by the (CISG) conference delegates, does this mean that the standard itself was rejected as

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<sup>107</sup> Schlechtriem, *op. cit.*

<sup>108</sup> Bridge, *op. cit.*, 534

<sup>109</sup> *Ibid.*

<sup>110</sup> Article 7(2) will be discussed later in this chapter.

a general principle or only that express mention of the standard was rejected? It seems that the latter approach is likely to gain ascendancy.<sup>111</sup>

In short, the underlying message in Article 7(1) is to avoid the trap of homeward tendency in interpretation and it urges the courts to avoid domestic preoccupation and, impliedly, to look at what other courts are doing. Interpretation is to be approached with an internationalist spirit and in this respect, legal literature has an important role to play. It is not mentioned that in Article 7 as a formal source of law but it is certain that it will be influential as authority in interpreting the CISG and it is particularly likely to play a role in formulating and expanding the general principles on which the Convention is based.<sup>112</sup>

### **2.7.1.2 Article 7(2) of the CISG**

#### **(i) The Underlying Problems**

If interpretation fails to adjust the Convention, gap-filling under article 7(2) has to be considered. There are two steps to fill a gap. First and foremost, a uniform rule based on general principles, on which the Convention is based, should be searched for and formulated. Second, but only if gap-filling by a uniform rule fails, recourse is to be had to domestic law denominated by the conflict of law rules of the forum. The problem of the first step is obvious - the general principles are not explicitly in the Convention. Therefore, they have to be derived from an analysis of concrete provision so to unearth the general principles underlying them. Thus, from a number of provisions one can derive the general principle of *estoppel*; or a number of provisions that allow withholding one's own

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<sup>111</sup> Bridge, *op. cit.*, 534-535.

<sup>112</sup> *Id.*, at 531-532.

performance until the other party has performed or has provided adequate assurance of its performance. This makes it possible to formulate a general right to retain one's own performance until the other party has fulfilled its part of the contract. On the other hand, where no principle can be found, gap-filling by uniform rules is impossible, and one has to revert to domestic law. For example, rules on set-off or assignment of receivables differ widely in domestic systems, and no uniform principle can be found in the CISG as to prerequisites and operation of set-off or assignments. Therefore, recourse to domestic law is unavoidable in most cases.<sup>113</sup>

#### (ii) Gaps in the CISG

A gap in the coverage of the CISG may be a subject that is omitted altogether, yet plainly falls within the province of the law of sale as defined by the CISG, or it may be a hole in the partly explicit coverage of the subject by the CISG. Examples of the former are quite hard to find, one possibility being penalty clauses. A prominent example of a gap in the sense of part coverage is the subject of interest. Article 78<sup>114</sup> provides that a right to interest arises in the event of non-payment of the price or other sums in arrears, but there it does not say when such interest begins to run, what the rate is and whether it is simple or compounded. And this issue has produced much litigation under the Convention.<sup>115</sup> Another example of partial coverage is Article 25 on fundamental breach, which, though not as barebones as Article 78, is somewhat lacking in detail. It describes that a breach is fundamental if it substantially deprives the injured party of what he was entitled to expect

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<sup>113</sup> Schlechtriem, *op. cit.*

<sup>114</sup> Article 78 will be discussed later in Chapter 6 of this dissertation.

<sup>115</sup> Bridge, *op. cit.*, 536

under the contract, provided that the breaching party either foresaw or should reasonably have foreseen this substantial deprivation, and not much else.<sup>116</sup>

### (iii) Discovering the General Principles

The question is now, how are the general principles in the CISG to be discovered with the aid of Article 7(2)? In addition to the general observations above, a different perspective on this issue could also be observed. It has been pointed out that if the code is, as it must be, comprehensive, then the answer to a problem will be found somewhere in the code. To find the general principles in a code requires its various provisions to be subjected to an inductive process that sees them as particular expressions of a more general principle.<sup>117</sup> From the general principle thus discovered, a particular application can be drawn to deal with a novel issue not expressly dealt with in the code. The text of Article 7(2) demands a search for the principles upon which the CISG is 'based'; an incidental reference to a principle may not be enough.<sup>118</sup>

For example, the CISG says nothing about penalty clauses. The first question is whether penalty clauses play no part in the law of sale but are rather part of general contract law. If they are, then they will be dealt with in terms of the applicable law and not under CISG. Moreover, different legal systems will define the border between sale and contract law in different ways. Some of the damages rules in the CISG are specifically relevant to the parties as buyer and seller but others are couched in general terms and could just as easily be located in a uniform law on contract. There is at least an argument that penalty clauses

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<sup>116</sup> *Ibid.* cf. with Article 7.3.1 of the UNIDROIT Principles which introduces further criteria such as intentional or reckless breach; strict compliance being the essence of the contract; the threat posed to future performance by the present breach; and any disproportionate loss caused to the breaching party compared to the benefit of the injured party arising out of termination.

<sup>117</sup> Bridge, *op. cit.*, 536

<sup>118</sup> *Id.*, at 536-537

are impliedly covered by the CISG as part of the law of sale. It is, moreover, for the CISG itself to determine the extent of its coverage and definition of sale matters. On the assumption that penalty clauses are impliedly covered, a search is needed under Article 7(2) to discover the relevant general principles. It is suggested that the starting point should be Article 74, the general damages provision. This states that damages may be awarded in respect of loss both caused by the breach and foreseeable by the party in breach at the contract date. The causation element could be seen as a particular manifestation of an unstated broader principle that the goal of damages is to compensate for loss and not to enrich. It is from this broad principle that one could infer the particular rule that penalties should be disallowed because they punish rather than compensate.<sup>119</sup>

#### (iv) The Role of UNIDROIT Principles and Private International Law

Shortage of time and the need for compromise meant that the CISG suffers from vagueness of expression and a number of omissions. It is here that the UNIDROIT principles, assuming the legitimacy of their use, might assist tribunals to fill in the gaps in the CISG despite the lack of any particular or general mention of them in the text of Article 7(2). Except where they would contradict the CISG, the UNIDROIT principles may stimulate the search for unstated general principles in the CISG. There is a clear need for them as the CISG can be changed only by means of a diplomatic conference. Nothing in the CISG corresponds to the continuing editorial work provided for in the US Uniform Commercial Code. The UNIDROIT principles are not the product of a diplomatic conference and may be modified with relative ease in the future. Moreover, they are drafted in much the same way as the Uniform Commercial Code with hypothetical illustrations and comment

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<sup>119</sup> *Id.*, at 537.

attached to each article.<sup>120</sup> As an illustration to this argument, in a case decided by the *Court of Hof 'S Hertogenbosch* of the Netherlands<sup>121</sup>, the court referred to the comments in Article 2.20 of the UNIDROIT principles in determining as to whether or not the seller's standard terms formed part of the contract since the CISG does not have any special provision on that particular issue.<sup>122</sup>

Finally, in the absence of a ruling general principle to determine a matter covered by the CISG but not expressly covered settled by it, Article 7(2) directs a reference to the rules of private international law. Although this provision may have been drafted with the intention of harmonising the law, it has been suggested that any court or tribunal faced with such a situation ought not to have adopted this expedient but should instead find the answer to the problem within the CISG itself. It is argued that a readiness to turn to rules of private international law in this way is destructive to uniformity.<sup>123</sup>

## **2.8 What is the International Chamber of Commerce (ICC)?**

### **2.8.1 The International Chamber of Commerce's Origins**

The Incoterms rules devised by the International Chamber of Commerce (ICC) are rules which explain standard terms that are used in contracts for the international sale of goods. The ICC was founded in 1919 with an international secretariat based in Paris. Its overriding aim remains unchanged, namely to serve world business by promoting trade and investment, open markets for goods and services, and the free flow of capital.<sup>124</sup>

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<sup>120</sup> *Id.*, at 538-539

<sup>121</sup> Decided on 16 October 2002. Retrieved 12 May 2010 from <<http://www.unilex.info/case.cfm?id=960>>.

<sup>122</sup> *Ibid.*

<sup>123</sup> Bridge, *op. cit.*, 539

<sup>124</sup> "What is ICC?". Retrieved 3 June 2010 from <<http://www.iccwbo.org/id93/index.html>>.

ICC has evolved tremendously since those early post-war days when business leaders from the Allied Nations<sup>125</sup> met for the first time in Atlantic City, the United States of America. The original nucleus, representing the private sectors of Belgium, Britain, France, Italy and the United States, has expanded to become a world business organisation with thousands of member companies and associations in and around 130 countries. Members include many of the world's most influential companies and represent every major industrial and service sector.<sup>126</sup>

### **2.8.2 The Voice of International Business**

Traditionally, ICC has acted on behalf of businesses in making representations to governments and intergovernmental organisations. Three prominent ICC members served on the Dawes Commission which forged the international treaty on war reparations in 1924, seen as a breakthrough in international relations at the time. A year after the creation of the United Nations (UN) in San Francisco in 1945<sup>127</sup>, ICC was granted the highest level consultative status with the UN and its specialised agencies. Ever since, it has ensured that the international business view receives due weight within the UN system and before intergovernmental bodies and meetings such as the G8<sup>128</sup> where decisions affecting the conduct of business are made.<sup>129</sup>

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125 The Allied Nations were Allies of World War II. The major allies consisted of France, Poland, the United Kingdom, the United States of America, the Union of Soviet Socialist Republics (USSR) and China. Other allies included Australia, Belgium, Brazil, Canada, Czechoslovakia, Ethiopia, Greece, India, Mexico, the Netherlands, New Zealand, Norway, the Philippine Commonwealth, Albania, the Union of South Africa and Yugoslavia. In December 1941, U.S. President Franklin Roosevelt devised the name "United Nations (UN)" for the Allies. The Declaration by United Nations, on 1 January 1942, was the basis of the modern UN. "Allies of World War II". Retrieved 3 June 2010 from <[http://en.wikipedia.org/wiki/Allies\\_of\\_World\\_War\\_II](http://en.wikipedia.org/wiki/Allies_of_World_War_II)>.

126 "What is ICC?". Retrieved 3 June 2010 from <<http://www.iccwbo.org/id93/index.html>>.

127 The United Nations was established on 24 October 1945 with 51 member countries. "UN at a Glance". Retrieved 3 June 2010 from <<http://www.un.org/en/aboutun/index.shtml>>

128 The Group of Eight (G8, and formerly the G6 or Group of Six and also the G7 or Group of Seven) is a forum, created by France in 1975, for governments of six countries in the world, namely, France, Germany, Italy, Japan, the United Kingdom, and the United States. In 1976, Canada joined the group (thus creating the G7). In becoming the G8, the group added Russia in 1997. In addition, the European Union is represented within the G8, but cannot host or chair. "G8". Retrieved 4 June 2010 from <<http://wikipedia.org/wiki/G8>>.

129 "What is ICC?". Retrieved 3 June 2010 from <<http://www.iccwbo.org/id93/index.html>>

### **2.8.3 Defender of the Multilateral Trading System**

ICC's reach - and the complexity of its work - have kept pace with the globalisation of business and technology. In the 1920s, ICC focused on reparations and war debts. A decade later, it struggled vainly through the years of depression to hold back the tide of protectionism and economic nationalism. When war broke out in 1939, ICC assured continuity by transferring its operations to neutral Sweden.<sup>130</sup>

In the post-war years, ICC remained a diligent defender of the open multilateral trading system. As membership grew to include more and more countries of the developing world, the organisation stepped up demands for the opening of world markets to the products of developing countries. ICC continues to argue that trade is better than aid. In the 1980s and the early 1990s, ICC resisted the resurgence of protectionism in new guises such as reciprocal trading arrangements, voluntary export restraints and curbs introduced under the euphemism of "managed trade".<sup>131</sup>

### **2.8.4 Challenges of the 21st Century**

After the disintegration of communism in Eastern Europe and the former Soviet Union, ICC faced fresh challenges as the free market system won wider acceptance than ever before, and countries that had hitherto relied on state intervention switched to privatisation and economic liberalisation. As the world enters the 21st century, ICC is building a stronger presence in Asia, Africa, Latin America, the Middle East, and the emerging economies of eastern and central Europe. Today, ICC's commissions of experts from the private sector cover every specialised field of concern to international business. Subjects range from banking techniques to financial services and taxation, from competition law to

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<sup>130</sup> *Ibid.*

<sup>131</sup> *Ibid.*

intellectual property rights, telecommunications and information technology, from air and maritime transport to international investment regimes and trade policy.<sup>132</sup>

Self-regulation is a common thread running through the work of the commissions. The conviction that business operates most effectively with a minimum of government intervention inspired ICC's voluntary codes. Marketing codes cover sponsoring, advertising practice, sales promotion, marketing and social research, direct sales practice, and marketing on the internet.<sup>133</sup>

### **2.8.5 Practical Services to Business**

ICC communicates with members all over the world through its conferences and biennial congresses. As a member-driven organisation, with national committees in 84 countries, it has adapted its structures to meet the changing needs of business. Many of them are practical services, like the ICC International Court of Arbitration, which is the longest established ICC institution. The Court is the world's leading body for resolving international commercial disputes by arbitration. The first Uniform Customs and Practice for Documentary Credits (UCP) was first introduced in 1933 and the current version is now the UCP 600, which came into effect in 1 July 2007. These rules are used by bankers, lawyers, traders, transporters and even academics throughout the world and they serve as a useful tool in relation to the application of documentary credits. A supplement to UCP 600, called the eUCP, was added in 2002 to deal with the presentation of all electronic or part electronic documents.<sup>134</sup>

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<sup>132</sup> *Ibid.*

<sup>133</sup> *Ibid.*

<sup>134</sup> *Ibid.*

In 1936, the first nine Incoterms were published, providing standard definitions of universally employed terms like CIF<sup>135</sup> and FOB<sup>136</sup>, and they are constantly revised and updated by the ICC. The current version is the Incoterms 2010, which came into effect on 1 January 2011. In 1951 the International Bureau of Chambers of Commerce (IBCC) was created. It rapidly became a focal point for cooperation between chambers of commerce in developing and industrial countries, and took on added importance as chambers of commerce of transition economies responding to the stimulus of the market economy. In 2001, on the occasion of the 2nd World Chambers Congress in Korea, IBCC was renamed the World Chambers Federation (WCF), clarifying WCF as the world business organisation's department for chamber of commerce affairs. WCF also administers the ATA Carnet system for temporary duty-free imports, a service delivered by the chambers of commerce, which began in 1958 and is now operating in over 57 countries. Another ICC service, the Institute for World Business Law was created in 1979, to study legal issues relating to international business.<sup>137</sup>

## **2.9 The Incoterms**

### **2.9.1 Introduction**

The global economy has given businesses broader access than ever before to markets all over the world. Goods are sold in more countries, in larger quantities and in greater variety but as the volume and complexity of international sales increase, so do possibilities for misunderstandings and costly disputes when sales contract are not adequately drafted.

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<sup>135</sup> "Cost, Insurance and Freight" means that the seller delivers the goods on board the vessel or procures the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel. The seller must contract and pay the costs and freight necessary to bring the goods to the named port of destination. The seller also contracts for insurance cover against the buyer's risk of loss of or damage to the goods during the carriage. Definition obtained from Ramberg, J, ICC Guide to Incoterms 2010, (Paris: ICC Services Publications, 2011), 199.

<sup>136</sup> "Free on Board" means that the seller delivers when the goods on board the vessel nominated by the buyer at the named port of shipment or procure the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel, and the buyer bears all costs from that moment onwards. The FOB rule is to be used only for sea or inland waterway transport. Definition obtained from Ramberg, *op. cit.*, 171.

<sup>137</sup> "What is ICC?". Retrieved 3 June 2010 from <<http://www.iccwbo.org/id93/index.html>>.

Incoterms, the official ICC rules for the interpretation of trade terms facilitate the conduct of international trade. Reference to the Incoterms in a sales contract defines clearly the parties' respective obligations and reduces the risk of legal complications.<sup>138</sup> Incoterms rules explain standard terms that are used in contracts for the sale of goods. They are essential ICC tools that help traders avoid misunderstandings by clarifying the costs, risks, and responsibilities of both buyers and sellers.

Since the introduction of Incoterms by the ICC in 1936, this it has been regularly updated to keep pace with the development of international trade. Incoterms 2000 take into account the spread of customs-free zones, the increased use of electronic communications in business transactions and changes in transport practices.<sup>139</sup> Since the last revision in 2000, much has changed in global trade. Cargo security is now at the forefront of the transportation agenda for many countries. In addition, the United States' Uniform Commercial Code was revised in 2004, resulting in a deletion of US shipment and delivery terms. The Incoterms 2010, reflects these changes and also others.<sup>140</sup>

### **2.9.2 The Evolution of the Incoterms Rules**

After their initial introduction in 1936, the Incoterms rules were revised for the first time in 1957 and thereafter in 1967, 1976, 1980, 1990 and 2000. It is put forward that the main purpose of the Incoterms rules is to reflect international commercial practice. Further, a revision of the Incoterms rules indicates that something important has taken place in commercial practice. For example, the first version of the Incoterms rules was clearly

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<sup>138</sup> Foreword to Incoterms 2000 by Maria Livanos Cattau, former Secretary General of the ICC (July 1996 – June 2005).

<sup>139</sup> *Ibid.*

<sup>140</sup> "Incoterms 2010". Retrieved 9 June 2010 from <<http://www.iccwbo.org/Incoterms/index.html?id=3042>>.

focused on commodity trading and fixed the important delivery points at the ship's side or at the moment when the goods are taken on board the ship.<sup>141</sup>

When carriage of goods by rail had increased, it was therefore necessary to introduce the appropriate terms and it is for such purpose that the Incoterms rules 1957 introduced the FOR (Free on Rail) and the FOT (Free on Truck) terms. In 1967, the ICC felt that it was necessary to add terms for cases in which the seller undertakes to deliver the goods at destination. In such cases, the seller concludes a contract of carriage in order to fulfil his obligation to deliver the goods to the buyer at destination. In 1976, a specific term for air transport was added, namely FOB Airport. In the 1980 revision of the Incoterms rules, it was necessary to add CIP (Carriage and Insurance Paid To) for non-maritime transport as an equivalent to CIF, under which the seller undertakes to arrange and pay for the carriage and insurance. As a result, the terms CPT (Carriage Paid To) and CIP, corresponding to CFR (Cost and Freight) and CIF for maritime transport, were both added to the Incoterms rules. The 1990 revision of the Incoterms rules was partly triggered by the shift from paper documents to electronic communication. As a result, a paragraph was added in the clauses dealing with the seller's obligation to tender documents to the buyer stating that paper documents could be replaced by electronic messages if the parties had agreed to communicate electronically.<sup>142</sup>

What then is the reason for the revision of the Incoterms rules resulting in the Incoterms 2010 rules? It appears that the main problem with the Incoterms 2000 rules was not so much what they contained but rather that it was not sufficiently clear how they should be used in practice. In addition, it was felt that it is important to expand the use of the Incoterms rules, particularly in the United States, where a possibility to do so has arisen as

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<sup>141</sup> Ramberg, *op. cit.*, 8.

<sup>142</sup> *Id.*, at 8-9.

a result of the removal of the 1941 definitions of trade terms from the Uniform Commercial Code (UCC).<sup>143</sup> It is stated that there are limits to what can be done to increase the understanding of the Incoterms rules. In particular, merchants retain old habits and are not easily persuaded to depart from the traditional maritime terms, although this is clearly necessary when contemplating non-maritime transport. In order to promote a better understanding of the Incoterms rules, the 2010 version starts by presenting trade terms that can be used for any mode or modes of transport and only then presents trade terms that can be used for sea and inland waterway transport.<sup>144</sup>

Another frequent misunderstanding concerns the very purpose of the Incoterms rules. Although they are needed to determine key obligations of sellers and buyers with respect to the different modalities of delivery, transfer of risk and cost, the terms do not represent the whole contract. It is also necessary to determine what rules apply when the contract is not performed as expected, owing to various circumstances, and how disputes between the parties should be resolved. While the Incoterms enlighten the parties on what to do, they unfortunately do not explain what happens if the parties do not do so. For this purpose, the parties need to lay down applicable rules in a contract or by using a standard form contract as a supplement. In practice, disputes might nevertheless arise owing to unexpected events that the parties have failed to consider in their contract in a clear and conclusive manner. In such cases, the applicable law may provide a solution. Fortunately, the CISG has now become recognised worldwide, thus contributing significantly to transparency and effective dispute resolution in international trade.<sup>145</sup>

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<sup>143</sup> *Id.*, at 9.

<sup>144</sup> *Id.*, at 10.

<sup>145</sup> *Ibid.*

Furthermore, the latest version of the Incoterms rules, have been officially endorsed by the United Nations Commission on International Trade Law (UNCITRAL), confirming their position as the global standard for international business transactions. UNCITRAL, whose mandate is to remove legal obstacles for international trade, applauded ICC for its “valuable” contribution to facilitating the conduct of global trade by making the Incoterms 2010 rules simpler and clearer, reflecting recent developments in international trade.<sup>146</sup>

### **2.9.3 The Incoterms Rules and their Functions and Referencing the Incoterms Rules in a Contract of Sale**

As it is understood, the Incoterms is the abbreviation of the International commercial terms and the chosen Incoterms rule is a term of the contract of sale and not of the contract of carriage. Although the Incoterms rules are primarily intended for international sales, they can also be applied to domestic contracts by reference. Trade terms are, in fact, key elements of international contracts of sale, since they allocate the roles of the contracting parties with respect to carriage of the goods from the seller to the buyer; export, import and security-related clearance; and the division of costs and risks between the parties.<sup>147</sup>

Merchants tend to use short abbreviations such as FOB and CIF to clarify the distribution of functions, costs and risks relating to the transfer of goods from the seller to the buyer but misunderstandings frequently arise concerning the proper interpretation of these and similar expressions. For this reason, it was considered important to develop rules for the interpretation of the trade terms that the parties to a contract of sale could agree to apply and the Incoterms rules constitute such rules of interpretation.<sup>148</sup>

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<sup>146</sup> “UN Endorses Incoterms 2010, ICC’s Rules for International Trade”. Retrieved on 27 November 2012 from <<http://www.uscib.org/index.asp?documentID=4393>>.

<sup>147</sup> Ramberg, *op. cit.*, 16.

<sup>148</sup> *Ibid.*

Although the Incoterms rules, in so far as they reflect generally recognised principles and practices, may become part of the contract of sale without express reference, the contracting parties are strongly advised to include in their contract in conjunction with the trade term the words “the Incoterms 2010 rules” and to verify whether a standard contract used in their contract of sale contains such a reference. If that is not the case, then the standardised reference “the Incoterms 2010 rules” must be superimposed to avoid the application of any previous version of the Incoterms rules.<sup>149</sup>

#### **2.9.4 What the Incoterms Rules Are Not Intended to Perform**

Although the Incoterms rules are incorporated into the contract of sale, it is imperative to take note that they are only rules for the interpretation of terms of delivery, and not of other terms of the contract of sale. The Incoterms rules do not, primarily, deal with the following:

##### **(i) Transfer of Property in the Goods**

In many jurisdictions, the transfer of property rights in the goods requires that the party take possession of the goods either directly or indirectly through the transfer of documents, such as the maritime bill of lading, controlling the disposition of the goods. However, in some jurisdictions, the transfer of property rights in the goods may depend solely on the intention of the contracting parties. Frequently, the contract of sale determines whether the buyer has become the owner of the goods. In some instances, the buyer may not become the owner when the seller, under a purported retention of title clause, may have decided to retain title to them until he has been paid. In such an instance, the applicable law will

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<sup>149</sup> *Ibid.*

decide the extent to which such clauses are effective in protecting the seller when he has surrendered possession of the goods to the buyer.<sup>150</sup>

#### (ii) Relief from Obligations and Exemptions from Liability in case of Unexpected or Unforeseen Circumstances

Although, according to the Incoterms rules, the parties undertake obligations to perform various tasks to the benefit of the other party, such as procuring carriage and clearing the goods for export and import, they may be relieved from such obligations or from the consequences of non-performance, if they can benefit from exemptions under the applicable law or terms of their contract other than those concerning the Incoterms rules. For instance, under Article 79 of the CISG, the parties may be relieved from their obligations if they are prevented from performing due to reasonably unforeseeable and unavoidable impediments beyond their control. It is noted that standard contracts typically contain explicit *force majeure*, relief or exemption clauses essentially corresponding to the main principle of Article 79 of the CISG.<sup>151</sup>

#### (iii) Consequences of Breaches of Contract

The Incoterms rules, in the A5, B5 and A6 and B6 clauses,<sup>152</sup> deal with the transfer of risks and the division of costs between the parties. It follows from the A5 and B5 clauses that the risk may be transferred from the seller to the buyer before the goods have been delivered, if the buyer has failed to fulfill his obligation to take delivery as agreed, or to give appropriate notice to the seller when the buyer is to nominate the carrier under the F-

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<sup>150</sup> Ramberg, *op. cit.*, 17-18.

<sup>151</sup> *Ibid.*

<sup>152</sup> In the Incoterms rules 2010, the A terms refer to the seller's obligations and the B terms refer to the buyer's obligations.

terms.<sup>153</sup> In these cases, costs arising from the buyer's failure to fulfill his obligations would also fall upon him under the B6 clauses of the Incoterms rules. However, apart from these specific cases involving the buyer's breach, the Incoterms rules do not deal with other consequences following from breaches of the obligations under the contract of sale. Such consequences follow from the applicable law or other terms of the contract.<sup>154</sup> For instance, Article 50 of the CISG provides a remedy to the buyer should the seller delivered goods that do not conform to the contract.

## **2.10 The Demise of the Ship's Rail**

The Incoterms rules 2010 has made a significant change to the concept of the "ship's rail" as was found in the previous editions of the Incoterms rules. The concept of the imaginary ship's rail is synonymous with the FOB term and has caused considerable difficulties in the past, in particular where the division of risks between the seller and buyer is concerned. In *Pyrene & Co v Scindia Steam Navigation Co*,<sup>155</sup> the plaintiff was able to recover £200 from the defendant carrier, after the carrier was found to be negligent in loading the goods which caused damage prior to the goods crossing the 'ship's rail'. This case raises questions of liability if the damage occurs at any point other than after crossing the 'ship's rail'. Devlin J stated that if the goods are damaged during loading, whether that damage occurs on either side of the 'ship's rail', then the carrier's liability for negligence would have to extend to cover the damages.<sup>156</sup>

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<sup>153</sup> The F-terms in the Incoterms rules 2010 are FCA (Free Carrier), FAS (Free Alongside Ship) and FOB (Free on Board). The letter "F" signifies that the seller must hand over the goods to a nominated carrier Free of risk and expense to the buyer. Ramberg, J, *op. cit.*, 49.

<sup>154</sup> Ramberg, *op. cit.*, 19.

<sup>155</sup> *Pyrene & Co v Scindia Steam Navigation Co* [1954] 2 QB 402

<sup>156</sup> *Ibid.* at 419.

The Incoterms rules 2010, defined the FOB term as “the seller delivers the goods *on board the vessel* nominated by the buyer at the named port of shipment or procures the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel, and the buyer bears all costs from that moment onwards”<sup>157</sup> as opposed to “the seller delivers when the goods *pass the ship’s rail* at the named port of shipment” in the Incoterms rules 2000. It is suggested that under the Incoterms rules 2010, for sea and inland waterway transport, the biggest change has been in the FOB term, and therefore CFR (Cost and Freight) and CIF (Cost, Insurance and Freight). The notion of the “ship’s rail” is dead. No longer will the parties have to concern themselves with the risk-in-transit swinging to and from the seller and the buyer across some imaginary line that extends perpendicularly from the ship’s rail into the stratosphere. What is put forward now is a different notion, and that is the risk passing when the goods are onboard the vessel, which means the whole consignment has been loaded. Should half a consignment be loaded and the ship sinks, then complete loading presumably will not have occurred and risk will not have transferred to the buyer.<sup>158</sup> It is hoped that with the demise of the concept of the ship’s rail, division of risks between the seller and buyer is now clearly defined and that the number of litigation in this area will be greatly reduced.

## **2.11 The Incoterms and the International Sale Contracts**

### **2.11.1 Variety of Contracts**

The Incoterms is but a part of a labyrinth of international sale contracts and it must be emphasised that the ways in which an overseas sale contract may be conducted are almost infinitely variable and that the applicable rules are almost always drawn from a

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<sup>157</sup> Ramberg, *op. cit.*, 171.

<sup>158</sup> Bergami, R, “The Ship’s Rail is Dead: Incoterms 2010”, (2010). Retrieved on 26 November 2012 from <[http://www.ibt-articles.com/absnet/templates/trade\\_article.aspx?articleid=402&zoneid=2](http://www.ibt-articles.com/absnet/templates/trade_article.aspx?articleid=402&zoneid=2)>.

construction of the contract.<sup>159</sup> Consequently, it is necessary to avoid dogmatism in dealing with overseas sales law. One cannot, for example, say that it is always the FOB's buyer's responsibility to select and engage the carrier; sometimes the seller is explicitly, perhaps even implicitly, obliged under the contract to do this.<sup>160</sup>

International sale contracts do not exist in a vacuum and they are frequently associated with other contracts such as contracts of carriage and insurance. Further, the significance of charter party<sup>161</sup> contracts needs to be considered. Where goods are sold in bulk commodities, it is commonly the head seller (in string CIF contracts) and end buyer (in string FOB contracts) who will fix a charter party to carry the goods. Therefore, charter parties have a number of clauses in common with sale contracts and the interaction of the two types of contract is an important matter that cannot be undermined.<sup>162</sup>

## **2.11.2 Interpretation of the Contract**

### **2.11.2.1 A Matter of Law and Harmonious Interpretation**

Until recent developments, it could have been said that the interpretation of a contract is a matter of law. Consequently, the views of experienced arbitrators as to the meaning of trade terms will be accorded respect but will not without more be adopted by the courts.<sup>163</sup>

The treatment of interpretation as a matter of law also provides some degree of assurance to those conducting business on the basis of well-known standard forms that they can conduct their business and measure their risk according to an authoritative judicial view of

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<sup>159</sup> Bridge, *op. cit.*, 9.

<sup>160</sup> *Ibid.*

<sup>161</sup> A charter party is a written contract between the owner of a vessel and the person desiring to employ the vessel (charterer); sets forth the terms of arrangement, such as duration of agreement, freight rate and ports involved in the trip. Retrieved 30 July 2010 from "Glossary of Shipping Terms, The U.S. Department of Transport, <[http://marad.dot.gov.documents/Glossary\\_final.pdf](http://marad.dot.gov.documents/Glossary_final.pdf)>.

<sup>162</sup> Bridge, *op. cit.*, 10.

<sup>163</sup> *Ibid.* The courts referred to in this chapter are the English courts by reason of their vast judicial experience in international commercial matters.

the meaning of standard provisions. Backed up by judicial interpretation, such standard form contracts become something more than mere contractual documents; they become a species of private legislation binding those in the trade who have submitted to them.<sup>164</sup>

Particular standard terms acquire a standard meaning and in this respect, English law diminishes transaction costs and enables participants in the trade to build upon their own and others' experience. This feature of interpretation is of particular importance in international sale and related contracts, concluded by ship's brokers, agents and the like without the benefit of legal advisers. However, in recent years, as courts have insisted that contracts are to be construed within their factual matrices, the view has gained ground that interpretation is a matter of law and fact.<sup>165</sup> The danger of such development is that the interpretation of international commercial contracts may eventually lose its certainty.

In other instances, when faced with a complex document, the court will seek to interpret it in a harmonious way so as to avoid conflicts between its various provisions, though this does not mean that individual clauses will be interpreted in an artificial way in order to avoid conflict.<sup>166</sup> The contested clause is not interpreted in isolation but in its written context along with other clauses. This important rule of interpretation highlights the danger of superficial reading of documents by focusing only on the particular contentious clause in the search for meaning.<sup>167</sup>

### **2.11.2.2 Avoiding Absurd Results**

If contractual provisions are susceptible to more than one interpretation, and one of these interpretations yields an absurd or unreasonable result, then the other result is to be

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<sup>164</sup> Bridge, *op. cit.*, 41.

<sup>165</sup> *Ibid.* See *Sea Success Maritime Inc v African Maritime Carriers Ltd* [2005] 2 Lloyd's Rep 692 at 16.

<sup>166</sup> Bridge, *op. cit.*, 41.

<sup>167</sup> See *International Fina Services AG v Katrina Shipping Ltd (The Fina Samco)* [1995] 2 Lloyd's Rep 344, CA

preferred.<sup>168</sup> In *The Alkeos*<sup>169</sup>, an FOB buyer had the right to call for the original shipment period to be extended. The buyer thereby incurred a duty to pay the seller's carrying charges. The contract went on to free the buyer from that duty if the ship was delayed on its way to berth by an event for which the buyer was not responsible, but only in the event of the ship being delayed in entering River Parana, on its way to the loading port of Rosario, by the actions of the Argentinian coastguard at Recalada, which is the first port in Argentina coastal waters. The Argentinian coastguard did indeed delay the ship not at Recalada but at the subsequent port of Interseccion, which lay between Recalada and Rosario. Staughton J held that the clause, properly interpreted, was designed to place on the seller the risk of carrying charges in all cases where the Argentinian coastguard delayed the ship within Argentinian coastal waters. It would make little sense for the seller to assume the risk of delay at Recalada but for that risk subsequently to swing back to the buyer within coastal waters, when the buyer had borne the various risks of marine delay prior to Recalada.

#### **2.11.2.3 Upholding the Validity of the Contract**

It is a well known principle of contractual interpretation that, faced with two possible interpretations of the contract, one upholding and the other denying the validity of the contract or one of its clauses, the court will lean in favour of the former interpretation (*magis ut res valeat quam pereat*).<sup>170</sup>

#### **2.11.2.4 Typed and Standard Clauses**

In the event of consistency between clauses in a standard form applied to the present contractual adventure and special clauses typed in to meet the needs of the particular

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<sup>168</sup> Bridge, *op. cit.*, 42.

<sup>169</sup> Bunge AG v Sesostrad [1984] 1 Lloyd's Rep 686. However, it is to be noted that this case was decided before the new definition of the FOB term in the Incoterms rules 2010.

<sup>170</sup> Bridge, *op. cit.*, 43.

contract, the latter will prevail. The rule is brought to play after the inconsistency has been established, which is where the litigation battle takes place.<sup>171</sup>

#### **2.11.2.5 Ambiguity and Extrinsic Evidence**

The conventional approach to interpretation is that extrinsic evidence is available to interpret a contract only if the document is ambiguous or if it contains terms that have a customary meaning or are technical expressions. According to long established principle, the ambiguity must be patent and not discoverable only when extrinsic evidence is called into play. Merely because a document is difficult to construe will not open the door to extrinsic evidence in the absence of a range of possible meanings.<sup>172</sup>

In resolving ambiguity, a pertinent point to note is that evidence of the parties' negotiating positions is not admissible to determine the meaning of a contractual document. Negotiating positions are adopted and abandoned during the course of pre-contractual process. Nor can one readily refer to the aim of the transaction. The process of reaching an agreement is inherently adversarial and the parties may have entered into the contract with different aims. Evidence of one party's aims is therefore unhelpful and potentially deceiving.<sup>173</sup>

#### **2.11.2.6 Factual Matrix**

The refusal to look at negotiating positions does not mean that contractual documents are to be interpreted in a vacuum. To that extent, statements made during the course of negotiations do have a part to play in the interpretation of a written document.<sup>174</sup> This stance by the courts is best summed up by Lord Wilberforce in *Readrdon Smith Line Ltd v*

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<sup>171</sup> *Ibid.* See *Naviera Amazonia Peruana SA v Cia Internacional de Seguros del Peru* [1987] 1 Lloyd's Rep 116

<sup>172</sup> *Bridge, op. cit.*, 44.

<sup>173</sup> *Ibid.*

<sup>174</sup> *Ibid.*

*Hansen-Tangen*<sup>175</sup> where His Lordship stated that “In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating”.

### **2.11.2.7 The Meaning of Documents**

One of the major developments in contractual interpretation in recent times can be said to stem from Lord Hoffman’s introduction of the ‘reasonable observer’ in *Investors Compensation Scheme v West Bromwich Building Society*<sup>176</sup> where His Lordship, in this case, introduces ‘the reasonable observer’ with all necessary background knowledge concerning the contract, into the process of interpretation. Through the eyes of the observer, His Lordship went on to say that the meaning of a document is not the same thing as the meaning of particular words in a document. It can be argued that the danger of this approach to interpretation is that, despite the invocation of the reasonable observer, it introduces a measure of subjective impressionism into the process of contractual interpretation. It is also unduly forgiving of lax draftsmanship.<sup>177</sup>

It can be observed that Lord Hoffman’s approach has more to commend it for contracts between parties who are not regular participants in the same trade, but poses a risk to commercial certainty in those trades, like the shipping and commodities trade, where participants do not need the assistance of the outside reasonable observer to instruct them in what they are doing.<sup>178</sup>

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<sup>175</sup> [1976] 1 WLR 989

<sup>176</sup> [1998] 1 WLR 896, HL

<sup>177</sup> *Bridge, op. cit.*, 47.

<sup>178</sup> *Ibid.*

### **2.11.2.8 Time of Interpretation**

Just as evidence of negotiations does not bear directly on contractual interpretation, so a contract is to be construed at the moment of its formation. Subsequent behaviour is inadmissible as a guide to interpretation, for otherwise the meaning of a contract might change from day to day. In this respect, English law is probably in a minority amongst developed legal systems.<sup>179</sup> Yet, it is common for contracts to be varied and for rights to be waived. Under English law, so long as waivers and promissory estoppel exist, and with a requirement of consideration to effect a binding variation, it is plainly dangerous or imprecise to read contractual meaning into subsequent behaviour.<sup>180</sup> Only Lord Denning, sitting in the Court of Appeal, in *LG Schuler AG v Wickman Machine Tool Sales Ltd*<sup>181</sup> had stated that subsequent behaviour could be looked at to evince contractual meaning because the parties themselves are the best guide to the way language was used, a view which was subsequently rejected by the House of Lords in the same case.<sup>182</sup>

### **2.12 Concluding Remarks**

The CISG can be considered a worldwide success given the fact that it is the uniform international sales law of countries that account for over three-quarters of all world trade. However, despite its success, there are a few weaknesses that can be observed in some of its provisions, either through an oversight or deliberately left out in the drafting process in the interest of harmony of all the Contracting States.

Article 1(1)(b), when explaining the applicability of the Convention, left out an important factor in determining its applicability according to the rules of private international law.

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<sup>179</sup> Note 157 (Bridge) at p. 48.

<sup>180</sup> Note 157 (Bridge) at p. 48.

<sup>181</sup> [1972] 1 WLR 840, CA

<sup>182</sup> [1974] AC 235 HL. There are other various methods of contractual interpretation adopted by the courts but which are outside the scope of this chapter.

Unfortunately, it does not say whose rules of private international law would trigger the application of the CISG but it is suggested that they can only be those of the forum State. Furthermore, the forum State must be a Contracting State if it is to be bound to apply the CISG. By allowing Contracting States to make a reservation under Article 95 not to bound by Article 1(1)(b), the situation may be even trickier should there be a litigation in a non-reservation State – does the CISG apply, or not? Article 6, in allowing a Contracting State to exclude the application of the Convention or derogate from the Convention (save for some limited exceptions), further compounded the complexity on the issue of application of the Convention. Although the reason in allowing exclusion and derogation is perhaps to promote freedom of contract, implied exclusion of the Convention, as opposed to explicit exclusion, may pose further problems to the courts and also to the parties involved.

By not defining ‘sale’, ‘goods’ or ‘contract for the sale of good’, the interpretation outlet is left wide open with different domestic courts possibly interpreting the above terms differently and possibly with different outcomes. Excluding specific types of goods in Article 2 may not be the best possible way of addressing this matter as firstly, the list may not be exhaustive and secondly, some of the items excluded may be outdated, for example auctions under Article 2(e) with the introduction of online auctions in the present day.

By not being concerned with the validity of the contract and the passing of property in the goods sold, it can be safely assumed that Article 4 has omitted pertinent aspects of a sales contract. While Article 7 is aimed at promoting uniformity and the observance in good faith in interpreting the Convention, leaving the rules of interpretation to the rules of private international law can be damaging rather than upholding harmony and uniformity. However, despite its shortcomings, the success of the CISG shows that pursuing the

unification of international sales law is the right way forward. The harmonising effect of the Convention has had on domestic legal systems, as well as its influence on other uniform instruments and projects cannot be undermined.

First published in 1936, the Incoterms rules are uniform rules defining costs, risks and obligations of sellers and buyers in international contracts of sale. Incoterms rules, if expressly provided for, will form part of the sales contract. Nevertheless, there are also other laws which apply to such transactions such as the CISG and domestic laws. When used correctly, Incoterms rules allow for prudent and efficient allocation of duties and risks between the contracting parties. However, incorrect use of Incoterms may bind the parties to obligations that they are not only beyond their understanding but also beyond their capabilities.

The Incoterms rules have been updated at approximately ten year intervals, the latest being the Incoterms rules 2010. One of the most significant changes made in the Incoterms rules 2010 is the abolishment of the contentious “the ship’s rail” phrase in the FOB terms, which has been replaced by a more definite expression, namely, “on board the vessel”. It is hoped that this new phrase will clear the doubts on the division of risks between the seller and buyer.

It can also be observed that the Incoterms rules do not exist in isolation but they are part of the extensive international commercial transactions in the multifaceted world of international trade. Usage of the Incoterms rules in contracts of sale are often intertwined with contracts of carriage and insurance and it may not be possible at all times to avoid conflicts in such complex transactions. It is in these situations that the courts can be an indispensable institution in interpreting such contracts to resolve such disputes. In respect

of the relationship between the CISG and the Incoterms, it is without a doubt that the CISG and the Incoterms rules complement each other in ensuring efficient transactions between sellers and buyers in international trade.



## CHAPTER THREE

### THE GENERAL PRINCIPLES OF CONTRACT AND CONTRACT OF SALE – THE *SHARI'AH* PERSPECTIVE

#### 3.1 Introduction - *The Shari'ah*

The word *shari'ah* is derived from the root of *shin ra'yan* which literally means the road to the watering place, the straight path to be followed<sup>1</sup> and it has been defined in the Qur'an in the following verse:

*“Then We put thee on the (right) Way of Religion: so follow thou that (Way), and follow not the desires of those who know not.”* (Al-Jathiya: 18).<sup>2</sup>

As a technical term, however, the word *shari'ah* was defined by al-Qurtubi<sup>3</sup> as the canon law of Islam, all the different commandments of Allah to mankind. Some scholars defined *shari'ah* as the injunctions revealed to the Prophets of Allah related to law and belief. However, a more comprehensive definition of the word *shari'ah* can be deduced from the different definitions as ‘the sum total of Islamic teaching and system, which was revealed to Prophet Muhammad (pbuh) recorded in the Qur'an as well as deducible from the Prophet's divinely guided lifestyle called the *Sunnah*.<sup>4</sup> This is the common definition recognised by contemporary Islamic scholars as it indicates that all the different commandments of Allah to mankind are part of *shari'ah*.<sup>5</sup>

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<sup>1</sup> Mohamad Akram Laldin, Introduction to *Shari'ah* & Islamic Jurisprudence, 2<sup>nd</sup> ed., (Kuala Lumpur: CERT Publications Sdn. Bhd., 2008), 2

<sup>2</sup> The translations of the Qur'an in this chapter are from Abdullah Yusuf Ali, The Holy Qur'an, English Translation With Original Arabic Text, (New Delhi: Kitab Bhavan 2000), unless otherwise stated.

<sup>3</sup> Also known as Imam Abu 'Abdullah Al-Qurtubi or Abu 'Abdullah Muhammad ibn Ahmad ibn Abu Bakr al-Ansari al-Qurtubi was born in 1214 in Cordoba, Spain and was an eminent Maliki scholar who specialised in *fiqh* (the study of Islamic law and jurisprudence) and *hadith* (the sayings and teachings of Prophet Muhammad (pbuh)). His best known book is the *Al Jami' li Ahkam il-Qur'an*, a ten-volume *tafsir* (commentary) on the *Qur'an* verses dealing with legal issues. Retrieved 30 August 2010 from <<http://en.wikipedia.org/wiki/Al-Qurtubi>>.

<sup>4</sup> Any reference to ‘the Prophet’ in this chapter refers to Prophet Muhammad (pbuh) unless otherwise stated.

<sup>5</sup> Mohamad Akram Laldin, *op. cit.*, 3.

## 3.2 Components of the *Shari'ah*

The *shari'ah* which contains all the different commandments of Allah to mankind can be divided into three disciplines. The first is *al-ahkam al-i'tiqadiyyah*, that is, sanctions relating to beliefs such as the belief in Allah and the day of Judgement. The second is *al-ahkam al-akhlaqiyyah*, namely sanctions relating to moral and ethics such as the injunction to tell the truth, sincerity and to be honest. The third category is *al-ahkam al-'amaliyyah*, that is, sanctions relating to the sayings and doings of the individuals and his relations with others, which is also called *fiqh*.<sup>6</sup>

### 3.2.1 *Fiqh*

*Fiqh* represents the whole science of jurisprudence as it implies the exercise of intelligence in deciding a point of law in the absence of a binding text (*nas*) of the Qur'an or *Sunnah*. *Fiqh* is derived from the root word of *fa qa ha* which literally means comprehension or true understanding.<sup>7</sup> The word *yafqahu*, which is derived from the same root of the word *fiqh*, was mentioned in the following verse of the Qur'an, which means 'understanding':

“And remove the impediment from my speech, So they may understand what I say.”

(Taha: 27-28)

The word *faqih hu* was also used in a *hadith* where the Prophet (pbuh) makes a *du'a*<sup>8</sup> for Ibn 'Abbas by saying “O, Allah, teach him *al-din* (Islamic religion) and make him understand the interpretation of the Qur'an.”<sup>9</sup>

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<sup>6</sup> *Id.* at 4. Of all the components of *shari'ah* mentioned above, only *fiqh* is relevant to this chapter and will be discussed in further detail.

<sup>7</sup> *Ibid.*

<sup>8</sup> A *du'a* is a private prayer, a personal supplication and prayer requests that are not part of the set prayer or *salah*. Ruqaiyyah Waris Maqsood, A Basic Dictionary of Islam, (New Delhi: Goodword Books, 2008), 63.

<sup>9</sup> Mohamad Akram Laldin, *op. cit.*, 5 citing a *hadith* narrated by Bukhari and Muslim.

Before the advent of Islam and during the early days of Islam, the word *fiqh* was used with the above technical meaning. However, after the development of the sciences of Islam begins, the word *fiqh* has been associated with various sciences of Islam such as *fiqh al-hadith*, which is used to explain the science of *hadith* to discuss the different subjects and topics related to *hadith* such as the chain of *hadith* or its text. Similarly, *fiqh al-Qur'an* is used to state the branches of knowledge related to the Qur'an. Currently, the phrase *fiqh al-sirah* is also commonly used to describe the branch of knowledge related to the life of the Prophet (pbuh). These are the general usage of the word *fiqh* in the past and present. As for the technical usage of the word *fiqh*, it is used to indicate matters related to Islamic law and is given various definitions by the scholars of *shari'ah*.<sup>10</sup>

Imam Abu Hanifah<sup>11</sup> defined *fiqh* as 'the knowledge of what is for man's self and what is against man's self' (*ma'rifat al-nafs ma laha wa ma 'alayha*). This is a general definition of *fiqh* as it includes all the knowledge of Islam.<sup>12</sup> However, al-Ghazali<sup>13</sup> confined the word *fiqh* to the sciences of the rules of law. *Al-Amidi*<sup>14</sup> provided a broader definition of *fiqh* by saying that *fiqh* is the science of understanding the legal obligations derived from its sources (namely the Qur'an, *Sunnah* and other sources of Islamic law).

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<sup>10</sup> *Ibid.*

<sup>11</sup> Nu' mān ibn Thābit ibn Zuṭ ā ibn Marzubān, better known as Imam Abū Ḥanīfah, (699 — 767 CE) was the founder of the Sunni Hanafī school of *fiqh* (Islamic jurisprudence). Abu Hanifa was also one of the Tabi'un (the disciples or successors of the Companions of the Prophet Muhammad), the generation after the Sahaba, who were the companions of the Prophet Muḥ ammad. This is due to the fact that Abu Hanifa saw the Sahabi, Anas ibn Malik, and transmitted hadiths from him and other Sahaba. Among his literary works are *Kitaab-ul-Aathaar* narrated by Imaam Muhammad al-Shaybani – compiled from a total of 70,000 *ahadith*, *Kitabul Aathaar* narrated by Imaam Abu Yusuf, *Aalim, wa'l-muta'allim, Fiqh al-Akbar, Musnad Imaam ul A'zam* and *Kitaabul Rad alal Qaadiriyah*. Retrieved 1 September 2010 from <[http://en.wikipedia.org/wiki/Abu\\_Hanifa](http://en.wikipedia.org/wiki/Abu_Hanifa)>.

<sup>12</sup> Mohamad Akram Laldin, *op. cit.*, 5.

<sup>13</sup> Abū Ḥāmed Muḥ ammad ibn Muḥ ammad al-Ghazālī (1058–19 December 1111) often Algazel in English, was an Islamic theologian, jurist, philosopher, cosmologist, psychologist and mystic of Persian origin. Ghazali contributed significantly to the development of a systematic view of Sufism and its integration and acceptance in mainstream Islam. He was a scholar of Sunni Islam, belonging to the Shafi'i school of Islamic jurisprudence and to the Asharite school of theology. There are more than 400 books attributed to him today, his major works ranging from the areas of theology, Sufism, philosophy and jurisprudence. Retrieved 1 September 2010 from <<http://en.wikipedia.org/wiki/Al-Ghazali>>.

<sup>14</sup> Sayf al-Din al-Amidi (d.1233) was an influential jurist of the Shafi'i school who worked to combine *kalam* (theology) with existing methods of jurisprudence. He spent his childhood and received in education in Damascus and Baghdad before moving to Egypt at an early age. His most famous work on Islamic jurisprudence is *Al-ihkam fi usul al-ahkam*. Retrieved 1 September 2010 from <[http://en.wikipedia.org/wiki/Sayf\\_al-Din\\_al-Amidi](http://en.wikipedia.org/wiki/Sayf_al-Din_al-Amidi)>.

The majority of Islamic authorities, however, defined *fiqh* in terms of its four basic sources as follows:

“*Fiqh* or the science of Islamic law is the knowledge of one’s rights and obligations derived from the Qur’an or *Sunnah* of the Prophet, or the consensus of opinions among the learned (*ijma’*) or analogical reasoning (*qiyas*).”<sup>15</sup>

### 3.2.2 Types of *Fiqh* Rulings

One of the important elements that should be observed about *fiqh* is its flexibility. There are two types of *fiqh* rulings, namely the fixed and variable rulings.<sup>16</sup>

#### 3.2.2.1 Fixed Rulings

Rulings that are deduced from the decisive evidence<sup>17</sup> from the Qur’an or *Sunnah*. This type of rulings cannot be changed or varied according to the change of time and place or circumstances. There are only a few rulings of this nature and all the rulings related to *ibadah* (any permissible action with the intention of serving Allah) falls under this category. Among the examples of such rulings are rulings related to prayer, fasting, punishment for adulterers and distribution of inheritance.<sup>18</sup> However, the implementation of such rulings can be deferred if the situation does not permit for it to be implemented or if the implementation of such rulings might result in defying the objectives of the *shari’ah*. For instance, such deferment took place during the reign of Caliph ‘Umar al-Khattab when he suspended the implementation of the punishment of theft as a result of the draught

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<sup>15</sup> Mohamad Akram Laldin, *op. cit.*, 6. Each of these sources will be discussed later in this chapter. Further discussion on the preferable definition of *fiqh* and its justifications is outside the scope of this chapter as this dissertation focuses more on the practical aspects of sale as opposed to the jurisprudential aspect of the *shari’ah*.

<sup>16</sup> *Ibid.*

<sup>17</sup> Decisive rulings or *qat’iyyah dilalah* are the rulings that is stated clearly in the text and is not subject to the different interpretations of the jurists.

<sup>18</sup> Mohamad Akram Laldin, *op. cit.*, 7

season in Madinah as the state of affairs prompted some people to steal food in order to survive.<sup>19</sup>

### 3.2.2.2 Variable Rulings

Variable rulings are rulings deduced by the scholars from their understanding and interpretations of the text of the Qur'an or *Sunnah* and from other sources of Islamic law such as juristic preference (*al-istihsan*), consideration of public interest (*masalih al-mursalah*), presumption of continuity (*al-istishab*), custom (*'urf*) and others.<sup>20</sup> This type of rulings depends largely on the ability of the jurists to employ the power of reasoning in deciding a certain *fiqh* issue. Most of the rulings of *fiqh*, particularly the rulings related to *mu'amalah* (commercial transactions) fall under this category. They are flexible and can be varied according to the changes of time, place and circumstances.<sup>21</sup>

## 3.3 The Position and Components of *Fiqh* – An Overview

So as to understand the position of *fiqh* among the Islamic discipline, it is important to appreciate the fact that *fiqh* is an important component of *shari'ah*. As mentioned earlier,<sup>22</sup> the subject matter of *shari'ah* can generally be divided into three categories namely, *al-ahkam al-i'tiqadiyyah*, *al-ahkam al-akhlaqiyyah* and *al-ahkam al-'amaliyyah* which is also called *fiqh*. *Fiqh* concerns the relationship between man and his Creator and also between man and man, and it encompasses various aspects of human life and not only restricted to

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<sup>19</sup> *Ibid.*

<sup>20</sup> *Ibid.*

<sup>21</sup> *Ibid.* The Qur'an in most cases has provided for the general principals and it is upon the jurists to interpret these principles to resolve the different issues of *fiqh* in modern times.

<sup>22</sup> Refer to paragraph 3.2 of this chapter, *supra*.

matters pertaining to *ibadah*. *Fiqh* can generally be divided into two main categories, namely *fiqh al-ibadah* and *fiqh al-mu'amalah* or *al-'adah*.<sup>23</sup>

*Fiqh al-ibadah* comprises the rulings that govern the relationship between man and Allah, also called *ibadah* (rituals) whilst *fiqh al-mu'amalah* encompasses rulings that govern the relationship between man and man, and man and other creatures of Allah. It can be said that this category of *fiqh* covers a diversity of issues as it concerns rulings and principles that regulate most actions and matters related to human beings. This part of Islamic law is concerned about the rules and regulations involving mankind and how they should respect each others' rights. In addition, it also provides the suitable penalty for those who transgress their limits and violate such rules and regulations. Commercial transactions (*al-ahkam al-mu'amalah*), which comprises sale and purchase contracts, leasing, pawn, rules and regulations on companies and others fall under this category of *fiqh*.

### **3.4 *Fiqh* Rulings (*Hukm*) – An Overview**

#### **3.4.1 *Al-Ahkam Al-Taklifiyyah* (Defining Law)**

*Fiqh* rulings or *hukm* means a legal rule or a *shari'ah* injunction. It refers to rulings that are deduced from the different sources of *fiqh* concerning an action by a morally responsible person. *Al-Ahkam Al-Taklifiyyah* or the defining law is a locution or communication from the Lawgiver addressed to the *mukallaf* (a competent person who is in full possession of his faculties) which consists of a demand or of an option.<sup>24</sup> Islamic jurists reasoned that there are five categories of injunctions under *fiqh* (*al-ahkam al-khamsah*), namely, *fard*, *sunnah*, *haram*, *makruh* and *mubah*.<sup>25</sup> *Fard* or *wajib* refers to an absolute command which

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<sup>23</sup> Mohamad Akram Laldin, *op. cit.*, 9

<sup>24</sup> Mohammad Hashim Kamali, *Principles of Islamic Jurisprudence*, (Selangor, Malaysia: Ilmiah Publishers, 2007), 323-324.

<sup>25</sup> Mohamad Akram Laldin, *op. cit.*, 9.

is supported by decisive proof and any defiance or disobedience to it without any legal excuse is a sin. Denial to *fard* also amounts to disbelief.<sup>26</sup> *Sunnah* or recommended acts refers to deeds that are recommended to be undertaken by Muslims.

*Haram* is an act that is prohibited by a decisive evidence (*adillah qat'iyah*) from the Qur'an or *Sunnah*. Committing such an act is punishable and omitting it is rewarded. Further, its denial amounts to disbelief. Some of the actions which are categorised as *haram* include the receiving and disbursement of interest (*riba*), adultery, consumption of liquor and many others.<sup>27</sup> *Makruh* are acts which are considered as undesirable. It is an act which omission is preferable and highly commended. Finally, *mubah* is an act that is permissible. It is also called *ja'iz* or *halal*. It refers to an act where both its commission or omission neither merit any reward nor entail any punishment, and no *shari'ah* injunctions are imposed on it. From the above explanation, acts or omissions of Muslims can generally be categorised as either as compulsory, recommended, prohibited, undesirable or simply permissible and the responsibility is on each and every Muslim individual to adhere to all these rulings in conducting their daily lives.

#### **3.4.2 Al-Ahkam Al-Wad'iyyah (Declaratory Law)**

Declaratory law is defined as communication from the Lawgiver which enacts something into a cause (*sabab*), a condition (*shart*) or a hindrance (*mani*) to something else. The function of declaratory law is explanatory in relation to defining law, in that the former explains the component elements of the latter. Declaratory law thus informs us whether certain facts or events are the cause, condition or hindrance in relation to defining law. It is, for example, by means of declaratory law that we know offer and acceptance in a

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<sup>26</sup> *Id.* at 12

<sup>27</sup> *Id.* at 12-13

contract of sale to be the cause of the buyer's ownership, that divorce causes the extinction of marital rights and obligations and that the death of a person is the cause of the right of the heir to his inheritance.<sup>28</sup>

In addition to the three varieties of declaratory law above, namely, cause, condition and hindrance, the other two varieties that fall under the category of declaratory law are the *azimah* (strict law) as opposed to *rukhsah* (concessionary law) and also valid (*sahih*) as opposed to invalid (*batil*).<sup>29</sup>

### 3.5 Sources of the *Shari'ah*

No study of the *shari'ah* is complete without discussing its sources.<sup>30</sup> Apart from its legal and technical meaning,<sup>31</sup> *shari'ah* can also be described as the way to Islam, as can be observed from the following Qur'an verses:

*"Verily, this is My Way leading straight: follow it: follow not (other) paths: they will scatter you about from His Path: thus doth He command you, that ye may be righteous"* (Al-An'am:153)

*"O ye that believe! fear Allah, and believe in His Messenger, and He will bestow on you a double portion of His Mercy: he will provide for you a Light by which ye shall walk (straight in your path), and He will forgive you (your past): for Allah is Oft-Forgiving, Most Merciful"* (Al-Hadid:28).

*Shari'ah* can be defined as the sum total of Islamic teaching and system, which was revealed to Prophet Muhammad (pbuh), recorded in the Quran as well as deducible from

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<sup>28</sup> Mohammad Hashim Kamali, *op. cit.*, 336

<sup>29</sup> *Ibid.* Further discussion of *Al-Ahkam Al-Taklifiyyah* and *Al-Ahkam Al-Wad'iyyah* is outside the scope of this chapter.

<sup>30</sup> In depth discussion on the sources of Islamic law is outside the scope of this chapter as this dissertation focuses more on the practical aspects of sale as opposed to the jurisprudential aspect of the *shari'ah*.

<sup>31</sup> Refer to paragraph 3.1, *supra*.

the Prophet's divinely guided lifestyle, namely, the *Sunnah*.<sup>32</sup> Its four principal sources are the Qur'an and the *Sunnah*, (primary sources) and the *Ijma* and *Qiyas* (secondary sources). There are other secondary sources such as *Istihsan* (equity in Islamic law or juristic preference), *Maslaha Mursalah* (opinion based on public interest), *'urf* (custom) and *Istishab* (presumption of continuity) and *Sadd al-dhara'i* (blocking the means).<sup>33</sup>

### 3.5.1 Primary Sources

#### 3.5.1.1 The Qur'an

Being the verbal noun of the root word *qara'a* (to read), Qur'an literally means 'reading' or 'recitation'. It may be defined as 'the book containing the speech of God revealed to the Prophet Muhammad in Arabic and transmitted to us by continuous testimony, or *tawatur*. It is a proof of the prophecy of Muhammad and the first source of the *shariah*. The revelation of the Qur'an began with the surah al-'Alaq (96:1) starting with the words "Proclaim! (or Read!) in the name of thy Lord and Cherisher, Who created- " and ending with the *ayah* (verse) in surah al-Ma'idah (5:3): "... *This day have I perfected your religion for you, completed My favour upon you, and have chosen for you Islam as your religion...*"<sup>34</sup>

There are 114 *suras* and 6235 *ayat* of unequal length in the Qur'an. The Qur'an was revealed piecemeal over a period of twenty three years in relation to particular events. It was revealed piecemeal so as to avoid hardship to the believers.<sup>35</sup> The *ulama*<sup>36</sup> are in

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<sup>32</sup> Mohamad Akram Laldin, *op. cit.*, 3

<sup>33</sup> *Id.* at 55

<sup>34</sup> Mohammad Hashim Kamali, *op. cit.*, 16

<sup>35</sup> *Ibid.*

<sup>36</sup> Scholars of Islamic law and jurisprudence.

agreement to the effect that the entire text of the Qur'an is *Mutawatir*, that is, its authenticity is proven by universally accepted testimony.<sup>37</sup>

### 3.5.1.2 The *Sunnah*

Literally, *Sunnah* means a clear path or a beaten track but it has also been used to imply normative practice, or an established course of conduct. The *Sunnah* supplements, clarifies and explains the provisions of the *Qur'an*. A *hadith* differs from *Sunnah* in the sense that *hadith* is a narration of the conduct of the Prophet whereas *Sunnah* is the example or the law that is deduced from it. *Hadith*, in its sense, is the vehicle or the carrier of *Sunnah*, although *Sunnah* is a wider concept and used to be so especially before its literal meaning gave way to its juristic usage. *Sunnah*, thus referred not only to the *hadith* of the Prophet (pbuh) but also to the established practice of the community. But once the literal meanings of *hadith* and *Sunnah* gave way to their technical usages and were both exclusively used in reference to the conduct of the Prophet (pbuh), the two became synonymous. This was largely a result of al-Shafi'i's<sup>38</sup> efforts, who insisted that the *Sunnah* must always be derived from a genuine *hadith* and that there was no *Sunnah* outside the *hadith*.<sup>39</sup>

### 3.5.2 Secondary Sources

#### 3.5.2.1 *Ijma* (Consensus of Opinion)

Unlike the Qur'an and *Sunnah*, *ijma* does not directly partake in divine revelation. As a doctrine and proof of *shariah*, *ijma* is basically a rational proof but only an absolute and universal consensus would qualify for an *ijma* to be binding (although absolute consensus

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<sup>37</sup> Mohammad Hashim Kamali, *op. cit.*, 17

<sup>38</sup> Abū ' Abdullāh Muhammad ibn Idrīs al-Shafī' ī was a Muslim jurist, who lived from 767 CE to 820 CE. He was active in juridical matters and his teaching eventually led to the Shafī'ī school of *fiqh* (or Madh'hab) named after him. Hence he is often called Imam al-Shafī'ī. He is considered the founder of Islamic jurisprudence. Retrieved 3 September 2010 from <[http://en.wikipedia.org/wiki/Imam\\_Shafi'i](http://en.wikipedia.org/wiki/Imam_Shafi'i)>.

<sup>39</sup> Mohammad Hashim Kamali, *op. cit.*, 47

on the rational content of *ijma* has often been difficult to obtain). The classical definition and the essential requirements of *ijma* , as laid down by the *ulama* of *usul*, are categorical on the point that nothing less than a universal consensus of the scholars of the Muslim community as a whole can be regarded as conclusive *ijma*. There is thus no room whatsoever for disagreement, or *ikhtilaf*, within the concept of *ijma*. The theory of *ijma* is equally unreceptive to the idea of relativity or a preponderance of agreement within its ranks.<sup>40</sup>

### 3.5.2.2 *Qiyas* (Analogical Deduction)

*Qiyas* is the extension of a *shari'ah* value from an original case, or *asl*, to a new case, because the latter has the same effective cause as the former. The original case is regulated by a given text, and *qiyas* seeks to extend the same textual ruling to the new case. It is by virtue of the commonality of the effective cause, or *illah*, between the original case and the new case that the application of *qiyas* is justified. Recourse to analogy is only warranted if the solution of a new case cannot be found in the Qur'an or the *Sunnah* or a definite *ijma*. For it would be futile to resort to *qiyas* if the new case could be resolved under a ruling of the existing law. It is only in matters which are not covered by the *nusus* and *ijma*, that the law may be deduced from any of these sources through the application of analogical reasoning.<sup>41</sup>

### 3.5.2.3 *Istihsan* (Equity in Islamic Law)

*Istihsan* is an important branch of *ijtihadh*<sup>42</sup> and it has played a prominent role in the adaptation of Islamic law to the changing needs of society. It has provided Islamic law

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<sup>40</sup> *Id.* at 168.

<sup>41</sup> *Id.* at 197.

<sup>42</sup> *Ijtihad* is the exercise of reason in order to try to find an appropriate ruling on a matter not directly ruled upon the Qur'an and also to make use of principles, similarities and comparisons. Ruqaiyyah Waris Maqsood, *op cit.*, 103.

with the necessary means with which to encourage flexibility and growth. However, because of its essential flexibility, Muslim jurists have discouraged an over-reliance on *istihsan* lest it will result in the suspension of the injunctions of the *shari'ah* and it becomes a means of circumventing its general principles.<sup>43</sup> *Istihsan* literally means 'to approve', or to deem something preferable. In its juristic sense, *istihsan* is a method of exercising personal opinion in order to avoid any rigidity and unfairness that might result from the literal enforcement of the existing law. If enforcing the existing law may prove to be detrimental in certain situations, departure from it may be the only way of attaining a fair solution to a particular problem.<sup>44</sup>

#### **3.5.2.4 *Maslahah Mursalah* (Considerations of Public Interest)**

Literally, *maslahah* means 'benefit' or 'interest'. However, when it is qualified as *maslahah mursalah*, it refers to unrestricted public interest in the sense of it not having been regulated by the Lawgiver insofar as no textual authority can be found on its validity or otherwise.<sup>45</sup> Technically, *maslahah mursalah* can be defined as a consideration which is proper and harmonious (*wasf munasib mula'im*) with the objectives of the Lawgiver; it secures a benefit or prevents a harm; and the *shari'ah* provides no indication as to its validity or otherwise.<sup>46</sup> The Companions, for example, decided to issue currency, set up prisons and also to impose tax (*kharaj*) on agricultural lands in the conquered territories despite the fact that no textual authority could be found in favour of this.<sup>47</sup>

Pertinently, the essence of *maslahah mursalah* can be found in the following Qur'anic verses:

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<sup>43</sup> Mohammad Hashim Kamali, *op. cit.*, 246

<sup>44</sup> *Ibid.*

<sup>45</sup> Mohammad Hashim Kamali, *op. cit.*, 267

<sup>46</sup> *Ibid.*

<sup>47</sup> *Ibid.*

*“And strive in His cause as ye ought to strive, (with sincerity and under discipline). He has chosen you, and has imposed no difficulties on you in religion...” (Al-Hajj: 78)*

*“Allah doth not wish to place you in a difficulty...” (Al-Maidah: 6)*

In order to validate reliance on *maslahah mursalah*, the *maslahah* must be genuine (*haqiqiyah*), general (*kulliyah*) and it must not be in conflict with a principle or value which is upheld by the *nass* (the definitive principle of the law) or *ijma* (consensus of opinions).<sup>48</sup>

### **3.5.2.5 ‘Urf (Custom)**

‘*Urf*’ is denoted by the collective practice of a large number of people, the habits of a few or even a substantial minority within a group do not constitute ‘*urf*. Consequently, ‘*urf*’ can be defined as ‘recurring practices which are acceptable to people of sound nature.’<sup>49</sup> This definition is clear on the point that, in order for custom to constitute as a valid basis for legal decisions, it must be sound and reasonable. For this reason, recurring practices among some people for which there is no benefit or which partake in prejudice and corruption are excluded from the definition of ‘*urf*.’<sup>50</sup>

‘*Urf*’ is generally permissible by virtue of the following verses from the Qur’an:

*“Ye are the best of Peoples, evolved for mankind, enjoining what is right, forbidding what is wrong, and believing in Allah” (Al-‘Imran:110)*

*“Hold to forgiveness; command what is right; but turn away from the ignorant.” (Al-A’raf:199)*

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<sup>48</sup> Mohammad Hashim Kamali, *op. cit.*, 274.

<sup>49</sup> *Id.* at 283.

<sup>50</sup> *Ibid.*

In addition to being reasonable and acceptable to people of sound nature, in order for ‘*urf*’ to be authoritative, it must represent a common and recurrent phenomenon, the custom must be in existence at the time a transaction is concluded, the custom must not contravene the clear stipulation of an agreement and finally, the custom must not violate the *nass*, that is, the definitive principle of the law.<sup>51</sup>

### **3.5.2.6 *Istishab* (Presumption of Continuity)**

*Istishab* denotes a rational proof which may be employed in the absence of other indications; specifically, those facts, or rules of law and reason, whose existence or non-existence had been proven in the past, and which are presumed to remain so for lack of evidence to establish any change.<sup>52</sup> The technical meaning of *istishab* relates to its literal meaning in the sense that the past ‘accompanies’ the present without any interruption or change. For the Shafi’is and the Hanbalis, *istishab* denotes ‘continuation of that which is proven and the negation of that which had not existed. *Istishab*, in other words, presumes the continuation of both the positive and the negative until the contrary is established by evidence.<sup>53</sup>

For example, once a contract of sale is concluded, it is presumed to remain in force until there is a change in status. Thus, the ownership of the purchaser is presumed to continue until a transfer of ownership can be established by evidence. *Istishab* only applies when no other evidence (*dalil*) is available, and it is not applicable when there is a clear text that could be invoked.<sup>54</sup>

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<sup>51</sup> Mohammad Hashim Kamali, *op. cit.*, 286-287

<sup>52</sup> *Id.*, at 297

<sup>53</sup> *Ibid.*

<sup>54</sup> *Ibid.*

### 3.5.2.7 *Sadd al-Dhara'i* (Blocking the Means)

*Dhari'ah* (pl. *dhara'i*) is a word synonymous with *wasilah*, which signifies the means to obtaining a certain end, while *sadd* literally means 'blocking'. *Sadd al-dhara'i* thus implies blocking the means to an expected end which is likely to materialise if the means towards it is not obstructed. In this context, blocking the means must necessarily be understood to imply blocking the means to evil, not to something good.<sup>55</sup> As a principle of jurisprudence, *sadd al-dhara'i* applies when there is a discrepancy between the means and the end on the good-neutral-evil scale of values. A typical case for the application of *sadd al-dhara'i* would thus arise when a lawful means is expected to lead to an unlawful result, or, when a lawful means which normally leads to a lawful result is used to procure an unlawful end.<sup>56</sup>

Both the means and end may be good or evil, physical or moral, and they may be visible or otherwise, and the two need not necessarily be present simultaneously. For example, *khalwah* or illicit privacy between members of the opposite sex is unlawful as it constitutes a means to *zina* (sex outside marriage) whether or not it leads to it. *Dhari'ah* may also consist of the omission of a certain conduct such as trade and commercial transactions during the time of the Friday congregational prayer. The means which obstruct the said prayer, in other words, must be blocked, namely, by abandoning trade at the specified time.<sup>57</sup> Allah the Almighty says to the effect:

*“O ye who believe! When the call is proclaimed to prayer on Friday (the Day of Assembly), hasten earnestly to the remembrance of Allah, and leave off business (and traffic): that is best for you if ye but knew!”* (Al-Jumu'a: 9)

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<sup>55</sup> Mohammad Hashim Kamali, *op. cit.*, 310.

<sup>56</sup> *Id.* at 311.

<sup>57</sup> *Ibid.*

In other words, the whole concept of *sadd al-dhara'i* is founded on the idea of preventing an evil before it actually materialises and it is not always necessary that the result should in fact occur. It is rather the objective expectation that a means is likely to lead to an evil result which renders the means in question unlawful even without the realisation of the expected result.<sup>58</sup>

*Sadd al-dhara'i* is recognised as one of the sources of Islamic law based on the following verse of the Qur'an:

*“Revile not ye those whom they call upon besides Allah, lest they out of spite revile Allah in their ignorance.”* (Al-An'am:108)

To conclude, the sources of Islamic law discussed above is important to determine the validity or otherwise, of our actions in our day to day activities. They can also be used as a means to resolve the various uncertainties pertaining to Islamic law. In addition, these sources can be employed to meet the ever increasing needs of the modern world, in particular pertaining to evolving issues of *mu'amalah* or Islamic commercial transactions.

### **3.6 The Islamic Principles of Contract**

#### **3.6.1 The General Principles**

The fundamental principles which lie at the root of all commercial operations in any legal system, not excluding Islamic law, are to be found in the principles governing the law of contract and the regulations of obligations arising therefrom. However, it is generally argued that Islamic law knows no general theory of contract.<sup>59</sup> This argument is based on

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<sup>58</sup> *Ibid.*

<sup>59</sup> Rayner, S.E., *The Theory of Contracts in Islamic Law: A Comparative Analysis With Particular Reference To The Modern Legislation In Kuwait, Bahrain and the United Arab Emirates*, (Graham & Trotman: London, 1991), 86

the method of development of the system of Islamic contracts by the *fuqaha* (jurists), who categorised each contract into classes of nominate contracts (*‘Uqud al-Mu’ayyana*) with their own distinctive rules. Further, it can be shown that the primary sources of the law formulated only the very broadest principles which are applicable to all classes of contracts. The Qur’anic injunction “*Aufu bi al-Uqud*” which means “*Fulfill your Obligations*”<sup>60</sup> is the fundamental principle which governs the sanctity of all contracts, whether private, public, civil or commercial.

Indeed, it has been shown that according to Muslim law, a national Islamic state has no vested right to cancel or alter a contract by unilateral action, whether such action takes the form of administrative, judicial or even legislative act.<sup>61</sup> Similarly, Muslim law does not discriminate against foreigners or non-Muslims in matters of contract, and apart from certain exceptions dictated by the state of war, the Muslim community has a duty to respect its contractual obligations towards aliens and non-Muslims. Likewise, the prohibitions and limitations upon validity provided by the Islamic sources were applicable to all contracts prior to the later allowances in certain cases made by the *fuqaha*. In addition, one of the important concepts in the Islamic law of obligations is that the role of mutual consent,<sup>62</sup> which derives its authority from the Qur’an and the *hadith*, as described below:

*“O ye who believe! Eat not up your property among yourselves in vanities: but let there be amongst you traffic and trade by mutual good-will”* (An-Nisaa: 29)

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<sup>60</sup> Al-Maidah: 1

<sup>61</sup> Rayner, S.E., *op. cit.*,87, citing Hamidulla, *Muslim Conduct of State*, (Revised Ed. 1945) p. 145, n.4 which states: “Party and Judge cannot be in one and the same person, not even the caliph.”

<sup>62</sup> Rayner, S.E., *op. cit.*,87.

The Prophet (pbuh) is reported to have said in his farewell sermon “It is not lawful to take the property of a Muslim except by his consent.”<sup>63</sup>

The Arabic word for contract is ‘*Aqd*’ (plural: ‘*Uqud*’) and it is derived from the root verb ‘*Aqada*’ which means ‘to tie or bind’. The Arabic term is loosely employed to describe all manifestations of the will which tie their author to the obligations arising therefrom. The most common use of the word is, however, to denote synallagmatic transactions (*Mu’awadat*) which are concluded by an offer (*Ijab*) and an acceptance (*Qabul*). The term ‘*Aqd*’ is also used by the jurists to denote dispositions of property (*mortis causa*) which are concluded by one party only, such as gift (*Hiba*), guarantee (*daman*), *Waqf*<sup>64</sup> bequests, the remission of debts and the archaic liberation of slaves. Mere juristic act such as marriage (*Nikah*) and divorce (*Talaq*) which do not necessarily involve the concept of consideration also fall under the heading of ‘*Uqud*’.<sup>65</sup>

For this reason above, it has been suggested that ‘*Aqd*’ can be divided into two notions of contract namely, the umbrella term to cover a large spectrum of general legal acts and obligations and the bilateral act concreting the relation of privity between two interested parties. It has also been suggested that the reason for such wide application to the fact that the term ‘*Aqd*’ is only used once in the Qur’an and that is in reference to a marriage contract.<sup>66</sup> The relevant verse in support of this argument is as follows:

“...nor resolve the tie of marriage till the term prescribed is fulfilled.” (Al-Baqarah: 235)

While some modernists are more inclined to apply ‘*Aqd*’ only to bilateral contracts and categorised other unilateral engagements under *Tasarruf* (Disposition) or *Iltizam*

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<sup>63</sup> Retrieved 30 September 2010 from <<http://muslim-canada.org/farewell.htm>>.

<sup>64</sup> *Waqf* is the donation of certain sources of income (for example, land or property revenue) to the service of a religious community such as a mosque, college, school or hospital, to provide for its upkeep or running costs. Ruqaiyyah Waris Maqsood, *op. cit.* 228.

<sup>65</sup> Rayner, S.E., *op. cit.*, 88.

<sup>66</sup> *Ibid.*

(Obligation), and various attempts have been made to formulate a general theory of contract by prominent jurists such as Ibn Taymiyya<sup>67</sup> and Ibn Nujaym<sup>68</sup>, the principles propounded by such jurists have been depicted as vague and broad and lack any true or watertight classifications.<sup>69</sup> However, the codification of Islamic civil principles in The Mejlle<sup>70</sup>, though it could not provide an explicit general theory governing obligations and contracts but it had in Article 103 provided a definition of *'Aqd* as “*Aqd* (concluded bargain) is the two parties taking upon themselves and undertaking to do something.” It is composed of the combination of an offer (*Ijab*) and an acceptance (*Qabul*). In Article 104 of The Mejlle, it was further explained that “*In 'iqad* (the making of *'Aqd* is the connecting, in a legal manner, the offer (*Ijab*) and acceptance (*Qabul*), the one with the other, in a way which will be clear evidence of their being mutually connected.”

However, in recent times, works have been produced, mostly by academicians, which impose a continually increasing importance on general theories, derived in abstract hindsight from the series of specific contracts and their regulations formulated by the early jurists.<sup>71</sup> The general theories of today cover such elements as impediments to consent, classification of legal acts and their effects and a *resume* of the various options (*Khiyarat*) open to the parties for remedy. It is true that the contract of sale provided a premise for analogy. The majority of legal treatises all contain a chapter on *Bay'*, in which important ground rules are provided for contracts in general.<sup>72</sup> It can therefore be concluded that the contract of sale or *Bay'* is one of the most important concepts in Islamic commercial law.

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<sup>67</sup> Taqi ad-Din Ahmad ibn Taymiyyah notably known as Ibn Taymiyya was a prominent Hanbali jurist.

<sup>68</sup> Imam Ibn Nujaym was a renowned classical Hanafi jurist.

<sup>69</sup> Rayner, S.E., *op. cit.*, 89-90.

<sup>70</sup> The Mejlle, Being An English Translation of Majallah el-Ahkam-I-Adliya And A Complete Code of Islamic Civil Law, (Kuala Lumpur: The Other Press, Malaysia, 2001).

<sup>71</sup> Rayner, S.E., *op. cit.*, 90-9.

<sup>72</sup> *Id.* at 91.

### 3.6.2 Freedom of Contract

The concept of freedom of contract in Islamic law operates around rather diverse principles, in that the question as discussed by the jurists makes as the primary presumption that fact that no contract which derogates from any principle of the *shari'ah* may be validly concluded. This presumption thus automatically sets the doctrine against freedom of contract as it is understood in the West, for the parties to a private transaction are only free to determine the terms and object of the agreement subject to the strictures placed upon them by the *shari'ah*. Hence, a contract providing for *riba* (interest) is no more valid, according to the classical doctrines, than a contract whose object (*mahall*) is illegal, or whose object of contract (*al-ma'qud 'alayh*) is prohibited.<sup>73</sup>

The classical discussions concerning freedom of contract do not, therefore, turn on the possibility of enforcing questionable contractual terms consented to within the private agreement. Rather, the discussions cover the possibility of enforcing variant contractual types, that is, outside the scope of the nominate contracts<sup>74</sup> established by the early *fuqaha*.<sup>75</sup> It is also necessary to observe that the exceptions between the Islamic nominate contracts far outweigh the generalities. It is this fact which prompts modern authors to assert that Islamic law is a law of contracts rather than a law of contract. It is also this same basis that was employed to substantiate the argument that Islam does not recognise freedom of contract.<sup>76</sup>

The protagonists of the view against freedom of contract in Islamic law argued that the list of nominate contracts is closed to new forms, based on the Qur'anic verses,

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<sup>73</sup> *Ibid.*

<sup>74</sup> Refer to paragraph 3.7 of this chapter on the explanation of nominate contracts.

<sup>75</sup> Rayner, S.E., *op. cit.*, 91.

<sup>76</sup> *Id.*, at 91-92.

“... so do not transgress them if any do transgress the limits ordained by Allah, such persons wrong (themselves as well as others).” (Al-Baqarah: 229)

“But those who disobey Allah and His Messenger and transgress His limits will be admitted to a Fire, to abide therein: and they shall have a humiliating punishment.” (An-Nisa:14)

and a tradition reputed to have been narrated by A'ishah, “Allah’s Apostle came to me and I told him about the slave-girl (Buraira) Allah’s Apostle said, “Buy and manumit her, for the Wala is for the one who manumits.” In the evening the Prophet got up and glorified Allah as He deserved and then said, “Why do some people impose conditions which are not present in Allah’s Book (Laws)? Whoever imposes such a condition as is not in Allah’s Laws, then that condition is invalid even if he imposes one hundred conditions, for Allah’s conditions are more binding and reliable,”<sup>77</sup> effectively asserts the conclusion that all contracts and conditions, not proven by text or consensus of opinion, or made outside any express rule of law permitting them are *prima facie* invalid.

If the legality of such contracts or conditions was not proven, they declared both contract and condition void. It is also argued that the same presumption should apply to all obligations, and that the Qur’anic verse enjoining Muslims to honour their obligations is only relevant to those obligations expressly permitted by rule of law.<sup>78</sup>

On the other hand, the advocates of freedom of contract in Islamic law (*Ahl al-Ibaha*) form the majority opinion of the Hanbali school. Non-restriction of nominate contract types is therefore the general rule in this school of thought and like their counterparts (the

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<sup>77</sup> Bukhari Book 3, Volume 34, Hadith 364

<sup>78</sup> Rayner, S.E., *op. cit.*, 92 quoting *Ibn Hazm*, *al-Ihkam Fi Usul al-Ahkam* (Cairo, 1374 AH) Vol. XXXII.

opponents of freedom of contract), they also base their argument on the Quran and *hadith* texts. They quote the sanctity of contract verses in the Quran, such as:

*“O ye who believe ! fulfil all obligations.”* (Al-Maidah:1);

*“Verily, this is My Way leading straight: follow it: follow not (other) paths: they will scatter you about from His path: thus doth He command you, that ye may be righteous.”*

(Al-An’am: 153); and also the verse *“... and fulfil (every) engagement, for (every) engagement will be enquired into (on the Day of Reckoning).”* (Al-Israa: 34) together with

a *hadith* of a similar vein where the Prophet (pbuh) is reported to have said that “The conditions most deserving of fulfilment are those whereby you make a woman lawful unto you” which was interpreted as meaning that all conditions relating to contracts deserved to be fulfilled.

Relying on these authorities, the above scholars concluded that the injunction to fulfil all contracts and undertakings is unqualified and absolute. Further, on the basis of the Qur’anic verse *“...He hath explained to you in detail what is forbidden to you...”* (Al-An’am: 119) and a *hadith sahih* related by al-Tirmidhi to the effect that “Every agreement is lawful among Muslims except one which declares forbidden that which is allowed, or declares allowed that which is forbidden”, the advocates of freedom of contract argue that there is a natural presumption of legality subject to the Qur’anic prohibitions.<sup>79</sup>

Apart from the general religious delimitations placed on the freedom of contract, the law does provide for considerable intervention by a judge to reconstruct or readjust an existing contractual obligation. Thus, extra-contractual obligations may be imposed upon the parties by this judicial intervention. For instance, a debtor who fails to meet his contractual

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<sup>79</sup> Rayner, S.E., *op. cit.*, 93.

term would not be ordered to settle interest payments agreed upon in the contract but may be allowed by the court to make payment at a later date or by instalments.<sup>80</sup> A court could also intervene, for example, in a case of *Istighlal* (unfair advantage), where a disproportion of obligation exists between the contracting parties, to readjust those obligations in a more equitable manner. The system of judicial intervention may therefore set aside the private arrangements of the contracting parties by seeking justification in an Islamic system of 'equity'. The intervention nevertheless operates in conjunction with the high esteem accorded to sanctity of contracts in Islam.<sup>81</sup>

Based on the above arguments, it can be seen that Islamic law does allow a certain measure of freedom of contract provided that the terms and conditions do not go against the Islamic principles. The justification can also be found the following verse of the Qur'an which, in essence, explains the reason behind such freedom is to simplify the affairs of mankind:

*"Allah intends every facility for you; He does not want to put you in difficulties."* (Al-Baqarah: 185)

In summary, the instances of a contract becoming invalid by reason of any part of it not being in line with the Divine principles are as follows:<sup>82</sup>

- 1) A contract which involves interest, bribery or gambling;
- 2) A contract which involves any element of uncertainty;
- 3) A contract which involves any element of cohesion;
- 4) A contract, where the terms or conditions contradicts the Qur'an and the *Sunnah*;

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<sup>80</sup> *Id.* at 93-94.

<sup>81</sup> *Id.*, 94. This system of judicial intervention is unlikely to be practised in Malaysia as its judicial system is based on the common law instead of Islamic law. Although Malaysia has its own *shari'ah* courts system, the cases that are dealt with by the *shari'ah* courts are mostly related to Islamic family law such as marriage, divorce and inheritance.

<sup>82</sup> Mohd Ma'sum Billah, *Shari'ah Standard of Business Contract*, (Kuala Lumpur: A.S. Noordeen, 2006), 64-65

- 5) A contract where the contracting parties are disqualified by the provisions in the Qur'an and the *Sunnah*;
- 6) A contract where the subject matter is not recognised in the Qur'an and the *Sunnah*;
- 7) A contract of restraint of any legal trade, transaction, dealing or proceeding; and
- 8) A contract where any other aspect or indirectly contrary to the Divine principles of the Qur'an and the *Sunnah*.

Briefly, the scope of contract under Islamic law is subject to substantiation by the Qur'an and the *Sunnah* and also, the scope of freedom of contract under Islamic law is conditional, as Islamic law insists on each and every aspect of the contract to be in conformity with the Divine principles of Allah laid down in the Qur'an and the *Sunnah*.<sup>83</sup> Any transactions entered into not in conformity with such principles may be deemed as *haram* or prohibited.

### **3.7 The Islamic Nominate Contracts**

Nominate contracts can be defined as contracts which are distinguished by particular names or contracts having a proper or peculiar name or form. In other words, a nominate contract is a kind of contract which has a particular name given by the jurists.<sup>84</sup> The development of Islamic contracts is therefore the result of the method taken by Muslim jurists to elaborate the very broad and piecemeal doctrines of the Qur'an and the *Sunnah*, and to impose them on the pre-Islamic norms of practice. Every so often among the works of the early jurists it is possible to find a solution or a rule of a certain category which a

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<sup>83</sup> *Id.*, at 65.

<sup>84</sup> *Id.* at 67.

*priori*<sup>85</sup> seems restricted to that certain type, but which, if tested on other categories, allows a principle of a certain generality to emerge.<sup>86</sup>

The method followed by the jurists in the development of the system of nominate contracts (*al-'Uqud al-Mu'ayyana*) was by applying the process of *qiyas*<sup>87</sup> to already existing contracts, and by authorising the resulting category with *hadith* or other legal sources. The system used by the jurists to categorise nominate contracts was to determine whether, in any given contract, right passed in ownership or possession, and whether consideration passed or otherwise.<sup>88</sup>

There are four basic nominate contracts in Islamic law, namely:<sup>89</sup>

- 1) *Bay'* (Sale): Where right of ownership passes for consideration (*Tamlík al-'Ayn bi-'Iwad*);
- 2) *Hiba* (Gift): Where right of ownership passes without consideration (*Tamlík al-'Ayn bila 'Iwad*);
- 3) *Ijara* (Hire): Where transfer of possession occurs for consideration; and
- 4) *'Ariya* (Loan): Where transfer of possession occurs without consideration.

Other nominate contracts include those of *Salam* (a contract for delivery with prepayment), *Mudaraba* ([sleeping] partnership agreement; equity sharing between bank and client), *Sharika* (Partnership), *Rahn* (Mortgage), *Ju'ala*, *Wadi'a* (Deposit), *al-Muzara'a* (an agricultural contract where the landlord provides the land, seed and plants, and the worker

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<sup>85</sup> *A priori* means being without examination or analysis. Retrieved 7 October 2010 from <<http://www.merriam-webster.com/dictionary/a%20priori>>.

<sup>86</sup> Rayner, S.E., *op. cit.*, 100.

<sup>87</sup> Refer to paragraph 3.5.2.2 of this chapter, *supra*.

<sup>88</sup> Rayner, S.E., *op. cit.*, 100.

<sup>89</sup> *Id.* at 101

provides the labour) and *'Umra* (an archaic form of an unconditional donation in perpetuity).<sup>90</sup> In a more recent exposition, Professor Sanhuri<sup>91</sup> listed nominate contracts as six, which are, Sale (*Bay'*), Gift (*Hiba*), Partnership (*Sharika*), Hire (*Ijara*), Piecework (*Muqawala*) and Agency (*Wakala*).<sup>92</sup>

In addition to the above, nominate contracts in The Mejjelle are categorised as *Bey* (Sale) (1<sup>st</sup> Book), Letting (2<sup>nd</sup> Book), Pledge (*Rehn*) (5<sup>th</sup> Book), *Hibe* (Gift) (7<sup>th</sup> Book), Joint Ownership, Ownership Servitudes and Partnership (*Shirket*) (10<sup>th</sup> Book), and Agency (*Vekyalet*) (11<sup>th</sup> Book).

In keeping up with the progression of Islamic commercial law, some modern authors have further classified the following as nominate contracts, namely, Contract of Compromise; Contract of Transfer;<sup>93</sup> Contract of Guarantee; Contract of Surety;<sup>94</sup> Contract of Partnership to Cultivate Trees; Contract of Agriculture; CIF and FOB contracts;<sup>95</sup> Contract of Insurance, International contracts such as covenants, treaties etc., Contract of Education; Contract of Employment, Contract of Manufacturing, Contract of Professional Services and also Contract for Arbitration.<sup>96</sup>

However, it can be argued that the most important nominate contract is that of sale (*bay'*). Sale formed the prototype contract around which the other classes of contract were

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<sup>90</sup> *Ibid.*

<sup>91</sup> Abdel-Razzak el-Sanhuri or 'Abd al-Razzāq al-Sanhūrī (1895-1971) was an Egyptian legal scholar and professor who drafted the revised Egyptian Civil Code of 1949. He was also notable for his twelve-volume *Al-Wasīf fī sharḥ al-qānūn al-madani al-jadīd* [Medium commentary on the new Civil Code] (Cairo: 1952-1970). Retrieved on 7 October 2010 from <en.wikipedia.org/wiki/Abd\_El-Razzak\_El-Sanhuri>.

<sup>92</sup> Rayner, S.E., *op. cit.*, 101

<sup>93</sup> Also in the 4<sup>th</sup> Book of The Mejjelle.

<sup>94</sup> Also in the 3<sup>rd</sup> Book of The Mejjelle.

<sup>95</sup> CIF refers to "Cost, Insurance and Freight" whilst FOB refers to "Free on Board". Both FOB and CIF are trade terms of the Incoterms rules 2010.

<sup>96</sup> Mohd Ma'sum Billah, *op. cit.*, 68-69.

analogously developed. Indeed it is the chapters on sale (*Kitab al-Buyu'*) in the various legal treatises which formed the basis for the jurists' procedure of analysis.<sup>97</sup>

### **3.8 The Contract of Sale (*Bay'*)**

The contract of sale is permitted in Islam and proof of its legitimacy is in the following verse of the Quran:

*“O ye who believe ! eat not up your property among yourselves in vanities: but let there be amongst you traffic and trade by mutual good-will.”* (An-Nisa: 29)

Also in a *hadith*: “Ibn Umar reported Allah’s Messenger (may peace be upon him) as saying: There is no transaction between two persons entering a transaction until they separate, but only when there is an option to annul it”.<sup>98</sup>

Despite being permissible, there are certain trade practices that are encouraged in Islam whilst others, like interest or usury (*riba*), is totally prohibited.

Allah the Almighty has commanded those who are involved in trade to be honest in weighing their goods and also to be just in their trade, sanctioned in the following verses:

*“So establish weight with justice and fall not short in the balance.”* (Ar-Rahman: 9);

*“...give measure and weight with (full) justice...”* (Al-An’am: 152); and

*“ Give full measure when ye measure, and weigh with balance that is straight: that is better and fairer in the final determination.”* (Al-Israa: 35)

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<sup>97</sup> Rayner, S.E., *op. cit.*, 102.

<sup>98</sup> Translation of Sahih Muslim, Book 010, Number 3660.

The guidelines in conducting trade and business activities are clear in Islam and any elements of interest (usury), gambling, misappropriation of another's person's property in an unlawful manner, unlawful monopoly, bribery and uncertainty (*gharar*) are all considered unlawful elements according to the *shari'ah*, which must be avoided at all costs in any sale contract. The following Qur'anic verses clarify the legal principles in relation to the above prohibitions:

The prohibition of interest:

*"... but Allah has permitted trade and forbidden usury."* (Al-Baqarah: 275);

*"That which you give in usury for increase through the property of (other) people, will have no increase with Allah..."* (Ar-Rum: 39)

The prohibition of gambling:

*"O ye who believe ! intoxicants and gambling, sacrificing to stones, and (divination by) arrows, are an abomination, - of Satan's handi-work: eschew such (abomination), that ye may prosper."* (Al-Maidah: 90)

The prohibition of the misappropriation of another's person's property in an unlawful manner:

*"O ye who believe ! eat not up your property among yourselves in vanities: but let there be amongst you traffic and trade by mutual good-will."* (An-Nisa: 29)

The prohibition of unlawful monopoly:

*“Woe to every (kind of) scandal-monger and backbiter, Who pileth up wealth and layeth it by, Thinking that his wealth would make him last forever! By no means! He will be sure to be thrown into that which Breaks to Pieces.”* (Al-Humaza: 1-4)

The prohibition of bribery:

*“And do not eat up your property among yourselves for vanities, nor use it as bait for judges, with intent that ye may eat up wrongfully and knowingly a little of (other) people’s property.”* (Al-Baqarah: 188)

The prohibition of uncertainty (*gharar*) in trade:

‘Malik said, “An addition to the price must not be made for a foetus in the womb of its mother when she is sold because that is *gharar* (an uncertain transaction). It is not known whether the child will be male or female, good-looking or ugly, normal or handicapped, alive or dead. All these things will affect the price”.’<sup>99</sup>

‘Yahya related to me from Malik from Abu’r-Rijal Muhammad ibn Abd ar-Rahman ibn Haritha from his mother, Amra bint Abd ar-Rahman that the Messenger of Allah, may Allah bless him and grant him peace, forbade selling fruit until it was clear of blight. Malik said, “Selling fruit before it has begun to ripen is an uncertain transaction”. (*gharar*).”<sup>100</sup>

As a conclusion, it can be observed that sales and trade are highly encouraged in Islam, as narrated by Al-Miqdam in a *hadith*, the Prophet (pbuh) said, *“Nobody has ever eaten a better meal than that which one has earned by working with one’s own hands. The Prophet*

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<sup>99</sup> Malik, Book 31, Hadith 31.1.1.

<sup>100</sup> Malik, Book 3, Hadith 31.8.12.

of Allah, David used to eat from the earnings of his manual labor.”<sup>101</sup>, however, it has to be conducted by means that are permitted and that do not go against the Divine principles of the *shari'ah*.

### 3.8.1 Definition of Sale

Article 105 of The Mejjelle defines sale as ‘to change property for property, and it is either *Mun’aqid* (by a concluded bargain) or *Ghayr Munaqid* (not by concluded bargain)’. Ibn ‘Arfa defines sale as “A contract of obligation by which each party transfers to the other the property of something for other than simple usage or pleasure. An additional limitation is that the contract is commutative of which one of the considerations shall be of legal tender, and the other shall be a specific object other than gold or silver.”<sup>102</sup> Other jurists have been content with simpler definitions, for example, “the exchange of one commodity for another, one of which is called the object, and the other the price” or the transfer of ownership of property for another”.<sup>103</sup> The Hanafi authors classify definitions of sale according to two principle headings, namely, Special Sales (*al-Bay’ bi al-Ma’na al-Khass*) and the General Sales (*Bay’ al-Ma’na al-Amm*). The Special sales are further recategorised according to Meaning, Object and Price, as follows:<sup>104</sup>

(1) Categories of Sale According to Meaning:

(i) *Nafidh*: Confers benefit immediately;<sup>105</sup>

(ii) *Mawquf*: Confers benefit upon the taking of possession;<sup>106</sup>

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<sup>101</sup> Translation of Sahih Bukhari, Book 3, Volume 34, Hadith 286.

<sup>102</sup> Rayner, S.E., *op. cit.*, 103.

<sup>103</sup> *Ibid.*

<sup>104</sup> Rayner, S.E., *op. cit.*, 104.

<sup>105</sup> *Bay’ al-Nafidh* is a contract of sale which does not involve any right of the third party. It is of two types: *lazim* (binding) and *ghair lazim* (non-binding). The *lazim* is a contract of sale which has no options (to rescind) for any of the parties and the *ghair lazim* is a contract of sale which may have at least one option for any of the parties. Muhammad Akram Khan, *Islamic Economics and Finance: A Glossary*, 2<sup>nd</sup> ed., (London: Routledge, 2003), 27.

(iii) *Fasid*: Confers benefit upon the taking of possession;<sup>107</sup> and

(iv) *Batil*: Confers no benefit in its original state.<sup>108</sup>

(2) Categories of Sale According to Object

(i) *Muqayada*: Exchange of object for object ('Object Barter'),<sup>109</sup>

(ii) *Sarf*: Exchange of price for price ('Money Barter'),<sup>110</sup>

(iii) *Salam*: Sale with immediate payment and deferred delivery;<sup>111</sup> and

(iv) *Mutlaq*: Absolute sale of object for money, whether immediately or deferred.

(3) Categories of Sale According to Price:

(i) *Tawliya*: Resale at cost price;

(ii) *Murabaha*: Resale with profit increase;<sup>112</sup>

(iii) *Wadi'a*: Resale with loss;<sup>113</sup> and

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<sup>106</sup> *Bay al-Mawquf* is an agreement of sale that is lawful in substance and description, but it is concluded with the consent of a third party who does not have an absolute right of ownership over the property of the buyer or the seller. Muhammad Akram Khan, *op. cit.*, 24-25.

<sup>107</sup> *Bay al-Fasid* is an agreement of sale which is lawful in its substance but unlawful in respect of its description. The substance of the agreement refers to proposal, acceptance and the article of sale. The description refers to characteristics other than the substance, such as the price of the article of sale. If an agreement of sale for a definite article is concluded by proposal and acceptance but the price is not settled, the agreement would be *fasid* although it is enforceable (*munaqad*) so far as its substance is concerned. Retrieved 12 October 2010 from <[www.islamicport.com/islamic\\_economic\\_terms/b.html](http://www.islamicport.com/islamic_economic_terms/b.html)>.

<sup>108</sup> *Bay al-Batil* is an agreement of sale which is unlawful in respect of its substance and description. For example, an agreement of sale concluded by a lunatic or a minor is *batil* since it does not possess the substance of the agreement which is the proposal and acceptance by a sane or major person. Similarly, an agreement to sell a dead body or alcohol is not lawful since it involves exchange of *mal* (property) for something valueless (*ghair mutaqawwam*). Retrieved 12 October 2010 from <[www.islamicport.com/islamic\\_economic\\_terms/b.html](http://www.islamicport.com/islamic_economic_terms/b.html)>.

<sup>109</sup> See Article 122 of The Mejlle.

<sup>110</sup> See Article 121 of The Mejlle.

<sup>111</sup> *Bay al-Salam* is a sale agreement that involves advance payment for goods that are to be delivered later. According to the general law, no sale can be affected unless the goods are in existence at the time of the bargain, but this type of sale forms an exception to the general rule provided the goods are defined, the price is paid in advance and the date of delivery is fixed. The objects of this sale are mostly fungible things and they cannot be gold or silver because they are regarded as monetary values. Muhammad Akram Khan, *op. cit.*, 28. See also Article 123 of The Mejlle.

<sup>112</sup> *Bay' al-Murabaha* is a contract of sale in which the seller declares his cost and profit. This has been adopted (with certain modifications) as a mode of financing by a number of Islamic banks. As a financing technique, it involves a request by the client to the bank to purchase a certain item for him. The bank does that for a definite profit over the cost which is settled in advance. Many people have questioned the legality of this financing technique because of its great similarity with *riba* (interest). Retrieved on 12 October 2010 from <[www.islamicport.com/islamic\\_economic\\_terms/b.html](http://www.islamicport.com/islamic_economic_terms/b.html)>.

<sup>113</sup> *Wadi'a* can also be described as a resale of goods with a discount on the original stated cost. Retrieved on 12 October 2010 from <[www.islamicport.com/islamic\\_economic\\_terms/w.html](http://www.islamicport.com/islamic_economic_terms/w.html)>.

- (iv) *Musawama*: Resale with agreement that no reference be made to the original cost price.

Although there are other variants of the categories of goods defined by the scholars, they generally overlap and have also been classified into three main categories, namely, the sale of commodity for commodity (barter trading or *muqayada*); the sale of commodity for money or vice versa and the sale of money for money or money exchange (*sarf*).<sup>114</sup>

### 3.9 The Elements of a Contract of Sale

In their treatment of the conditions of substantive areas of the law, the Muslim jurists analysed the constituent elements of contracts which formed the basic foundations by which a contract would become validly concluded. These elements are called *Arkan* (Pillars), of which the five most important for any nominate contract are to be found in the constituent elements of sale, as follows:<sup>115</sup>

- (1) An Agreement;
- (2) Consent and Intention to Contract;
- (3) Contracting parties with capacity to contract;
- (4) An Object of Sale and a valid Cause; and
- (5) Consideration.

The definitions of contract make it immediately apparent that the pillars of contract as laid down in the chapters of sale are first and foremost for the application of the sale contract.

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<sup>114</sup> Zahraa Mahdi and M Shafaai Mahmor, Definition and Scope of the Islamic Concept of Sale of Goods, ALQ [2001], 16(3), 215-238 at p. 216.

<sup>115</sup> Rayner, S.E., *op. cit.*, 104

Invariably, they do constitute general principles but in dealing with contracts such as hire (*ijara*) and gift (*hiba*), it may not be always be safe to assume sale as a prototype, as it will require special explanation.<sup>116</sup>

### **3.9.1 The Agreement: *Majlis Al-‘Aqd***

The jurists developed a system of formation of contract based upon a contractual séance called *Majlis al-‘Aqd*. The *Majlis* occurs in any natural place where the contractors meet to form their agreement. The agreement is formed by the linking of an offer (*Ijab*) and an acceptance (*Qabul*) which may be either express (*Sarihan*) or tacit (*Damanan*), by conduct (*Mu’atah*) or by gestulation (*Isharat*) when the party is mute,<sup>117</sup> but for which there is no special form. In certain cases, acceptance may also be implied from a party’s silence.<sup>118</sup> Article 181 of The Mejlle refers to the *Majlis* as “the meeting for bargaining.”<sup>119</sup>

#### **3.9.1.1 The Tense to be used in the *Majlis***

The Islamic prohibition against *gharar* also covers any degree of uncertainty and therefore any express stipulations must not be formed in the future tense but in the present or *preterite* (for example *bay’tuka* which means “I sold you). However, The Mejlle in Article 169 expressly states that the offer and acceptance must be expressed in the past tense (“for offer and acceptance the past tense is generally used”).

Article 171 of The Mejlle states that “A sale (*Bey’*) is not concluded by words in the future tense, such as “I will take” “I will sell”, which mean merely a promise. Article 172

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<sup>116</sup> Rayner, S.E., *op. cit.*, 105.

<sup>117</sup> See also Article 174 of The Mejlle.

<sup>118</sup> Rayner, S.E., *op. cit.*, 106.

<sup>119</sup> With the above definitions of the *Majlis*, regard must also be had to the conduct of offer and acceptance through instantaneous communication such as electronic mail and also sale by documents in a CIF (Cost Insurance and Freight) contract for which, strictly speaking, there is no *Majlis* to speak of.

further states that “A sale (*Bey*) is also not concluded in the imperative sense, such as “Sell” “Buy”. But a sale is concluded by an imperative which of necessity indicates the present.<sup>120</sup>

### 3.9.1.2 Unity of Time and Place

Subject to certain Hanafi and Maliki principles, the *fiqh* has ruled that the double declaration of offer and acceptance from which the contract is concluded must take place almost simultaneously in the *Majlis*, whether it is a *Majlis* between the principals themselves or between their authorised representatives. At the moment that the parties separate, the offer falls and the acceptance is rendered impossible. The offer must be renewed and a new *Majlis* created for the acceptance to have any legal effect after separation of the parties.<sup>121</sup>

This notion of the *Majlis* which evolved during the period of *inter praesentes*<sup>122</sup> contracts and prior to the advancement of new communication technology, that made distant contracting possible is now being revisited, to see whether it can accommodate new contracting methods brought about by the fast changing landscape of communication technology. The classical definition of the *Majlis* invariably implies the physical presence of both the contracting parties and the *Majlis* as an occasion of the meeting of both minds and bodies continue to dominate the Islamic contractual jurisprudence for quite some time.

However, in another context, it has been argued that the ‘*Majlis*’ is the period of time when an offer remains capable of acceptance, hence that period has no relevance to the physical

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<sup>120</sup> An example given in Article 171 explains that, if the buyer say ‘sell this property to me for so many piastres’ and the seller say ‘I sold it’, the sale is not concluded. But if on the seller saying ‘take it for so many piastres,’ the buyer say ‘I have taken it’ or on the buyer saying ‘I have taken it’ the seller say ‘Take it’ or may you enjoy the benefit of it’, the sale is concluded. Because to use the expression ‘Take’ or ‘May you enjoy the benefit of it’ are in the place of saying ‘I have sold, take.’

<sup>121</sup> Rayner, S.E., *op. cit.*, 107. However, there have been criticisms by certain authors of this strict doctrine with regard to unity of time and place of the *Majlis*.

<sup>122</sup> *Inter praesentes* means face to face.

presence or absence of the parties.<sup>123</sup> The *Majlis* is deemed spatiotemporal and not restricted to mere physical presence, especially in reference to contracts *inter absentes*<sup>124</sup> made through an agent (*Rasul*) or by a written document (*Kitab*). While it has also been argued that the *Majlis* refers to the offer during its currency, the rules of acceptance dictate that if an offer is to be accepted, if it is accepted at all, at the place where the offer is communicated. That apart, the *Majlis* here must surely convey the period during which the minds are capable of meeting to produce a consensus.<sup>125</sup>

The spatiotemporal significance of the *Majlis* is further reiterated by Wahbah Az-Zuhayli who states that the *Majlis* does not imply the imperative physical presence of both parties in the same place; both parties may be in different places as long as there is a medium of communication which can connect them.<sup>126</sup>

The *Majlis* therefore creates an essential unity of time and place necessary for the dual declarations of intention and consent. All schools are in agreement on this point, but variations in opinion arise out of certain situations concerning the *Majlis* and the extension of the offer.

### **3.9.1.3 Termination of the *Majlis***

The first point of divergence arises from the termination of the *Majlis* and whether the *Majlis* itself is unequivocally terminated by the separation of the parties, subject to the definition of “separation”. Certain interruptions during the *Majlis* are held to terminate the

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<sup>123</sup> Siti Salwani Razali and Shaik Mohd Nor Alam SM Hussain, Consensus Ad Idem And Majlis Aqad in Islamic Contract Law, [2005] 4 ShLR 1-4 at p. 2-3

<sup>124</sup> *Inter absentes* means that the parties are not in each other's presence.

<sup>125</sup> Siti Salwani Razali and Shaik Mohd Nor Alam SM Hussain, *op. cit.*, 3

<sup>126</sup> Wahbah Az-Zuhayli, *Al-Fiqhul Islami Waadillatuhu*, Vol 4, (Damascus: Darul Fikr, 1984), 2947

*Majlis*, for example, stopping to pray, discussing other subjects, changing positions or attitudes or even falling asleep.<sup>127</sup>

#### **3.9.1.4 Immediate Acceptance**

The second divergence of opinions emanates from the question of whether acceptance should follow immediately from the offer, and the jurists' definition of "immediate" (*Halan*). The majority of the schools allow the second party until the end of the *Majlis* to make his acceptance known but the Shafi'is take the definition of "immediate" in its strictest sense. This interpretation would seem unnecessarily draconian if it were not for the fact that the Shafi'is also allow the acceptor to withdraw his acceptance once given, at any time before the *Majlis* comes to an end.<sup>128</sup>

The Mejlle in Article 182 did not expressly state that acceptance must be immediate but explains that "At the meeting for bargaining, after the offer, until the end of the meeting, both parties have an option."<sup>129</sup>

#### **3.9.1.5 Withdrawal of Offer Prior to Acceptance**

The third divergence of opinion relates to whether the offer may be withdrawn before acceptance is given. It is only the Maliki school which seems to be at odds here, for all the other schools unequivocally accept the right of either party to withdraw their declarations during the period of the *Majlis*. The Malikis however hold that the offeror must stand by his offer until it has received a response from the offeree. The effects of this opinion are

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<sup>127</sup> Rayner, S.E., *op. cit.*, 107-108.

<sup>128</sup> *Id.* at 108.

<sup>129</sup> An explanation to Article 182 states that "If one contracting parties, at the meeting for making the bargain, make a proposal for sale, saying "I have sold" or "I have bought this property for so many piastres," when the other does not say immediately afterwards "I have bought" or "I have sold", and after the passing of an interval of time and at that meeting, make acceptance, the sale (*Bey'*) is concluded. However, much the meeting is drawn out at a great length, and the interval between the offer and acceptance is prolonged, it does no harm."

obviously mitigated by the rules governing termination of the *Majlis*: an offeror can simply terminate the *Majlis* by walking away from the offeree if he later regrets his offer.<sup>130</sup>

With regard to this point of contention, Article 183 of The Mejjelle states that “After the offer and before acceptance if one of the two parties gives an indication of dissent, whether by word or act, the offer becomes void, and there is no longer room for an acceptance. Article 184 further states that “When one of the two contracting parties makes an offer, but withdraws from it before the acceptance of the other, the offer becomes void. After that the sale (*Bey*) is not concluded by an acceptance.”

### **3.9.1.6 Option of *The Majlis* (*Khiyar al-Majlis*)**

The fourth difference of opinion between the schools arises from the question of revocation of offer and acceptance once given. Here, the Malikis and Hanafis hold that once a contract has been concluded by corresponding offer and acceptance, neither of the parties may retract their declarations, whether or not the *Majlis* has been terminated. Contrastingly, the Hanbalis and Shafi’is regard such declarations as provisional for the duration of the *Majlis*.<sup>131</sup> In this respect, they have formulated a principle of an “Option of the *Majlis*” (*Khiyar al-Majlis*) whereby, following declaration of consent in a bilateral contract, the parties may retract their declarations of consent prior to the termination of the *Majlis*. This opinion is based on the *hadith* attributed to the Prophet (pbuh) which state:

*“The two contracting parties have a right of option in a sale, as long as they have not separated.”*<sup>132</sup> However, this option of the *Majlis* is not recognised by the Malikis and

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<sup>130</sup> Rayner, S.E., op. cit., 108-109.

<sup>131</sup> *Id.* at 110.

<sup>132</sup> *Ibid.* See also Article 182 of The Mejjelle.

Hanafis, who view it as contrary to the Qur'anic verse enjoining Muslims to fulfil their undertakings.<sup>133</sup>

### **3.10 Consent and Intention to Contract**

Consent (*Rida*) to the contract, its form and principles is an example where the jurists have regulated detailed causes and ground rules on a broad Qur'anic injunction. The Qur'an and *ahadith* (plural of *hadith*) determine that bilateral contracts can only take place by the free consent of the parties but neither of these sources go so far as to explain how mutual consent may be ascertained.<sup>134</sup> It was therefore by virtue of the reasoning of the jurists that a series of inductive regulations governing consent and intention has come about. Intention and consent have become the two fundamental precepts to any contract but this is not to say that the *fiqh* in any way adopted a formalistic approach to the expression of the concordant wills of the contracting parties.<sup>135</sup>

#### **3.10.1 Non-Verbal Expression of Consent**

It was determined by the jurists that mere intention was not sufficient to conclude a bilateral contract but that such intention could be most simply conveyed by verbal expression.<sup>136</sup> Should verbal expression be impossible such as in cases where either of the parties are deaf or mute or absent, then Muslim law allows for that intention to be conveyed by other means; either by writing, signs or gesticulations.<sup>137</sup>

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<sup>133</sup> *Ibid.* See Al-Maidah:5

<sup>134</sup> Rayner, S.E., *op. cit.*, 115. See An-Nisaa: 29

<sup>135</sup> *Ibid.* For example, contracts that go against the tenets of Islam will not be enforced even though it is agreed by mutual consent of the contracting parties.

<sup>136</sup> *Ibid.*

<sup>137</sup> *Ibid.*

### 3.10.2 Silence as an Expression of Consent

In certain cases where a person is required to indicate his position explicitly, silence may also be considered as an expression of positive intention. Generally, silence is not considered as having any significance except in cases where a response must be given and then it is considered as verbal acquiescence.<sup>138</sup> Cases where silence is deemed verbal acquiescence are the virgin girl's consent to marriage; the acceptance of her dower by her guardian; the master's consent for his slave to enter into commercial transactions and the guardian's consent for his ward to enter into commercial transactions when both are done in the knowledge of the master or guardian.<sup>139</sup>

Also in this category are the silence of the beneficiary in non-contractual transactions such as *waqf*, donation and remission of debts, when an act is subordinate to the taking of possession. Also, the seller in a contract of sale loses his right of retention if he sees that the buyer has taken possession of the goods without paying the price: if he remains silent, he loses his right of lien.<sup>140</sup>

### 3.11 Contractual Capacity (*Ahliya*)

The capacity of the parties to contract is a prime consideration of the validity of contract. There is a natural presumption of capacity to contract subject to three categories of restrictions where a party belonging to one or more of those categories is interdicted from contracting and therefore any contract entered into by that person (with restriction) is null and void *ab initio*.<sup>141</sup>

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<sup>138</sup> Rayner, S.E., *op. cit.*, 116.

<sup>139</sup> *Ibid.*

<sup>140</sup> *Ibid.*

<sup>141</sup> Rayner, S.E., *op. cit.*, 121.

### 3.11.1 Restrictions to Capacity

#### 3.11.1.1 Majority

Every person entering into a contract must have reached the age of majority. Certain jurists designate a specific age of majority but most jurists specify that majority means having reached puberty.<sup>142</sup> The Qur'an says:

*“Make trial of orphans until they reach the age of marriage; if then ye find sound judgment in them, release their property to them...”* (An-Nisaa: 6)

On the basis of the above verse, the age of majority is linked to a manifestation of prudence (*Rushd*) but certain limited capacities may be granted to persons manifesting discernment or discretion (*Tamyiz*). It was generally thought that prudence and puberty occurred at around the fifteenth year but in any event, the minimum age of puberty was set at nine years for females and twelve for males.<sup>143</sup> All acts entered into by a minor are null and void, except where such acts are purely to the advantage of a minor of perfect understanding and which must be ratified by the guardian.<sup>144</sup> This is in congruence with the Hanafi school of thought where a minor's sale contract is valid if he is discerning and his guardian permits it.<sup>145</sup> Article 968 of The Mejlle further states that “The guardian can give leave to an infant, who understands business, to trade, by handing him a quantity of his property for trial, and if he proves capable of managing his own affairs, he delivers him the rest of his property.”

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<sup>142</sup> *Id.* at 122.

<sup>143</sup> *Id.* at 122-123.

<sup>144</sup> *Id.* at 123.

<sup>145</sup> Ala' Eddin Kharofa, *Transactions in Islamic Law*, (Kuala Lumpur: A.S. Noordeen, 2000), 73.

However, in Shafi'i school, a minor cannot enter into a contract of sale until he is of age. The Hanbali scholars consider a discerning minor's contract as valid based on the Qur'anic verse above (An-Nisaa: 6).<sup>146</sup> A minor of imperfect understanding may not make any valid disposition of his property even with his guardian's consent or ratification.<sup>147</sup>

### **3.11.1.2 Sound Mind**

The quality of a sound mind or prudence (*Rushd*) is a condition for contractual capacity. A lunatic (*Ma'thuh* or *Majnun*), prodigal spendthrift (*Safih*) or negligent person (*Dhu al-Ghafla*) is considered lacking in discernment (*Tamyiz*) and therefore any act entered into by them is null and void (*Batil*).

### **3.11.1.3 Legal Interdictions in the Interests of Third Parties**

The *fiqh* has set aside certain situations, where, in the interests of relatives or third parties, a person is interdicted from disposing off his property. Such dispositions made are suspended (*Mawaqif*) subject to ratification by the third parties concerned. The categories of persons interdicted are the insolvent (*al-Muflis*); a person ill with death sickness; virgin Maliki females (unmarried Maliki women are considered as lacking full discernment); a pledgor disposing of a pledge before the pledge defaulted (as this would nullify the rights of the pledge) and also city dwellers are not allowed to act as agents selling agricultural produce on behalf of country people (in fear that the latter class would be prejudiced due to their ignorance of true market prices).<sup>148</sup>

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<sup>146</sup> *Ibid.*

<sup>147</sup> Rayner, S.E., *op. cit.*, 123.

<sup>148</sup> Rayner, S.E., *op. cit.*, 129-130.

### 3.12 Object of Contract (*Al-Ma'qud Alayh*)

The law of contract is based around the concept of Property (*al-Mal*). Although there have been some controversies with regard to the definition and scope of the concept of *Mal*,<sup>149</sup> most schools require four conditions concerning the object which must be satisfied to effect a valid contract. These are legality, existence, the property being deliverable and precise determination.<sup>150</sup>

#### 3.12.1 Legality

The first condition of the object of a contract means that the object must be legal (*Mubah*), in that it is beneficial, that it is a commodity capable of being traded in (*Mal Mutaqawwim*),<sup>151</sup> that its subject matter (*Mahall*) and underlying cause (*Sabab*) are lawful and that it is not proscribed by Islamic law, public order or morals.<sup>152</sup> The object of a contract may also constitute benefits derived from property, or a particular act or service. Further, the contract must also be lawful in its cause (*Sabab*).

#### 3.12.2 Existence of the Object

The second principle governing the object of a contract is that the object must be in existence at the time of the contract. It is therefore illegal to sell the foetus of an animal before its birth, or the fruit which has not yet appeared on the tree. *Narrated Anas bin Malik: Allah's Apostle forbade the sale of fruits till they are almost ripe. He was asked what is meant by 'are almost ripe.' He replies,, "Till they become red." Allah's Apostle*

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<sup>149</sup> Zahraa Mahdi and M Shafaai Mahmor, *op. cit.*, 218. The main concerns of the controversy over its meaning have been regarding its quantitative and qualitative aspects and the relationship between *Mal* and concepts such as ownership, corporeal and usufruct property. Such discussion is however outside the scope of this chapter.

<sup>150</sup> Rayner, S.E., *op. cit.*, 131.

<sup>151</sup> Article 199 of The Mejlle "It is necessary that the thing sold should be *Mal Mutaqavim*."

<sup>152</sup> Rayner, S.E., *op. cit.*, 131.

further said, “If Allah spoiled the fruits, what right would one have to take the money of one’s brother (i.e. other people)?”<sup>153</sup> The Mejlle in Article 197 states that “The existence of the thing sold is necessary.” It can be therefore be seen that such sales are contrary to the rule that the object of the contract should be in existence at the time the contract was made.<sup>154</sup> Article 205 of The Mejlle further provides that “The sale of non-existing thing is invalid.”

However, the principle of the existence of the object of the contract of sale becomes mitigated by the authorisation of *Salam* and *Istisna*’ contracts which provide respectively for future provision of goods and future manufacture of goods.<sup>155</sup>

### 3.12.3 Certainty of Delivery

The third principle governing the object of a contract is that it must be capable of certain delivery. Article 198 of The Mejlle states that “It is necessary that the delivery of the thing sold be possible.” Where a contract consists of an obligation for performance, this performance must be capable of being executed immediately. The classical jurists therefore prohibit the sale of a camel or slave which has fled, a bird in the air or a fish in water. Likewise, a contract to perform a service which is not certainly possible, such as, an undertaking by a doctor to cure a person who is ill, is also void.<sup>156</sup>

In Article 209 of The Mejlle, it explains that “The sale of a thing, the delivery of which is not possible, is invalid.”

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<sup>153</sup> Translation of Sahih Bukhari, Volume 3, Book 34, Number 403.

<sup>154</sup> Rayner, S.E., *op. cit.*, 133.

<sup>155</sup> *Ibid.*

<sup>156</sup> Rayner, S.E., *op. cit.*, 139.

### 3.12.4 Precise Determination of Object

The final condition regarding the object of a contract is that it must be precisely determined as to its essence, its quantity and its value. In the case of benefits derived from property, acts, services or property not present at the time of contracting, the subject matter should be feasible and defined, or capable of definition and lawful.<sup>157</sup> This is the principle which the *fuqaha* (the experts in Islamic law) formulated in the interest of the parties, in order to prevent uncertainty and conflict between them in situations where a contract is rescinded or terminated for some cause, and the party is seeking a remedy.<sup>158</sup>

The above principle has further been divided by the jurists into two categories, namely Indetermination and Non-serious Indetermination. The first category of Indetermination results in nullification of the contract (*Fasid*), whilst Non-serious Indetermination does not affect the contract but may be remedied by one of the parties under one or more of the various options of rescission which were prescribed by the *fiqh* (specifically relevant in this case is the *Khiyar al-Ta'yin* or Option of Determination).<sup>159</sup>

With regard to the essence and quality of the object of the contract, the determination given must be sufficient to render it distinguishable as the object. It is not permissible to say “I will sell you one of the sheep from my flock” for this is insufficient description to distinguish the intended object from all the other objects in that class. In this case, the contract would be considered as *Fasid*. This precise determination of the object is also sanctioned in Article 201 of The Mejlle, which states “The thing sold becomes known by a description of its qualities and state, which will distinguish it from other things.”

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<sup>157</sup> *Ibid.*

<sup>158</sup> *Ibid.*

<sup>159</sup> Rayner, S.E., *op. cit.*, 139-140.

Goods sold in bulk are also subject to the condition of precise determination. Goods sold in this manner must be viewed and their quantity must be at least capable of determination, even if that quantity is not known to the parties. There must be difficulties present in bulk sales which prevent the goods from being counted, weighed or measured and it must be customary for such goods not to be sold by the piece. The Maliki and Hanafi schools hold that unseen goods cannot be sold in bulk. If inspected goods are sold in bulk and only one of the parties to the contract has knowledge of the quantity involved, the party who is ignorant of the quantity will be able to rescind the contract by option upon discovery of his contractor's advantage.<sup>160</sup>

According to the Hanafi and Maliki schools, contracts concluded for goods which are not present or seen at the *Majlis* are valid provided that a precise description has been specified by the seller. The Shafi'i school is divided on this matter of unseen commodities: one view is that such a sale is illegal and the other is that the sale is valid subject to the buyer's Option of Inspection.<sup>161</sup> Similarly, where the seller describes goods to be sold as being of a certain quality, and the goods upon inspection prove to be of inferior quality, the Islamic abhorrence of unjustified enrichment allows for the purchaser to exercise an option, either to cancel the sale under the Option of Misrepresentation or to accept the goods for the whole of the fixed price.<sup>162</sup>

### **3.12.5 Consideration**

Consideration in Islamic law is not restricted to a monetary price but may be in the form of another commodity. The Islamic prohibition against uncertainty requires that the price must be in existence and determined at the time of the contract and cannot be fixed at a

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<sup>160</sup> Rayner, S.E., *op. cit.*, 140.

<sup>161</sup> *Id.* at 141.

<sup>162</sup> *Ibid.*

later date with reference to the market price, nor can it be left subject to determination by a third party.<sup>163</sup> The Mejlle in Article 237 mentions that “It is necessary that the price should be named at the time of the sale (*Bey*’). Therefore, if the price of the thing sold is not mentioned at the time of the sale, the sale is bad (*Fasid*).” Article 238 further states that “It is necessary that the price should be known.”

When the consideration consists of monetary payment (as opposed to payment in kind), the jurists state that the currency must be in circulation and that its value and species must be exactly determined. In certain contracts such as money-changing (*Sarf*), a contract will be automatically declared null and void on the grounds of *riba* and *gharar* if there is any element of uncertainty regarding either the object or the consideration. If a merchant sells a commodity without agreement as to the time or manner of payment, and it is customary to obtain the price by weekly instalments for such sales, then the contract of sale will be valid and interpreted according to the particular custom.<sup>164</sup>

If a type of currency unit is incompletely defined in the contract, custom will dictate that the currency will be construed as meaning the unit type most frequently in use in the country where the contract has been concluded.<sup>165</sup> Due to the uncertainty in consideration which arises therefrom, there is no unanimous agreement among the jurists as to whether a rate fixed in respect of a consignment of goods may constitute a valid sale if applied to the whole consignment, where the exact quantity is not known. However, detailed provision is made by the jurists for the time of payment. A contract of sale must provide for the

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<sup>163</sup> *Ibid.*

<sup>164</sup> Rayner, S.E., *op. cit.*, 141-142.

<sup>165</sup> *Id.* at 141.

consideration, whether it is to be paid immediately at the *Majlis*, at some time in advance of delivery or at an affixed term.<sup>166</sup>

### **3.13 Concluding Remarks**

As a conclusion, it can be observed that Islamic law has provided extensive rules which covered almost every aspect of the general principles of contract and in particular the contract of sale. It can also be said that whilst there is no general theory of contract, so to speak, as the development of the Islamic contracts are categorised by nominate contracts, the principles governing the contract of sale are normally applicable to the other types of contracts, subject to certain modifications.

The underlying foundation of such principles are that whilst the contract of sale is permissible in general, certain prohibitions apply and trade practices which are contrary to Islamic principles are not only frowned upon but prohibited. Although most of the principles and examples given may refer to traditional sales contract, there is a need in these modern times to adapt to those principles to reflect the rapid changes in commercial transactions while maintaining its sanctity according to the tenets of Islam.

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<sup>166</sup> *Ibid.*



## CHAPTER FOUR

# RIGHTS AND OBLIGATIONS OF SELLERS AND BUYERS – THE UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (CISG) AND THE ISLAMIC CONTRACT OF SALE COMPARED

### 4.1 Introduction

Contracts of sale are universal, and among the objectives of the CISG is to develop international trade on the basis of equality and mutual benefit and also as an important element in promoting friendly relations among member States. It is also the Convention's objective to adopt uniform rules which govern contracts for the international sale of goods and to take into account the different social, economic and legal systems that would contribute to the removal of legal barriers in international trade and promote the development of international trade.<sup>1</sup>

Despite such noble objectives, the Convention<sup>2</sup> only governs the formation of the contract and the rights and obligations of the seller and buyer arising from such a contract.<sup>3</sup> In addition, the Convention is also not concerned with the validity of the contract and the effect which the contract may have on the property sold in the goods.<sup>4</sup> Looking from a different perspective, the *shari'ah* also comprises rules and regulations pertaining to the rights and obligations of sellers and buyers in contracts of sale. This chapter aims to analyse such rights and obligations and make a comparison between the provisions of the CISG and the Islamic sale of goods law and to further contribute ideas towards the

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<sup>1</sup> Preamble to the CISG.

<sup>2</sup> The abbreviation CISG is used interchangeably with the word 'Convention' in this chapter.

<sup>3</sup> Article 4 of the CISG. All articles mentioned in this chapter refer to the articles of the CISG unless otherwise stated.

<sup>4</sup> Article 4(a) and (b) of the CISG respectively.

betterment of the implementation of an improved system in both the conventional and the *shari'ah* regimes in relation to international trade.

## **4.2 Obligations of the Seller under CISG**

It has been deliberated that sales laws do not usually expressly define the rights and obligations of both parties because the rights of the buyer are at the same time the obligations of the seller and *vice versa*.<sup>5</sup> Under a sale contract, the seller has the obligation to deliver the goods and transfer the property in the goods. And these are exactly the rights of the buyer, namely, to demand delivery and the transfer of property in the goods to him. Whereas the buyer is obliged to take delivery and pay the price, it is the seller's right to demand that delivery be taken by the buyer and that the price is paid. Therefore, sales laws usually deal only with the obligations of the parties, which is the case in the CISG. The CISG contains Chapters on the obligations of the seller and those of the buyer, but not their rights as these are implied in the obligations of the other party.<sup>6</sup> The said obligations of the seller are contained in Chapter II, Part III of the CISG.<sup>7</sup>

### **4.2.1 The Seller's Principal Obligations - Article 30**

The first obligation is under Article 30 which is, to "... deliver the goods, hand over any documents relating to them and transfer the property in the goods, as required by the contract and the Convention." This seems like a rather fascinating Article for at least two reasons: firstly, it appears to be contrary to Article 4(b) of the Convention<sup>8</sup>, which literally

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<sup>5</sup> Enderlein, F. (1996). Rights and Obligations of the Seller under the UN Convention on Contracts for the International Sale of Goods. Retrieved on 9 November 2010 from <<http://www.cisg.law.pace.edu/cisg/biblio/enderlein1.html>>.

<sup>6</sup> *Ibid.*

<sup>7</sup> Chapter II, Part III of the CISG contains Articles 30-52 with regard to the obligations of the seller but not all articles are relevant for discussion in this chapter.

<sup>8</sup> Article 4(b) has been discussed in paragraph 2.6 of Chapter 2 of this dissertation.

is not concerned with “the effect which the contract may have on the property in the goods sold” and secondly, the contract appears to be a dominant factor in specifying the seller’s obligations towards the buyer, rather than the Convention itself. For these reasons, it has been argued that Part III of the Convention<sup>9</sup> cannot be separated from Part I.<sup>10</sup>

Part I concerns not only the scope of the Convention but also the nearly absolute party autonomy in Article 6.<sup>11</sup> Briefly, Article 6 allows the parties to derogate from or vary the effect of any of the provisions of the Convention. Since the only exception to this freedom of the parties is referred to in Article 12,<sup>12</sup> the whole of part III does not contain any mandatory provisions.<sup>13</sup> Therefore, it can be understood that the parties may stipulate and agree to any provisions in the contract so long as such provisions do not contradict the general principles of good faith and fair trading. Ultimately, this will eventually lead to the application of Article 7, where in the interpretation of the Convention, regard must be had, *inter alia*, to its international character and the observance of good faith in international trade.<sup>14</sup>

Consequently, it should also be mentioned that if the judges applying the Convention are to develop goodwill, they will have to regard the observance of good faith not only when interpreting the Convention but even more so when interpreting the contract and activities of the parties.<sup>15</sup> The rules of the Convention will only come into play only if the parties did

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<sup>9</sup> Part III of the Convention relates to ‘Sale of Goods’ and contains three Chapters: Chapter I (General Provisions), Chapter II (Obligations of the Seller), Chapter III (Obligations of the Buyer), Chapter IV (Passing of Risk) and Chapter V (Provisions Common to the Obligations of the Seller and of the Buyer).

<sup>10</sup> Enderlein, *op. cit.* Part I of the Convention is concerning the ‘Sphere of Application and General Provisions’. It has two Chapters, namely, Chapter I (Sphere of Application) and Chapter II (General Provisions).

<sup>11</sup> Article 6: “The parties may exclude the application of this Convention or, subject to Article 12, derogate from or vary the effect of any of its provisions.” Article 6 has also been discussed in paragraph 2.2.2.2 in Chapter 2 of this dissertation.

<sup>12</sup> Article 12: “Any provision of article 11, article 29 or part II of this Convention that allows a contract of sale or its modification or termination by agreement or any offer, acceptance or other indication of intention to be made in any form other than in writing does not apply where any party has his place of business in a Contracting State which has made a declaration under article 96 of this Convention. The parties may not derogate from or vary the effect of this article.” Article 96 relates to provisions for continuation of a Contracting State’s requirement that contracts be in writing.

<sup>13</sup> Enderlein, *op. cit.*

<sup>14</sup> Article 7 has been discussed at length in paragraphs 2.7.1.1 and 2.7.1.2 in Chapter 2 of this dissertation.

<sup>15</sup> Enderlein, *op. cit.*

not stipulate the necessary provisions themselves. Therefore, it can be concluded that the basis for the relations between the parties is their contract. In reference to Article 30 again, it appears that emphasis is placed on the requirements of the contract, while those of the Convention are only supplementary.<sup>16</sup>

As an illustration, in the case of *Wolfram R. Seidel GMBH, Crotton S.A.*<sup>17</sup> a German buyer and a Spanish seller entered into an agreement for the sale of cars. The agreement provided that the seller would deliver the goods to Dubai, while the buyer would pay for the price and transportation costs before the goods were to be delivered. The agreement also provided that the buyer would subsequently sell the goods to its own customers in the Middle East. Before delivery, the seller became aware that the buyer's customer was probably planning to resell the goods in Japan, where the seller already had an exclusive distributor. The seller therefore notified the buyer that it would not deliver the goods. The buyer then asked the seller to fulfil its obligations, but the seller refused to do so.

However, the seller returned the entire amount paid by the buyer for the goods minus € 257.12 for bank costs. The buyer then filed a suit for the outstanding amount, plus interest. It also claimed for loss of profits as a result of its inability to resell the goods to its own customer, as well as legal fees. In doing so, the buyer argued that it had fulfilled all of its obligations under the contract and that it had no obligation to guarantee that its customer would not resell the goods outside the region.

On its part, the seller asserted that the buyer had breached its obligation to resell the goods exclusively to parties in the Middle East and that such behaviour amounted to an

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<sup>16</sup> *Ibid.*

<sup>17</sup> The case was decided by the Court of First Instance, n 3 Badalona, Spain on 22 May 2006. Retrieved on 12 November 2010 from <<http://www.unilex.info/case.cfm?id=1145>>.

anticipatory breach of contract. As a result, the seller alleged that it was no longer bound to pay interest, nor the remaining € 257.12 which had been withheld for bank costs.

The Court found CISG to be applicable since both Spain and Germany are Contracting States (by virtue of Article 1(1) of the CISG) and that a contract had been formed in accordance with Article 23 of the CISG. As to the merits, the Court found that the buyer had not committed any anticipatory breach because its obligation was only to deliver the goods to a subsequent customer in the Middle East, and not to control where the customer was going to resell the goods. Moreover, the Court found that the contract at hand was neither a distributorship contract, nor an instalment contract governed by Art. 73(2) CISG, since it had been agreed that there would be only one delivery of the goods. Thus, the seller could not avoid the contract by claiming for an anticipatory breach by the buyer.<sup>18</sup>

The Court also found that, since the buyer had fulfilled its obligations while the seller had breached its obligation to deliver the goods, the buyer was entitled to declare the contract avoided (Article 49(1)(a) CISG) and consequently to receive damages under Article 45 CISG, as well as those provided for by Arts. 74 – 77 CISG. The Court first found that the buyer had the right to recover the amount it had previously paid to the seller, as required by Article 81(2) CISG, together with interest on that amount, as per Article 84(1) CISG. The Court further awarded the buyer legal fees as well as loss of profits (Article 74 CISG) calculated as the difference between the purchase price and the price agreed upon by the buyer and the subsequent customer.<sup>19</sup>

In respect of the seller's obligation under Article 30 to hand over the relevant documents to the buyer, the Commission for the Protection of Foreign Commerce of Mexico

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<sup>18</sup> *Ibid.*

<sup>19</sup> *Ibid.*

(COMPROMEX) decided in the case of *Preserves the Costena SA de CV v. Lanis San Luis SA & Agro-industrial Santa Adela SA*<sup>20</sup> that the seller should have provided the buyer with all documents (invoices) corresponding to the amount and value of the goods paid for by the buyer and failing to do so amounted to a breach of contract by the seller. The Commission further held that the seller should pay to the buyer a sum equal to the price paid for the goods due to the goods deterioration, and provide the buyer with invoices expressing the correct value of the transaction.<sup>21</sup>

It is perhaps obvious that the main obligations of the seller, namely, delivering the goods and transferring property in the goods are essential in all legal systems, only the manner on how the goods are to be delivered and the transfer of property occurs may be different. It has to be borne in mind that there is no sale without delivery and transfer of property. However, The CISG does not go into detail with regard to the transfer of property in the goods, in fact it is silent on the matter. It does not designate when the property passes, nor what has to be done in order to let property in the goods pass. Therefore, the effect of the contract in relation to the property in the sold goods is, according to Article 4, outside the scope of the Convention. It is entirely left to national law to decide on the matter.<sup>22</sup>

#### **4.2.2 Place of Delivery - Article 31**

Article 31 deals with the place of delivery and specifies what the seller has to do to in order to fulfil his obligation with regard to delivery. The place of delivery is usually agreed to by the parties and it is therefore the reason that Article 31 begins with the phrase “If the seller is not bound to deliver the goods at any other particular place...” The parties to the sale contract quite seldom fail to agree on the place of delivery since the place of the delivery

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<sup>20</sup> Case number M/21/95 decided on 29.04.1996. Retrieved on 12 November 2010 from <<http://www.unilex.info/case.cfm?id=258>>.

<sup>21</sup> *Ibid.*

<sup>22</sup> Enderlein, *op. cit.*

of the goods is generally decisive of other factors, usually the passing of risk. More often than not, the parties agree on the place of delivery by referring to the clauses of the Incoterms.<sup>23</sup>

If the parties did not agree on the place of delivery, the obligation of the seller to deliver is fulfilled if he hands over the goods to the first carrier.<sup>24</sup> Article 31 mentions the first carrier as there are usually several carriers involved in international sales. For the purpose of Article 31, a single carrier is also the first carrier if there are no subsequent carriers involved.<sup>25</sup> In a case decided by the Commercial Court of the Canton of Zurich, Switzerland,<sup>26</sup> it was held that the buyer was not entitled to recover damages for non-performance (Article 45(1)(a) CISG), because the seller had delivered the goods in time to the carrier under Article 31 CISG, and, in the absence of a contractual obligation to carry out the freight, the seller was not liable for the carrier's failure to perform its obligations under the contract of carriage (Article 79 (2) CISG).<sup>27</sup> It is also important to note that a contract of sale does not necessarily involve a contract of carriage, for example, if the goods are already with the buyer.<sup>28</sup> The seller's obligation to deliver the goods also includes an element of time – he has performed the delivery only if he has delivered the goods to a certain place and at a certain time.<sup>29</sup>

In relation to the delivery of the goods, it must also be noted that the place of delivery should not be mistaken for the place of destination. The seller is considered as having delivered the goods after having handed them over to the first carrier, and not at a later date

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<sup>23</sup> *Ibid.*

<sup>24</sup> Article 31(a): "if the contract of sale involves carriage of the goods – in handing the goods over to the first carrier for transmission to the buyer."

<sup>25</sup> Enderlein, *op. cit.*

<sup>26</sup> Case No: HG 970238.1. Decided on 10.02.1999. Retrieved on 17 November 2010 from <<http://www.unilex.info/case.cfm?id=484>>.

<sup>27</sup> *Ibid.*

<sup>28</sup> The goods can be considered as already with the buyer if, for instance, it is a machine which was originally on lease or if the buyer himself goes to the seller and takes possession of the goods.

<sup>29</sup> Enderlein, *op. cit.* Time of delivery will be discussed in Article 33 of the CISG.

when the goods have been transported by the carrier or carriers to the place of destination where the buyer is to take delivery of the goods.<sup>30</sup> Thus, if the seller has to arrange for carriage, the place of delivery of by the seller and the place of taking delivery by the buyer may well be at different places. It must be borne in mind that the place of destination is significant in view of the buyer's obligation to examine the goods.<sup>31</sup> Occasionally, the place of delivery and the place of destination are identical, as in the case of an "ex-ship" delivery clause.<sup>32</sup>

If the contract of sale does not involve carriage of the goods, the seller's obligation to deliver will then fall under Article 31(b) which states that "if, ... the contract relates to specific goods, or unidentified goods to be drawn from a specific stock or to be manufactured or produced, and at the time of the conclusion of the contract the parties knew that the goods were at, or were to be manufactured or produced at, a particular place, in placing the goods at the buyer's disposal at that place."<sup>33</sup>

Finally, if both situations in sub-paragraph (a) and (b) do not apply, the seller's obligation to deliver will be under sub-paragraph (c), which is, "... placing the goods at the buyer's disposal at the place where the seller had his place of business at the time of the conclusion of the contract." An important factor to note with regard to Article 31 is that, once the seller has delivered the goods, he is considered to have fulfilled his delivery obligation towards the buyer as the Convention makes no mention of delivery of goods which has to

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<sup>30</sup> Enderlein, op. cit.. See Article 60 of CISG.

<sup>31</sup> *Ibid.* See Article 38(2) of CISG.

<sup>32</sup> *Ibid.* An "ex-ship" delivery clause or "Delivery Ex Ship (DES) means that the seller delivers when the goods are placed at the disposal of the buyer on board the ship not cleared for import at the named port of destination. The seller has to bear all the costs and risks involved in bringing the goods at the named port of destination before discharging. This term can only be used when the goods are to be delivered by sea or inland waterway or multimodal transport on a vessel in the port of destination. Retrieved on 17 November 2010 from <[www.iccwbo.org/incoterms/preambles/pdf/DES.pdf](http://www.iccwbo.org/incoterms/preambles/pdf/DES.pdf)>.

<sup>33</sup> The place where the goods have to be placed at the buyer's disposal could be, for example, a factory, a mill, a plantation or a warehouse.

conform to the contract. Thus, the delivery of non-conforming goods is nevertheless considered a delivery under the Convention but the buyer caught in this predicament has recourse to several other remedies.<sup>34</sup>

#### **4.2.3 Time for Delivery - Article 33<sup>35</sup>**

In Article 33, it is stipulated that, “The seller must deliver the goods: (a) if a date is fixed by or determinable from the contract, on that date”. In this regard, the parties will usually agree on the time of delivery in their contract. This again is the result of party autonomy given by the Convention to the contracting parties. A date is determinable from the contract if the language used by the parties makes it possible to determine a date by recourse to external evidence.<sup>36</sup> Thus, a provision requiring delivery to be made 10 days after completion of a specified stage in the construction of the goods would make the date determinable. Similarly, a date of delivery fixed by reference to when a named ship reaches a named port would be determinable, notwithstanding the fact that the ship might never reach the port.<sup>37</sup>

On the contrary, provisions requiring that the seller should deliver “as soon as possible” or “promptly” would not fall within Article 33 (a) as it is impossible to determine a date with any certainty from the contract. Further, if a date has been fixed by the contract or is determinable from it, delivery must be made precisely on that date. The buyer is not obliged to take delivery of goods delivered before the date on which delivery is due.<sup>38</sup>

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<sup>34</sup> Enderlein, *op. cit.* The remedy of the buyer for non-conformity of the goods is contained in Article 50 of CISG.

<sup>35</sup> Article 32 on the obligations of the seller in respect of carriage of goods will not be discussed in this chapter.

<sup>36</sup> Huber, P, and Mullis, A, *The CISG, A New Textbook for Students and Practitioners*, (Munich, Germany: Sellier. European Law Publishers, 2007), 122-123.

<sup>37</sup> *Id.* at 123.

<sup>38</sup> *Ibid.* On the early delivery of the goods, see Article 52(1) of CISG where it states that “If the seller delivers the goods before the date fixed, the buyer may take delivery or refuse to take delivery.”

Alternatively, the time of delivery can also be determinable from the contract if it follows from established practices or usages impliedly made applicable.<sup>39</sup> The CISG, by virtue of Article 9, recognises any usage and practices which the parties have established among themselves.<sup>40</sup> In a case decided by the Supreme Court of Austria,<sup>41</sup> it was held that although the CISG does not deal with the validity of usages in Article 4, it does deal with the application of usages in Article 9. The Court stated that a local usage need not be internationally accepted. The Court further stated that in order to be considered widely known and regularly observed in international trade as per Article 9(2) of the CISG, a usage has to be recognised by the majority of the people acting in the trade concerned. Furthermore, a party knew or ought to have known of a particular usage if the party either had its place of business in the geographical area where the usage was applicable, or if the party permanently deals within the area where the usage is applicable.<sup>42</sup>

Article 33 (b) stipulates that the seller must deliver the goods “if a period of time is fixed by or determinable from the contract, at any time within that period unless circumstances indicate that the buyer is to choose a date.” In principle, what the Article means is that it is for the seller to choose when during the period that he wishes to deliver. Therefore, if the seller delivered all the goods on the first or last day of a delivery period, the buyer could not refuse to take delivery.<sup>43</sup> Article 33(b), also states that the circumstances may indicate that the buyer is to choose a date, where, if that is the case, the buyer may require the seller

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<sup>39</sup> Enderlein, *op. cit.*

<sup>40</sup> Article 9 of the CISG.

(1) The parties are bound by any usage to which they have agreed and by any practices which they have established between themselves.  
(2) The parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract or its formation a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by parties to contracts of the type involved in the particular trade concerned.

<sup>41</sup> Case number 10 Ob 344/99g decided on 21.3.2000. Retrieved on 17 November 2010 from <<http://cisgw3.law.pace.edu/cases/000321a3.html>>.

<sup>42</sup> *Ibid.*

<sup>43</sup> Huber and Mullis, *op. cit.*, 123.

to deliver on any date during the specified period. However, it has been suggested that such a conclusion should not be lightly drawn as the absence of an express term giving the buyer the right to choose the date of delivery, it will be rare that the circumstances will include that the buyer has the right to choose.<sup>44</sup> If the buyer wants to have an option to choose a date for delivery during a specified period, he should stipulate for it and if he fails to do so, a court should not be readily treat the general rule as having been displaced. The mere fact that delivery is effected by placing the goods at the buyer's disposal (for instance under Article 33(b) and (c)), so that it is for the buyer to collect the goods, is not, of itself, enough to indicate that the buyer has the right to choose a date of delivery.<sup>45</sup>

Where the contract provides a period during which delivery is to be made but the buyer is to choose the delivery date, the seller will normally need notice of that date in time to prepare the goods for shipment and, if he is obliged by the contract to do so, to make the necessary contract of carriage. In many contracts, there will be an express provision requiring the buyer to give the seller a specified number of days notice. In the absence of an express provision to that effect, the buyer must give the seller a reasonable period of time do to so.<sup>46</sup>

When no time is fixed for delivery, Article 33(c) requires the seller "in any other case" to deliver within a reasonable period of time after the conclusion of the contract. Notwithstanding the words "in any other case" in Article 33(c), there may be circumstances where a provision in the contract as to the time of delivery does not fall within the provisions of Article 33(a) or (b), yet it does not also fall within the ambit of

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<sup>44</sup> Huber and Mullis, *op. cit.*, 124. However, where the parties have contracted by reference to certain trade terms, for example, the FOB (Free on Board) term under the Incoterms, the right to choose the date of delivery may be placed on the buyer.

<sup>45</sup> *Ibid.*

<sup>46</sup> Huber and Mullis, *op. cit.*, 124-125.

Article 33(c).<sup>47</sup> For instance, provisions requiring the seller to deliver “promptly”, ‘as soon as possible” or “immediately” probably do not fall within either Article 33(a) or (b) of the CISG as they express an intention that delivery should be made sooner than within a reasonable period of time after conclusion of the contract. Such terms should, it is argued, be treated as derogating from the provisions of Article 33 of CISG and should be interpreted in such a way as to give effect to the parties’ intentions.<sup>48</sup>

Article 33(c) demands that the seller to deliver “within a reasonable time after the conclusion of the contract” but one of the drawbacks of the CISG is that, despite the rather frequent usage of words such as “reasonable”, “usual”, “adequate” and “appropriate”, these words are not defined in the Convention itself. Therefore, what is a reasonable period of time is a question of fact to be determined by taking account of all the relevant circumstances of the case and by weighing the interests of both parties without giving preference to the seller’s interests.<sup>49</sup> Amongst the circumstances that may be considered relevant to the issue of what is a reasonable period of time are – the nature of the goods sold; whether the goods are to be manufactured or are already in stock; the purpose for which the buyer requires the goods and whether the seller has to acquire the goods from his supplier.<sup>50</sup>

Where Article 33(c) applies, the seller is not usually bound to deliver on any specific date. He is considered to have performed his obligation of timely delivery if he delivers at any time after the conclusion of the contract but before the expiration of a reasonable period of

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<sup>47</sup> *Id.* at 125.

<sup>48</sup> *Ibid.*

<sup>49</sup> *Ibid.* It must be noted that in none of these cases is it possible to ascertain a definite date on which delivery must be made.

<sup>50</sup> Huber and Mullis, *op. cit.*, 125-126.

time. In other words, in the usual case, Article 33(c) allows the seller a period of time within which he may deliver and still comply with the obligation of timely delivery.<sup>51</sup>

#### **4.2.4 Documents Relating to the Goods - Article 34**

Contracts for the international sale of goods commonly make provision for the tender of documents and the tender of such documents is often a condition of obtaining payment. The first part of Article 34 stipulates that “If the seller is bound to hand over documents relating to the goods, he must hand them over at the time and place in the form required by the contract.” It appears from the wordings of Article 34 that there is no flexibility in terms of the time and place to hand over the documents, unlike the provisions relating to the time, place and delivery of the goods in Article 33. Yet again, the contract is dominant.

The seller is not bound to hand over documents in all cases; in fact the Convention does not oblige the seller to hand over documents at all. If the seller is bound by the contract directly, by the chosen clause of the Incoterms or by past usages, then, he must comply with the terms of the contract or such clauses and usages with regard to the kind of documents, their form, and also the time and place for handing the documents over.<sup>52</sup> Furthermore, Article 34 does not even define “documents relating to the goods”.

On the contrary, since Article 34 merely states, in essence, that the seller must perform such documentary obligations as he undertook, it is argued that there is no practical need to precisely define the meaning and phrase “documents relating to the goods”. Distinguishing such documents from documents that the seller must tender but which do not relate to the goods becomes unnecessary since with respect to both types of documents, the seller must

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<sup>51</sup> *Id.* at 126.

<sup>52</sup> Enderlein, *op. cit.*

comply with such obligations that he undertook. There are no additional obligations imposed by Article 34 with respect to documents which relate to the goods that are not imposed with respect to documents that do not relate to the goods.<sup>53</sup>

In the case of *GmbH Lothringer Gunther Grosshandelsgesellschaft für Bauelemente und Holzwerkstoffe v. NV Fepco International*,<sup>54</sup> a Belgian seller and a German buyer entered into a contract for the supply of construction materials. The contract was exclusively regulated by the seller's standard terms which also provided for payment by “cash against documents (B/L)”. The buyer did accept partial deliveries of the goods and with respect to delivery without original documents, the Court affirmed that Article 34 of the CISG had not been breached since the buyer had paid for several deliveries without objecting to the fact that documents had not been handed over. Furthermore, since the buyer had requested to take delivery of only part of the goods, the seller could do nothing else but hand over a delivery order instead of the bill of lading (B/L), as provided for under the contract.<sup>55</sup>

Examples of documents that the seller may have to tender under the contract are - bills of lading or other documents which by law or trade usage give the possessor of the document a right to have the goods delivered to him; notices or declarations of appropriation or shipment;<sup>56</sup> certificates and policies of insurance; commercial and consular invoices; certificates of origin, quality, quantity, weight and phyto-sanitary health and also export and import licences. However, in accordance with the wordings of Article 34, what are the

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<sup>53</sup> Huber and Mullis, *op. cit.*, 127.

<sup>54</sup> Case number 2002/AR/2087. Decided on 24 April 2006, The Appellate Court, Antwerp, Belgium. Retrieved on 17 November 2010 from <<http://cisgw3.law.pace.edu/cases/060424b1.html>>.

<sup>55</sup> *Ibid.*

<sup>56</sup> They will usually be made the subject of a separate obligation by the contract and will usually be tendered before the “shipping documents” must be tendered.

documents that must be delivered in any particular case depends upon the terms of the contract, previous course of dealings and trade usage.<sup>57</sup>

The time at which any documents relating to the goods must be handed over is frequently made the subject of an express provision in the contract. Furthermore, an obligation to deliver any document by a particular time may be implied from the circumstances, for instance, from the payment terms. Similarly, if the seller's obligation to deliver consists in placing the goods at the buyer's disposal on a particular date, the necessary documents should be tendered in sufficient time to enable the buyer to take delivery of the goods on that date.<sup>58</sup> Where neither the contract nor the circumstances indicate the time by which the documents must be handed over, it is suggested that the seller must take steps to hand them over "as soon as possible" after the goods have been shipped,<sup>59</sup> or (in case of goods sold afloat) after the seller has "destined the cargo to the particular vendee or consignee."<sup>60</sup>

With regard to the place for handing over the documents, where there is an express provision as to the place of handing them over to the buyer, then the seller must hand the documents over at that place. If there has been no specific agreement on a place of delivery, it may nevertheless be possible to identify one from the circumstances, such as by reference to the contractually agreed method of payment. Thus, if payment is to be made by documentary credit through a bank in the seller's country, the place of handing over is likely to be the premises of the bank. In the usual case, however, the place of delivery of the documents will be the buyer's place of business<sup>61</sup>

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<sup>57</sup> Huber and Mullis, *op. cit.*, 127-128.

<sup>58</sup> *Id.* at 128.

<sup>59</sup> *Ibid.* This is also the position under the English law (*C. Sharpe & Co. Ltd. v Nosawa* [1917] 2 K.B. 814) and the Uniform Commercial Code (UCC s.2-320(2)(e) which requires that documents be tendered with "commercial promptness").

<sup>60</sup> *Ibid.* Citing *Sanders Bros. v Mclean Co.* (1883) 11 Q.B.D. 327.

<sup>61</sup> Huber and Mullis, *op. cit.*, 128-129.

On a final note, if the seller has handed over documents before the relevant time, he may, up to that time, cure any lack of conformity in the documents only if the exercise of this right does not cause the buyer unreasonable inconvenience or unreasonable expense.<sup>62</sup> However, the buyer would still retain any right to claim damages as provided for in the Convention.<sup>63</sup>

#### **4.2.5 Conformity of the Goods and Third Party Claims – Articles 35 to 44<sup>64</sup>**

This section of the Convention explains about conformity of the goods and third party claims with regard to the goods. In essence, Articles 35 and 36 explain the seller's obligations with respect to the quality of the goods whilst Articles 41 and 42 contain the seller's obligations relating to the delivery of goods which are free from rights of third parties. This section further contains obligations of the buyer such as his obligation to examine the goods in Article 38 and to notify the seller of any non-conformity of the goods in Article 39 or of any third party claim over the goods in Article 43.

Article 35(1) requires that “The seller must deliver the goods which are of the quantity, quality and description required by the contract and which are contained or packaged in the manner required by the contract.” From the phrasing of Article 35, it can be seen yet again, in particular circumstances, how the Convention stresses on the importance of the contract between the parties. It is also evident that under national law, the seller must deliver goods in accordance with the contract. Article 35 differs from certain national laws in its combination of quantity, quality and description with respect to non-conformity of the

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<sup>62</sup> See Article 34 of the CISG, second sentence.

<sup>63</sup> See Article 34 of the CISG, third sentence.

<sup>64</sup> Third party claims will not be discussed in detail in this chapter, only Article 41 will be briefly explained with regard to the subject matter.

goods. Therefore, the obligation of the buyer to give notice of any non-conformity to the goods relates not only to quality but to quantity and description as well.<sup>65</sup>

In a case decided by the Arnhem Court of Appeal of the Netherlands,<sup>66</sup> a Dutch buyer and a German seller entered into negotiations for the supply of a mixture of potting soil which would contain, among others, an ingredient named clay “Baraklei”. The seller then forwarded an offer for a mixture of potting soil at the price of €49.00 per m<sup>3</sup>, which the buyer rejected. In his offer, the seller stated that the mixture of potting soil would contain 3% clay. Soon afterwards, the seller faxed another offer at the price of €41.74 per m<sup>3</sup>, stating that the mixture would possess “40 kg clay per m<sup>3</sup>” and the buyer accepted. The seller supplied the buyer with seven subsequent deliveries; and on each delivery, the buyer was provided with a note specifying that the soil mixture contained 3% of the clay “Baraklei”. Two months after the first delivery, the buyer notified the seller that the soil delivered did not comply with the contract since it did not contain the contracted amount of clay (“40 kg clay per m<sup>3</sup>). Additionally, the buyer complained that the soil had caused damage to its plants.

The Court of Appeal in confirming the Court of First Instance’s decision found that, under Article 35(1) of the CISG, the seller is under a contractual obligation to provide the buyer with goods conforming to the quantity, quality and description stated in the contract. Nonetheless, the Court found that the buyer should have known from the first delivery that the quantity of clay contained in the goods delivered was other than that agreed upon, since

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<sup>65</sup> Enderlein, *op. cit.*

<sup>66</sup> Case number 2005/1005 decided on 18 July 2006. Retrieved on 28 November 2010 from <[www.unilex.info/case.cfm?id=1151](http://www.unilex.info/case.cfm?id=1151)>.

the buyer had signed the bill of receipt. Moreover, there was evidence to show that the buyer knew that the quantity of 3% was not equal to the quantity of “40kg clay per m<sup>3</sup>”.<sup>67</sup>

Consequently, the Court held that the buyer had lost its right to rely on the lack of conformity under Article 39(1) of the CISG, having failed to give notice thereof on or a few days after the first delivery, that is, after the time that the buyer became aware of or should have become aware of the non-conformity of the goods in question. In reaching this conclusion, the Court rejected the buyer’s argument that the reasonable time provided for by Article 39 within which notice of lack of conformity is to be given, has to run not from the time the buyer became or should have become aware of lack of conformity but only after it had discovered that the difference in the amount of clay would cause damage to its plantations.<sup>68</sup>

Conformity is then further described in Article 35(2) (subject to any agreement to the contrary) that the goods:

“(a) are fit for the purpose for which the goods of the same description would ordinarily be used;

(b) are fit for any particular purpose expressly or impliedly made known to the seller at the time of the conclusion of the contract, except where the circumstances show that the buyer did not rely, or that it was unreasonable for him to rely, on the seller’s skill and judgement;

(c) possesses the qualities of goods which the seller has held out to the buyer as a sample or model;

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<sup>67</sup> *Ibid.*

<sup>68</sup> *Ibid.*

(d) are contained or packaged in the manner usual for such goods or, where there is no such manner, in a manner adequate to preserve and protect the goods.”

However, it has been suggested that the most common requirement for the quality of goods is under Article 35(2)(a) where the goods should be “fit for the purposes for which goods of the same description would ordinarily be used.”<sup>69</sup> Additionally, under Article 35(3), the seller would not be in breach of paragraphs (a) to (d) for any lack of conformity of the goods if at the time of the conclusion of the contract the buyer knew or could not have been unaware of such lack of conformity.

Within the sphere of international sales, with regard to the question of whether there is a prerequisite under Article 35(2)(a) that the goods exported should meet the requirements of the importing country where that is the place the goods will subsequently be marketed and sold, there has been some confusion on the matter.<sup>70</sup> On the one hand, in a case decided by the Federal Supreme Court of Germany,<sup>71</sup> it was considered that it was not reasonable to expect a seller to know what local requirements are, and as such, there was no breach of Article 35(1) and Article 35(2) if the goods are acceptable in some countries but not the importing state. It was ruled in this case that the fact that the mussels sold to the buyer’s country contained cadmium levels exceeding the recommendations of the buyer’s country health regulations did not mean the mussels failed to conform to the requirements.<sup>72</sup>

On the other hand, in a case decided by the District Court of Darmstadt, Germany,<sup>73</sup> a seller who delivered video recorders to a Swiss buyer with instructions only in German and

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<sup>69</sup> Enderlein, *op. cit.*

<sup>70</sup> Chuah, J, *Law of International Trade: Cross-Border Commercial Transactions*, 4<sup>th</sup> ed., (London: Thomson Reuters, 2009), 158.

<sup>71</sup> Case number VIII ZR 159/94 decided on 08 March 1995. Retrieved on 28 November 2010 from <<http://cisgw3.law.pace.edu/cases/950308g3.html>>.

<sup>72</sup> *Ibid.*

<sup>73</sup> Case number 10 O 72/00 decided on 09 May 2000. Retrieved on 28 November 2010 from <<http://cisgw3.law.pace.edu/cases/000509g1.html>>.

not in other languages spoken in Switzerland was held to have delivered non-conforming goods.<sup>74</sup> It can be argued that the difference lies very much in what is reasonable under the circumstances and what is known to the seller.<sup>75</sup> In the latter case, it was reasonable that, given the close proximity between the German seller and the Swiss buyer, the seller would know that instructions should be provided in the main languages spoken in Switzerland. On the other hand, it was not reasonable to expect the seller in the earlier case to know what the local health requirements were.<sup>76</sup>

As can be observed in Article 35, lack of conformity comprises quality as well as quantity and description. However, the decisive time for determining whether or not conformity exists can be found in Article 36. Article 36 (1) states that “The seller is liable in accordance with the contract and this Convention for any lack of conformity which exists at the time when the risk passes to the buyer, even though the lack of conformity becomes apparent only after that time.” In other words, Article 36(1) lays down the general rule that the seller is liable for a lack of conformity that exists at the time the risk passes to the buyer.<sup>77</sup> Therefore, the relevant time is the time when the loss of conformity comes into existence, not the time it is discovered or indeed, the time when it ought to have been discovered. Evidence showing the lack of conformity at the time the risk passes is therefore critical. It thus becomes imperative to also ascertain who bears the burden of proof. Unfortunately, there is no guidance on how best to resolve this issue.<sup>78</sup>

In the practice of international trade, there is considerable difficulty with regard to evidence connected with the time of passing of the risk. Risk usually passes when the

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<sup>74</sup> *Ibid.*

<sup>75</sup> Chuah, *op. cit.*, 159.

<sup>76</sup> *Ibid.*

<sup>77</sup> The Convention deals with the passing of risk in Articles 66 to 70.

<sup>78</sup> Chuah, *op. cit.*, 159.

seller hands over the goods to the first carrier, as stipulated in Article 67 of the Convention. For instance, under the FOB (Free on Board) clause, the risk passes when the goods have effectively passed the ship's rail but in practice, it is rare that anyone ever inspects the goods at that very moment. Only in rare cases does the carrier detect irregularities or defects of the packaging or discover, when tallying the consignments that items are missing.<sup>79</sup> In most cases, the buyer will detect any apparent defect only at the time of taking over the goods, and more often than not, the buyer will only detect any latent defect only after a thorough examination of the goods or not until after the goods have been used.

The situation in which the lack of conformity becomes apparent only after the risk has passed to the buyer is covered under Article 36(1). Nevertheless, even in these cases, the buyer must prove that the lack of conformity already existed at the time of passing of the risk.<sup>80</sup> However, there is no such requirement in Article 36(2). Article 36(2)<sup>81</sup> explains that the seller is liable to the buyer even after risk has passed in two situations, namely, where, one, the seller has given a guarantee and the other even without having issued a guarantee, the seller has committed a breach of any of his obligations, for instance, failure to package the goods in a manner which preserves and protects them.<sup>82</sup>

Article 37 can be understood as not an obligation of the seller but one of his rights as it concerns the cure of defects before the date of delivery.<sup>83</sup> As can be observed earlier in

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<sup>79</sup> Enderlein, *op. cit.*

<sup>80</sup> *Ibid.*

<sup>81</sup> Article 36(2): "The seller is also liable for any lack of conformity which occurs after the time indicated in the preceding paragraph and which is due to a breach of any of his obligations, including a breach of any guarantee that for a period of time the goods will remain fit for their ordinary purpose or for some particular purpose or will retain specified qualities or characteristics."

<sup>82</sup> Enderlein, *op. cit.*

<sup>83</sup> *Ibid.* Article 37 stipulates that "If the seller has delivered goods before the date of delivery, he may, up to that date, deliver any missing part or make up any deficiency in the quantity of the goods delivered, or deliver the goods in replacement of any non-conforming goods delivered or remedy any lack of conformity in the goods delivered, provided that the exercise of this right does not cause the buyer unreasonable inconvenience or unreasonable expense. However, the buyer retains any right to claim damages as provided for in this Convention."

Article 33<sup>84</sup>, the date for delivery of the goods may be at the very beginning or within a period of time. If the seller has chosen a date for delivery at the beginning of the period, he may cure any non-conformity up to the end of the period. It seems that the seller has the same right even if the buyer has chosen a date within the agreed period. The buyer's choice of a specific date does not change the originally agreed period of time of delivery by the seller.<sup>85</sup>

It is suggested that the right to cure non-conformity under Article 37 comprises four different possibilities which could appear singly as well as combined.<sup>86</sup> Firstly, the seller may deliver any missing part of the goods, for example of a machine; secondly, the seller may make up for any deficiency in the quantity of the goods delivered; the third method is for the seller to deliver goods in replacement of the non-conforming goods delivered earlier (but whether or not the goods conforms to the contract has to be judged in accordance with Article 35) and finally, the seller could cure non-conformity is to remedy any lack of conformity in the goods delivered. To remedy in this sense means to repair the defective goods or part of the goods either at the seller's or buyer's place of business, whichever is more convenient, effective and less expensive. Whatever the case is, it has to be borne in mind that curing non-conformities to the goods should never cause the buyer any inconveniences or expenses that are unreasonable.<sup>87</sup>

The buyer has a duty to examine the goods as provided for in Article 38 of the Convention. Article 38(1) specifies the time for examination where "The buyer must examine the goods, or caused them to be examined, within a short period as is practicable in the

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<sup>84</sup> Refer to paragraph 4.2.3, *supra*.

<sup>85</sup> Enderlein, *op cit*. The issue of premature delivery of the goods is also provided for in Article 52(1) of the Convention, where the buyer has a choice of whether to take or refuse delivery.

<sup>86</sup> Enderlein, *op cit*.

<sup>87</sup> *Ibid*.

circumstances.” It is argued that Article 38 is not independently sanctioned as the duty to examine the goods in the Article is necessary for determining when a non-conformity ought to have been discovered, and thus triggering the application of Article 39.<sup>88</sup> Article 38, therefore, prescribes a duty for the buyer to inspect the goods delivered to him within a short period. The purpose of the provision is to familiarise the buyer with any defects, and thus, via Article 39, compel him to notify the seller, enabling the seller to remedy a lack of conformity by delivering missing or substitute goods, repairing, or in some other way reducing the buyer’s loss.<sup>89</sup>

Accordingly, Article 38 is prefatory to Article 39 and it establishes a time when a buyer ought to have discovered a non-conformity and thus establishes the moment from which Article 39 timeframe is to be measured. It also ultimately launches the possibility for the drastic sanction of Article 39, namely, a total loss of remedies, to the buyer.<sup>90</sup> Article 38 is peculiar in a sense that it uses the timeframe term “within as short a period as practicable”, a parameter which is not used elsewhere in the Convention. Nevertheless, it is the practicability of the term which lends an understanding of the fact that it is tailored to the individual practical facts of each case in the determination of its extent.<sup>91</sup>

In case law, permitted timeframes for examination vary. Some are rather straightforward, on the one hand, where the goods were examined on the same day as they were delivered was held to be satisfactory by the court<sup>92</sup> and on the other, where textiles which lay unexamined for two months before the buyer looked at them were found to be

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<sup>88</sup> Andersen, Camilla B, “The Duty to Examine Goods under the Uniform International Sales Law – An Analysis of Article 38 CISG.” [2007] EBLR 797-814, at 797-798. Article 39(1) states that “The buyer loses the right to rely on lack of conformity of the goods if he does not give notice to the seller specifying the nature of the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it” and it will be discussed later in this chapter.

<sup>89</sup> Andersen, [2007] *op. cit.*, 798.

<sup>90</sup> *Ibid.*

<sup>91</sup> Andersen, [2007] *op. cit.*, 799.

<sup>92</sup> *Id.* at 801. Citing a case from Germany, Landericht Aachen of 03.04.1990 [41 0 198/89].

unsatisfactory by the court.<sup>93</sup> Different considerations were also taken into account by the courts, for instance, in cases involving immediately discernable non-conformities<sup>94</sup> and of those where there is no easily discernible non-conformities to the goods,<sup>95</sup> where different timeframes may be applied. Further, where the defect is very specific, the examination period will be similarly specific. In a Spanish case from Coruna,<sup>96</sup> the time for examination of rainbow trout eggs were detailed very thoroughly by determining that the virus infection in question had a seven day incubation period, and that an infestation could be discerned two to seven days after this time, therefore allowing a maximum of fourteen days for discovery of the non-conformity.<sup>97</sup>

Efforts at setting up fixed guidelines and uniformity in fixing the timeframe in Article 38 have been plagued with problems such as where the courts attempt to set up guidelines for determining timeframes without influence from or regard to other jurisdictions<sup>98</sup> and also in tendencies of buyer friendliness from domestic law.<sup>99</sup> However, a case decided by the Austrian Supreme Court<sup>100</sup> commented that: “Primarily relevant for the type of examination are the agreements between the parties. In the absence of any such agreements, the required manner of examination can be gleaned from trade usages and

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<sup>93</sup> *Ibid.* Citing another case from Germany, Oberlandesgericht Dusseldorf of 10.02.1994 [6U 32/193].

<sup>94</sup> See *Chicago Prime Packers, Inc. v Northam Food Trading Co., et al.* Case number 01 C 4447 decided by the United States Federal District Court on 21 May 2004. Retrieved on 6 December 2010 from <<http://cisgw3.law.pace.edu/cases/040521u1.html>> where the goods in question are frozen ribs that had turned green, slimy and smelly and the fact that they were frozen should not detract from the fact that the buyer should thus have discovered it almost immediately when able.

<sup>95</sup> See *EP S.A. v FP Oy*, case number S 96/1215 decided by the Helsinki Court of Appeal on 30 June 1998. Retrieved on 6 December 2010 from <<http://cisgw3.law.pace.edu/cases/980630f5.html>>. The goods in this case are skin care creams where the sampling took two weeks to complete. In this type of cases, the period of time in Article 38 is normally added to the timeframe for examination of the goods.

<sup>96</sup> Case number 201/2001 decided by the Appellate Court Coruna on 21 June 2002. Retrieved on 6 December 2010 from <<http://cisgw3.law.pace.edu/cases/020621s4.html>>.

<sup>97</sup> *Ibid.*

<sup>98</sup> Andersen, [2007] *op.cit.*, 803.

<sup>99</sup> *Id.* at 809.

<sup>100</sup> Case number 1 Ob 223/99x decided on 27 August 1999. Retrieved on 6 December 2010 from <<http://cisgw3.law.pace.edu/cases/990827a3.html>>.

practices [...] a reasonable examination, which must be thorough and professional, must definitely take place.”<sup>101</sup> This case cites several home truths regarding Article 38, namely, the burden of proof is on the buyers, the duty to examine encompasses the duty for a specialist examination and, most importantly, the hierarchy of the CISG as evidenced in Article 6 (on primacy of the contract) and Article 9 (on usages and practices applicable to the contract) as it influences examination by prioritising the contract and trade usage over Article 38 itself.<sup>102</sup> All things considered, it can be safely said that the contract can still reign supreme over a number of the provisions of the Convention.

Article 39 (1) reads “The buyer loses the right to rely on lack of conformity of the goods if he does not give notice to the seller specifying the nature of the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it.” Here, the Convention not only mention the time when the buyer has discovered lack of conformity but also the time when he ought to have discovered it. The time, at least as far as apparent defects are concerned, is when the buyer is obliged to examine the goods in accordance with Article 38.<sup>103</sup> The right of the buyer to rely on a lack of conformity of the goods lapses if he does not give notice to the seller within a “reasonable time”.

Article 39 can perhaps be considered as a draconian provision as the implication of not giving notice within a “reasonable time” would result in the buyer losing all his remedies under the Convention, which includes, the right to claim damages under Article 45(1); to require delivery of substitute goods under Article 46(2); to require repair under Article

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<sup>101</sup> *Ibid.*

<sup>102</sup> Andersen, [2007], *op. cit.*, 808-809.

<sup>103</sup> Enderlein, *op. cit.*. The relationship between Articles 38 and 39(1) has been explained in the preceding paragraph above.

46(3); to fix an additional period of time for performance under Article 47; to declare the contract avoided under Article 49 and to reduce the price under Article 50.<sup>104</sup>

The drastic effect of Article 39(1) can be seen in the judgment of the *Oberlandesgericht* (Higher Regional Court) of Hamburg, Germany<sup>105</sup> where, after examining, in the light of Article 8(2) of the CISG (with regard to interpretation of statements or other conduct of a party), the letters sent by the buyer to the seller, the Court concluded that they did not constitute a notification of lack of conformity and, therefore, the buyer had lost its right to rely on Article 39. Consequently, the buyer's assignees were not in a position to declare the contract avoided under Article 49(1)(a) for the purpose of claiming either reimbursement of the purchase price under Article 81(2) or a price reduction under Article 50. Nor could the contract clause according to which the seller was obliged to make the equipment (the goods in question) available in a ready for use condition be interpreted as a warranty for lack of defects and thereby as derogating from the requirements set out in Article 39.<sup>106</sup>

Nonetheless, despite its far-reaching consequences, "reasonable time" is not defined in Article 39(1). It has been suggested that of all the references to reasonableness in the CISG, the reference to "reasonable time" in Article 39(1) has captured the most judicial and arbitral attention. There are numerous reasons for this phenomenon, the most significant of which is probably the vagueness of the term, coupled with the fact that the criteria for determining this "reasonable" time period were never laid down in the Convention or in the *travaux préparatoires* (preparatory work) leading up to the

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<sup>104</sup> Enderlein, *op. cit.*

<sup>105</sup> Case number 12 U 39/100 decided on 25.01.2008. Retrieved on 7 December 2010 from <[www.unilex.info/case.cfm?id=1352](http://www.unilex.info/case.cfm?id=1352)>.

<sup>106</sup> *Ibid.*

Convention. It has thus been up to practitioners, scholars and jurists to determine what “within reasonable time” is.<sup>107</sup>

In a case decided by the *Landericht* (District Court) of Berlin, Germany<sup>108</sup> notice of non-conformity of the goods given by the buyer seven weeks after the goods were delivered was considered unreasonable by the Court. In reaching this conclusion, the Court observed that the period within which notice of non-conformity has to be given includes the period for the examination of the goods in Article 38 as well as that for the notice itself in Article 39. In the opinion of the Court, even if in the case at hand the defects could only be detected once the cloth had been dyed, the buyer should have dyed a sample of the cloth shortly after delivery. Consequently, even if the buyer gave notice to the seller immediately after it had actually discovered the non-conformity, an examination of the goods about seven weeks after delivery had to be considered untimely.<sup>109</sup>

In a case from Switzerland,<sup>110</sup> the Court decided that reasonableness depends on the circumstances of the case and the nature of the goods. In this case, which involves the sale of a certain quantity of clothes, the Court held that a period of one month could be considered as a reasonable time for giving notice of the non-conformity. Consequently, the Court found that the buyer had complied with its duty to examine the goods under Article 38(1) and to notify the seller of the lack of conformity within a reasonable time according to Article 39(1) only with reference to the thirteen items it had returned to the seller. With respect to the additional items it had complained were defective, the notice of non-

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<sup>107</sup> Andersen, Camilla B. (1998). “Reasonable Time in Article 39(1) of the CISG – Is Article 39(1) Truly a Uniform Provision?” Retrieved 29 November 2010 from <<http://www.cisg.law.pace.edu/cisg/biblio/andersen.html>>.

<sup>108</sup> Case number 103 O 213/02 decided on 21 March 2003. Retrieved on 7 December 2010 from <<http://www.unilex.info/case.cfm?id921>>.

<sup>109</sup> *Ibid.* This case seems to further reinforce the relationship between Articles 38 and 39 of the CISG.

<sup>110</sup> Case number O1Z 08 1 decided on 18 August 2008 by the Superior Court of the Canton of Appenzel Outer Rhodes. Retrieved on 6 December 2010 from <<http://www.unilex.info/case.cfm?id=1494>>.

conformity was untimely since it had been given seven months after the first notice of non-conformity.<sup>111</sup>

In addition to case law to determine the “reasonable time” in Article 39(1), it has also been argued that the contract and agreement between the parties is the most important aspect of their relations in the CISG regime, as the Convention serves only as a gap-filler.<sup>112</sup> Other criteria that may assist a practitioner is determining “reasonable time” include the perishable nature of the goods (such as foodstuff); their affiliation with a particular season (such as fashion goods) or any knowledge that a buyer may have which would require a speedy notice to the seller (such as a deadline for publication). Although the term “reasonable time” as it is defined today has proven too imprecise due to its flexibility without a uniform scale to assist practitioners in a uniform application of Article 39(1), a benchmark setting or vantage point where the factors of each individual case determine the precise notice time-frame seems a likely path towards an autonomous definition of “reasonable time.”<sup>113</sup>

And finally, under Article 41, the seller must deliver the goods free from any right or claim of a third party, unless the buyer agreed to take the goods subject to that right or claim.<sup>114</sup> The reason being, that the CISG only regulates the relations between the seller and the buyer, and not between the buyer and a third person. Whether or not it is possible for the buyer to acquire title as a *bona fide* purchaser is outside the scope of the Convention.<sup>115</sup>

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<sup>111</sup> *Ibid.*

<sup>112</sup> Andersen (1998), *op. cit.*

<sup>113</sup> *Ibid.*

<sup>114</sup> Article 41 further states that if such a right or claim is based on industrial property or other intellectual property, the seller’s obligation will then be governed by Article 42. However, Article 42, 43 and 44 will not be discussed as they are outside the scope of this chapter.

<sup>115</sup> Enderlein, *op. cit.*

### 4.3 Commercial Transactions – The *Shari'ah* Approach

#### 4.3.1 Introduction

Honesty in commercial dealings is said to be more strictly enjoined by Islam than by any other religion. It is because Islam is a religion which regulates and directs life in all its departments. It is not to be regarded, as a personal or private affair, which has no relation to his economic and political life. It is not merely a body of dogmas or a bundle of rites and rituals; it is a practical code which governs life in all its spheres. Its laws are as effectively operative in our commerce and politics as in our domestic life and social relations. Islam censures political chicanery and economic exploitation as strongly as social excesses and individual dishonesty. Indeed, a true Islamic society is based upon honesty, justice and fraternity, and is absolutely intolerant of dishonesty in all its various forms. That is the reason why perfect honesty in business and truthfulness in trade are much emphasised by the Holy Prophet (pbuh). It will not be an exaggeration to say that absolute honesty in business and commerce is really an Islamic concept. It was Prophet Muhammad (pbuh) who, on the one hand, urged his followers to adopt trade as their profession, and, on the other hand, exhorted them to observe truthfulness and honesty in their business transactions.<sup>116</sup>

Islam is most vehement in its condemnation of commercial dishonesty. It denounced, in the strongest possible terms, any manner of deceitful dealings and illegal profits. It has disallowed all transactions not based upon justice and fair play. The Holy Prophet (pbuh), while reprimanding the dishonest dealer, was quoted as saying: "*Laisa minna man ghashshana*" (*Whosoever deceives us is not one of us*). According to Imam Ghazali, a Muslim who makes up his mind to adopt trade as a profession or to set up his own business

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<sup>116</sup> Translations of Sahih Muslim, Book 10: The Book of Transactions (Kitab Al-Buyu').

should first acquire a thorough understanding of the rules of business transactions codified in the *shari'ah*. Without such understanding he will go astray and fall into serious lapses making his earning unlawful. No people in the world have ever attached so much importance to lawful trading, as did the early Muslims, nor has any other nation evinced such a dread of unlawful trading as they did. It is the main reason why Imam al-Ghazali emphasised on a clear understanding of the rules and laws governing business transactions as a necessary prerequisite to adopting trade or business as a profession.<sup>117</sup>

The Holy Qur'an has stressed the importance of fairness in business through the verse:

*“And, O my people, give full measure and weight justly, and defraud not men of their things, and act not corruptly in the land making mischief. What remains with Allah is better for you, if you are believers”* (Hud: 85-86).

In short, the Holy Qur'an enunciates the fundamental principles of commerce as follows, namely, to give just measure and weight; not to withhold from the people the things that are their due; not to commit evil on the earth with the intent of doing mischief and to be contented with the profit that is left with us by God after we have paid other people their due.<sup>118</sup>

Pertaining to business transactions, it can be clearly observed that the Holy Prophet (pbuh) put strict emphasis on conducting business dealings strictly on truth and justice. He has strongly disapproved all transactions which involve any kind of injustice or hardship to the buyer or the seller. The underlying principle is that both the seller and buyer should be truly sympathetic and considerate towards each other. One should not take undue

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<sup>117</sup> *Ibid.*  
<sup>118</sup> *Ibid.*

advantage of the simplicity or ignorance of the other. The seller should not think that he has unrestricted liberty to extort as much as possible from the buyer - he has to be just; should only take his own due and give the buyer what is rightfully his.<sup>119</sup>

In a *hadith* reported by Malik, “*Yahya related to me from Malik from Abdullah ibn Dinar from Abdullah ibn Umar that a man mentioned to the Messenger of Allah, may Allah bless him and grant him peace, that he was always being cheated in business transactions. The Messenger of Allah, may Allah bless him and grant him peace, said, “When you enter a transaction, say, ‘No trickery.’ So whenever that man entered a transaction, he would say, ‘No trickery.’”*”<sup>120</sup>

In another reported *hadith*, “*Malik related to me that Yahya ibn Said heard Said ibn al-Musayyab say, “When you come to a land where they give full measure and full weight, stay there. When you come to a land where they shorten the measure and weight, then do not stay there very long.”*”<sup>121</sup>

From the above verse of the Qur’an and the *hadiths*, the *shari’ah* has clearly laid down the foundations of the acceptable conduct of parties in a sale contract.

#### **4.3.2 The Concept of *Milk* (Ownership) and Property**

Some of the most important objects to which a man’s worldly desires relate and with reference to which men deal with one another are regarded in law as the subject of *milk* which is usually translated as ownership. The proper subject- matter of *milk* is physical objects, but the word as used by the jurists covers a wider range of ideas than those included in mere propriety rights. So long as this is borne in mind, there is no harm in

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<sup>119</sup> *Ibid*

<sup>120</sup> Translations of Malik’s Muwatta, Book 31: Business Transactions. Book 31, Number 31.45.99.

<sup>121</sup> *Ibid*. Book 31, Number 31.45.100

adopting the word ‘ownership’ as the nearest English equivalent of *milki*.<sup>122</sup> *Milki* is defined by Sadru’sh-Shariat in ‘Sharhi Viqayah’ as the expression of the connection existing between a man and a thing (*shayun*) which is under his absolute power and control to the exclusion of control and disposition by others and by Taftazani as the power of exclusive control and disposition. The person who has such exclusive power and control is called the *malik* (owner).<sup>123</sup>

The thing over which the juristic conception of *milki* extends may be *mal*, a physical object or what is connected therewith, namely, usufruct (*manfaat*) either in the shape of produce of a physical object or of labour and services of man, or *muta’t*, that is, a right to a conjugal society.<sup>124</sup> When *milki* refers to *mal* or physical objects, it is further divisible into *milku’r-raqba* (proprietary rights), *milki’l-yad* (rights of possession) and *milku’t-tasarruf* (right of disposition). *Milku’r-raqba* expresses the fact that the owner being specially identified with the thing owned, and it leads to rights of the final two categories and the right of disposition has been legalised for the acquisition of right of control and possession.<sup>125</sup>

*Mal*, on the other hand, is defined as something that which can be hoarded or secured for use and enjoyment at a time of need, or that to which a man’s desires incline and which men are in the habit of giving away to others, and of excluding others therefrom. This removes from the category of *mal* usufruct and right to conjugal society.<sup>126</sup> The term *mal* is generally translated as property, but it has a much narrower significance than the English

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<sup>122</sup> Abdur Rahim, M.A., The Principles of Islamic Jurisprudence According to the Hanafi, Maliki, Shafi’i and Hanbali Schools (Originally Published as “The Principles of Muhammadan Jurisprudence”), 2<sup>nd</sup> ed., (New Delhi: Kitab Bhavan, 1994), 248.

<sup>123</sup> *Ibid.*

<sup>124</sup> *Ibid.* The right to conjugal society is the subject of *munakahat* or matters relating to marriage and is under the jurisdiction of Islamic family law.

<sup>125</sup> Abdur Rahim, *op. cit.*, 248-249.

<sup>126</sup> *Id.* at 249.

word which is often used in a very wide sense. The word is properly applicable only to objects which have a perceptible existence in the outside world, that is to say, to things corporeal and tangible. Future produce or *manfaat*, for instance, may be the subject of ownership, but is not called *mal*.<sup>127</sup>

Nothing can be deemed as property unless it be such that men can derive advantage from it, namely, it must be of some use to them. Occasionally, the law prohibits the use of a certain thing if it fails to confer any use or advantage to men. However, such things would still possess the quality of property if they are of use to persons to whom the prohibition does not extend. For instance, the use of wines and pigs which are declared unclean (*najisun bi a'inihi*) is forbidden to a Muhammadan but as their use is lawful to non-Muslims, they are nevertheless regarded as property, though they have no value to the Muhammadans. On the other hand, things which are of no use to anyone, such as dead bodies or human blood are not considered as property.<sup>128</sup>

Again, the value of a thing may be so inconsiderable that the law would not recognise it at all as something of value. The Arab jurists have put down one *fals* (a small copper coin) as the minimum. Hence, a handful of earth picked up from another person's ground cannot be the subject of a charge of theft, nor would broken crumbs of bread be the subject of a contract of sale.<sup>129</sup> However, there are certain things and advantages which the law does not permit to be exclusively appropriated by anyone, leaving them to a greater or lesser extent for the common use of all (*al-ashya'ul-mubahatu'l'umumah*) as indispensable to individual and social life. These include air; light; fire; grass; water of the sea, rivers,

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<sup>127</sup> *Ibid.*

<sup>128</sup> Abdur Rahim, *op. cit.*, 250. With regard to dead bodies and human blood, perhaps it can be argued that they can be regarded as property in terms of selling and buying them for medical research purposes but such a discussion is outside the scope of this chapter.

<sup>129</sup> *Ibid.*

streams etc.; public roads and commons. The only condition relating to the extent and mode of user of such things is that it should not cause injury to the community.<sup>130</sup>

#### (i) Moveable and Immoveable Property

Under the *shari'ah*, there are two principal classes of property, namely, moveable (*manqul*) and immovable (*ghairumanqul*). By immovable property is primarily meant land, and along with it all permanent fixtures such as buildings. Land and buildings are also called *aqar* or landed property. On the other hand, the characteristic of a moveable property is that it may be removed from one place to another, and may be destroyed, which can (but rarely) happen to immovable property. It is because of this susceptibility to moveable property to destruction that a buyer of such property cannot sell such a property before he has received possession of it. This is because if the goods are destroyed in the intervening time, the buyer would not be able to take possession of the goods.<sup>131</sup>

However, this is not the case for immovable property. A moveable property generally perishes in the act of the user, that is, it cannot be used for an indefinite length of time, or, permanently without it ultimately wearing out and vanishing. This is one of the reasons why moveable properties cannot be dedicated as *waqf* (endowment).<sup>132</sup> Moveable property is further classified as *makilat* (things which are ordinarily sold by measurement or capacity) such as wheat and barley; *mauzunat* (things which are ordinarily sold by measurement of weight such as gold, silver or oil; *'adadiyat* (things which are sold by tale<sup>133</sup>) such as fruits and *madhurat* (things which are estimated by linear measurement)

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<sup>130</sup> *Ibid.*

<sup>131</sup> Abdur Rahim, *op. cit.*, 253. It must be noted that most goods traded internationally are sold in transit, especially in CIF (Cost Insurance Freight) sales. A few sale transactions may have taken place during such transit before the goods are finally sold to the ultimate buyer.

<sup>132</sup> *Id.* at 253.

<sup>133</sup> The word "tale" used here is an archaic term used to describe by enumeration or count.

such as a yard of cloth. All articles of the nature of *makilat*, *mauzunat*, *'adadiyat* and *madhru'at* are also comprehensively called *muqadarat*, whereas gold and silver are called *nuqud* or price. Besides the abovementioned articles, other moveables are mostly *'urud* or goods such as articles of furniture and *haiwanat* (animals).<sup>134</sup> In general, most goods traded in the international market are goods under the categories of *muqadarat* and *'urud*.

## (ii) Similar and Dissimilar

Nevertheless, the classification of property which is of the greatest importance in Islamic law is one of *mithli* and *qimi*, which are generally translated as similar and dissimilar respectively.<sup>135</sup> Similar things are those which are sold by weighing and measurement and dissimilar things are things which are different in quality but sold in exchange (as wheat for its price in coins). In the case of similar things, such as wheat for rice, when they are sold after being measured or weighed, delivery should take place at once.<sup>136</sup> When such goods are sold unconditionally, the buyer has no right to choose the best part of it from the whole, unless the seller consents to it.<sup>137</sup> It must also be noted that the things sold or exchanged cannot remain undelivered or unadjusted on the mere responsibility of the parties, but if a thing is sold against its value in money, time is allowed in receiving money. In such a case, an option is allowed to the buyer and seller for three days (in case a thing is not removed from the seller's premises) to avoid the transaction.<sup>138</sup>

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<sup>134</sup> Abdur Rahim, *op. cit.*, 254.

<sup>135</sup> *Ibid.*

<sup>136</sup> Anwar A. Qadri, *Islamic Jurisprudence in the Modern World*, 2<sup>nd</sup> ed., (Kashmiri Bazaar, Lahore: Sh. Muhammad Ashraf, 1973), 325. This decree should be reexamined in the light of today's international trade transactions where cross-border immediate delivery may not be possible. The *shari'ah*, however, recognises two kinds of sale for delivery in the future (under strict safeguards against gambling in options), namely, *salam* and *istisna'*. In *salam*, the price must be paid in cash at the conclusion of the bargain and the bargain must be for definite delivery at a definite future date of a *res fungibilis* (that is something which is not specific but is sold quantity by quantity). An *istisna'* is the giving of an order of a workman to make a definite thing, with an agreement to pay a definite wage or price for that thing when made. For an explanation on *salam* and *istisna'*, refer to the same author, *op. cit.*, 325-326.

<sup>137</sup> Anwar A. Qadri, *op. cit.*, 325.

<sup>138</sup> *Ibid.*

If a thing is purchased without inspection or examination and a difference is found afterwards in the quantity or the quality of the goods specified by the seller, or asked for by the buyer, the latter may refuse to take delivery of such goods. Any uncertainty in the thing to be delivered (except where a choice among specified things is allowed to the buyer) or the price to be paid will invalidate the transaction.<sup>139</sup>

### (iii) Determinate and Indeterminate Property

Associated with the concept of things into similars and dissimilar is the division of property into *'ayn* (specific or determinate) and *dayn* (non-specific or indeterminate) property. The chief distinguishing test is whether, when a man is to get certain property from another who either borrowed it from him or took it by force, whether he is entitled to recover it in specie (in the same kind) or not. If he is, then that is called a specific or determinate property, and if he is not, then it is non-specific or indeterminate property.<sup>140</sup>

Articles of the same class of similar cannot, as a rule, be recovered specifically, and are thus regarded as *dayn* or indeterminate property. Hence, gold and silver in the shape of coins or otherwise, grain, oil and the like are considered as *dayn* or indeterminate property.<sup>141</sup> But similar may be made determinate by specification, for instance, when a quantity of wheat secured in certain bags is sold or when a thing is sold of the money contained in a particular bag, the wheat and the money would then become determinate and capable of specific recovery. Generally speaking, all indeterminate property rests on

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<sup>139</sup> *Ibid.*

<sup>140</sup> Abdur Rahim, *op. cit.*, 255.

<sup>141</sup> *Ibid.* For example, if a man sells an article for one hundred dirhams out of a bag of money pointed out to him by the buyer, he does not become entitled to be paid out of the identical bag but his claims will be satisfied on being paid an equivalent amount. Similarly, if A, having a hundred mounds of rice in his godown agrees to sell to B a hundred mounds of rice without specification, B will not be entitled to ask A to deliver to him the rice which is in his godown. So is the case when a man that has lent another a sum of money is not entitled to ask for the identical coins lent by him. These examples are given by the author at the same page of this footnote.

the mere responsibility or obligation of the person from whom it is recoverable. In this respect, it stands on the same footing as a debt, which is also called *dayn*.<sup>142</sup>

The types of properties mentioned here are the types that are regularly traded in the international market, especially under the CISG, except for gold and silver which are traded in a different financial market.

### **4.3.3 Physical and Constructive Possession of Goods**

One of the fundamental conditions that validate a selling contract is that the *mahalal-aqd* or *maqud alaih* (objects in trade) to be traded must exist and be owned by the seller at the time of contract. This is important because the purpose of a sale contract is to transfer ownership of the object to the buyer in return for the stipulated price. Otherwise the sale contract is deemed to be invalid sale (*bai al-fasad*), also known as *bai madum* (selling an object that does not exist) which has become a matter of contention amongst scholars for so long. This issue of collection of goods or taking possession by the buyer is normally known in Islamic jurisprudence as *qabd*.<sup>143</sup>

In Arabic, *qabd* means ‘to take possession’. Literally, it means ‘to grip with the hand’ or ‘to take or catch’ something. *Taqaabud* (a reciprocal taking possession of commodity and its monetary equivalent by buyer and seller respectively) adds a bilateral connotation of mutual swapping of possession. The *qabd* issue has been discussed by jurists at great length since early times, specifically in purchase and sale contracts and other contracts in general. There have been different views about what constitutes *qabd* for different goods,

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<sup>142</sup> *Ibid.*

<sup>143</sup> Ashraf Wajdi Dusuki, “Status of Ownership (Qabd) in Islamic Sale Contract”, (2010). Retrieved on 25 August 2013 from <http://www.newhorizon-islamicbanking.com/index.cfm?section=iibinews&action=view&id=10866>.

such as real estate and goods sold through measurement and other portable goods, such as clothes, animals and the like; that is, is it necessary that the goods be accepted by the buyer's hand, or is it sufficient to grant the buyer access to the goods without restriction (*al-tamkin* or *al-takhliyah*).<sup>144</sup>

A number of *hadiths* are used to justify the status of *qabd*:

*“From Ibn Abbas, it was narrated that the Prophet (pbuh) had forbidden a man from selling food he had not yet received. Ibn Abbas was asked as to its form. He answered; dirham with dirham, and food after it had been procured.”* (narrated by Bukhari, Muslim and Tirmizi). In another *hadith*, it is reported by Abdullah bin Dinar that he had heard *‘Ibn Umar say, the Prophet (pbuh) said: ‘Whoever buys food, he should not resell it before he has received it.’* (narrated by Bukhari and Malik). In general, the scholars of Islamic jurisprudence have divided *qabd* into two forms, namely, physical possession [*qabd haqiqi*] and legal [or constructive] possession [*qabd hukmi*].<sup>145</sup>

#### **4.3.3.1 *Qabd Haqiqi***

This type of *qabd* refers to taking possession explicitly or when the buyer is observed taking the goods sold to him. This form of *qabd* is normally evidenced in transactions involving two types of assets. First, in the case of immovable assets such as land and buildings, *qabd* is said to have taken place when the original owner gives the permission to the buyer to take control of the land and carry out whatever activity he wishes without hindrance. In case of trading a property or real estate, a *qabd* is completed when the new owner's name appears on the grant title or the ownership certificate. The second type of

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<sup>144</sup> *Ibid.*

<sup>145</sup> *Ibid.*

asset that renders the similar attribute of *qabd haqiqi* is moveable property such as food, vehicles etc. Hence, *qabd haqiqi* becomes effective when the buyers collect or receives the goods upon paying the price.<sup>146</sup>

#### 4.3.3.2 *Qabd Hukmi*

In contrast to *qabd haqiqi*, *qabd hukmi* refers to taking possession implicitly or not in a physical form. However, the status of *qabd hukmi* is still the same with that of *qabd haqiqi*, provided that it constitutes one of the following conditions, namely:

First, the buyer must have full permission by the seller to access the object of sale without any encumbrances (*al-tamkin altakhliyah*). For example, a person purchases furniture in a house and the seller gives him the key to the house saying: 'I have given you full access and permission to take the object of sale'. By doing this the seller has given the consent for the buyer to take possession of the goods bought without hindrance.<sup>147</sup>

Second, the legal ownership can also take effect by means of a contra-debt (*muqassah*) or an implicit settlement of debt takes place between two parties, which results in both parties owing no more debt to each other. For example, if X owes Y\$1000, then Y owes X the same amount. This means the two parties are no longer in debt to each other. In this context, *qabd hukmi* to the amount of the debt has taken place in the form of contra.<sup>148</sup>

Third, *qabd hukmi* can also take place due to an earlier action which implies that ownership has taken place earlier, although the earlier form of *qabd* is different from the new form. For example, in the case of an Islamic hire-purchase contract, *al-ijara thumma al-bai*, a *qabd* rental exists first when the tenant occupies the rented premises. Then, when

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<sup>146</sup> *Ibid.*

<sup>147</sup> *Ibid.*

<sup>148</sup> *Ibid.*

the premise is sold to the tenant, *qabd hukmi* takes place although the *qabd haqiqi* is after the sale and purchase *aqad* [contract].<sup>149</sup>

Finally, *qabd hukmi* or legal ownership also takes place when there is an element of spoiling or *itlaf*. If the buyer spoils purchased goods while they are in the possession of the seller, then he is considered a recipient of the goods, that is, *qabd* takes place, and he is liable for the price. This is because giving access and permission also implies giving the ability to affect the objects, and spoiling the goods certainly affects them.<sup>150</sup>

#### **4.3.3.3 Scholars' Views on *Qabd***

According to the Hanafis, *qabd* is not an essential requirement (*rukun*) of sale but rather a subsidiary condition (*shart al-nifadh*). They clearly validate a bona fide sale by an unauthorised person (*fuduli*) who does not own the object but sells it nevertheless. In this case, the sale is deemed to be valid but not effective. It becomes effective only upon obtaining the owner's consent. Thus, *qabd* is not a prerequisite of a valid contract and it is perfectly lawful to postpone it to a later date. Only in the case of the transaction of *ribawi* items (e.g. sale of gold with gold) is *qabd* elevated to a prerequisite of a valid contract. Abu Hanifah exempted what is movable and transferable from what is immovable and non-transferable, for transfer of possession, according to him, is still possible by making the property available.<sup>151</sup>

The Malikis postulated the *hadith* on *qabd* to be applied only to food grains, which means that non-food grain items (e.g. cotton, palm oil etc) may be sold prior to taking possession. Ibn Rusyd confirmed this and stated: 'There is no dispute in Maliki's school about the

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<sup>149</sup> *Ibid.*

<sup>150</sup> *Ibid.*

<sup>151</sup> *Ibid.*

permissibility of selling things, other than food, before taking possession, and there is also no dispute in his school about *ribawi* food (wheat, barley, dates and salt) that possession is a condition for its sale.’ As for non-*ribawi* food, the Malikis have two opinions. One is that it is disallowed (without prior possession). This is better known and is also the opinion of Ahmad and Abu Thawr, though these two authorities stipulated that food should be measured and weighed. The other one is that it is permitted to sell non-food grain items prior to taking possession.<sup>152</sup>

For the Shafi’is, possession is a condition for all kinds of property. [Imam] Shafi’i deduced his opinion based on the *hadith* of the Prophet (pbuh) : “*It is not permitted: to sell with a loan; to have two conditions in a sale contract; to sell what you do not possess; or to profit without corresponding liability [for loss].*” On the *hadith*, “*do not sell anything until you receive it*”, the Shafi’is strictly adhere to the literal meaning of the *hadith* to the extent that even the selling of immovable objects needs to satisfy possession requirement prior to resale. However, his view is not shared by other schools which do not require *qabd* prior to reselling in the case of immovable objects like land.<sup>153</sup>

Ibn al-Qayyim and his teacher IbnTaimiyah departed from the majority position by extending the concept of *qabd* to considerations of custom or *urf* (the common practices of the local community). They based their opinion on the lack of any prohibition of the sale of that which is not mentioned in the Quran, the *Sunnah* or the [sayings] of the Companions. What was narrated in the *Sunnah* is the prohibition of sale with excessive risk and uncertainty (*gharar*), where the object maybe undeliverable, whether it exists or not (e.g. a runaway horse or camel). Thus, the wisdom in the prohibition is neither existence nor lack

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<sup>152</sup> *Ibid.*

<sup>153</sup> *Ibid.*

thereof. In general, the majority of scholars of Islamic jurisprudence assert that the rationale (*illah*) of prohibiting sale prior to taking possession was mainly due to the presence of *gharar*, which may lead to dispute amongst the transacting parties. This was because of the concern that the goods might not be delivered due to damage or other factors. Thus, Islam prohibits any transactions involving *bai madum* since the delivery of the subject matter cannot be effected and this brings about the prohibited element of *gharar*.<sup>154</sup>

#### **4.4 Seller's and Buyer's Rights and Obligations under the Islamic Contract of Sale**

##### **4.4.1 Introduction**

Islam, which condemns every kind of injustice and exploitation in human relations, wants its followers to conduct business in a sublime spirit of justice tempered with human kindness. The conduct of the seller in a transaction should be characterised not only by *insaf* (justice), but also by *ihsan* (magnanimity). The Holy Prophet said “*God will forgive the sins of a Muslim who absolves a fellow-Muslim from a sale contract not liked by the latter.*”<sup>155</sup>

All transactions should be based on the fundamental principle of “*ta’awanu ala birri wa’t-taqwa*” (mutual co-operation for the cause of goodness or piety). A transaction not based upon this sound principle is not lawful. Unlawful transactions are motivated by lust for money and an ignoble desire to build up prestige. Islam strikes at the root of the passion for money and suggests a different yardstick to measure the prestige of a person. The Holy Qur’an, on the one hand, condemns hoarding and the excessive love for wealth, and, on the other, declares virtue and piety to be the criterion for determining a person's worth, “*Inna*

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<sup>154</sup> *Ibid.*

<sup>155</sup> Translations of Sahih Muslim, Book 10: The Book of Transactions (Kitab Al-Buyu’).

*akramaku `ind-Allahi atqakum*”(the noblest in the eyes of God is the most pious among you). It can be observed that what Islam does is to minimise, in every possible way, the temptation to illegal trade and traffic.<sup>156</sup>

As a comparison to the CISG, there may not be every right and obligation of the seller and buyer under the *shari’ah vis-à-vis* every Article of the CISG but it is most important to understand the basic concept of “*ta’auanu ala birri wa’t-taqwa*” above as a basis for all sale contracts under the *shari’ah*. Another related principle provides for the prohibition of unlawful deals, taking of interest, undue and vitiated profits, unfair trade practices and the process of the sacred law arranged for individual earning as to what is to be earned, what is to be spent and on what it should be spent. Man is commanded to act lawfully and for the welfare of others under social principles, and he is to enter into transactions of trade and business, to work and perform his roles.<sup>157</sup>

It is one of the fundamental principles of the sacred law that “no person must deal with the property of another person unless by his permission or acting as his trustee”.<sup>158</sup> Thus, it is of utmost importance that the seller, in an Islamic contract of sale, is the owner of the goods that he is selling to the buyer.<sup>159</sup> The person contravening the maxim is called a *ghasib* or wrongdoer. The person who has no permission of the owner to deal with the property is called *faduli*, an unauthorised agent or *negotiorum gestor*.<sup>160</sup> Imam Shafi’i holds the view that such acts are invalid even though it is accepted by the owner of the property. The majority of the jurists such as Abu Hanifah and Malik have held, however,

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<sup>156</sup> *Ibid.*

<sup>157</sup> Anwar A. Qadri, *op. cit.*, 310.

<sup>158</sup> *Id.* at 319.

<sup>159</sup> cf. Article 30 of the CISG which merely states that “the seller must deliver the goods” and the provision of Article 41 where “the seller must deliver goods which are free from any right or claim of a third party” but both provisions did not mention that the seller must be the owner of the goods. The concept of *milk* or ownership of goods under *shari’ah* has been explained in paragraph 7.2.2 above.

<sup>160</sup> Article 112 of The Mejlle recognises the “*fuzuly*” as someone making a disposition of property of another without the sanction of the *Sher’* (the Law of God or *shari’ah*).

that the validity of the acts of the unauthorised agent is dependent upon the ratification of the owner of the property.<sup>161</sup> Thus, if the owner ratifies them, the act of the *faduli* becomes valid and effective in accordance with the principle that “later ratification has the same effect as a previous authorisation to an agent.”

On the basis of the Qur’anic rule “*O ye who believe! devour not your property amongst yourselves vainly, unless it be a merchandise by mutual consent*” (An-Nisa:29 ), the maxim states that “no one may take another’s property without legal cause”. Under the principle, the jurists have laid down that a sum paid without obligation should be restored to the payer, regardless of whether payment had been made in error, for prohibited purposes, or for a purpose which has not been fulfilled. The rule has been formulated that compensation must be commensurate with the act or thing for which compensation is claimed. It applies in cases where a prior contract does not exist, has expired, has been invalidated, is silent on the amount of compensation and in cases where the unlawful enrichment results from pooling or amalgamation of property.<sup>162</sup> The above principles demonstrate the importance of ownership of property, not taking another’s property without a lawful cause and also the prohibition of unjust enrichment.

Unlike the CISG, the seller’s and buyer’s obligations under the *shari’ah* are not found in a single document but are dispersed in the Muslim jurists’ views, The Mejjelle and also some of the civil and/or commercial codes of selected Muslim countries.<sup>163</sup>

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<sup>161</sup> Anwar A. Qadri, *op. cit.*, 319-320.

<sup>162</sup> *Id.* at 320.

<sup>163</sup> This chapter will view some relevant provisions in The Mejjelle and the civil and/or commercial codes of Egypt, Lebanon and Iran. Both Egypt and Lebanon are signatories to the CISG. Some of the Muslim jurists’ views on property and ownership have been explained in the preceding paragraphs.

#### 4.4.2 The Conditions and the Description of the Goods Sold

First and foremost, the object of sale must be in existence, according to Article 197 of The Mejlle “The existence of the thing sold is necessary” and the seller must have ownership of the goods sold.<sup>164</sup> Article 199 further states that “It is necessary that the thing sold be *Mal Mutaqavvim (mutaqawwim)*<sup>165</sup> . In Article 200, it is stated that “It is necessary that the thing sold should be known to the buyer”, while Article 201 provides that, “The thing sold becomes known by a description of its qualities and state, which will distinguish it from other things.” However, Article 203 explains that “It is sufficient that the purchaser, of the thing sold, has known it himself, there is no necessity for a description in another way” which means that if the buyer is already aware of the description of the goods that he’s buying from the seller, there is no requirement for any further description of the goods. In emphasizing the importance of the existence of the goods sold, Article 205 of The Mejlle stresses that “The sale of a non-existing thing is invalid” or *bathil*.<sup>166</sup>

In the Civil Code of Egypt<sup>167</sup>, a contract of sale is defined in Article 418 as “Sale is a contract whereby the vendor binds himself to transfer to the purchaser the ownership of a thing or any other proprietary right in consideration of a price in money”. In relation to the condition and description of goods, Article 419 of the said Code echoes a similar principle when it provides that “The purchaser must have sufficient acquaintance with the thing sold. This acquaintance will be deemed sufficient if the contract contains the description of the thing sold and its essential qualities, so that it may be identified.”

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<sup>164</sup> Refer to paragraph 4.4.2, *supra*, on property and ownership.

<sup>165</sup> Article 127 of The Mejlle explained that *Mal Mutaqavvim* is used in two senses: “One is a thing the benefit of which it is permissible by law to enjoy. The other means property (*Mal*) acquired. For example – a fish in the sea is not *Mal Mutaqavvim*, when it is caught and taken it is *Mal Mutaqavvim*.”

<sup>166</sup> For example – To sell a trees fruit, which has not appeared at all, is invalid (sic).Article 110 of The Mejlle further explains that “*Bey Bathil* is a “*Bey*” which is not good (*Sahih*) in its foundation.

<sup>167</sup> Commercial Laws of the Middle East, ed. Allen P.K. Keese, The Arab Republic of Egypt, The Civil Code (Law No. 131 of 1948), (Oceana Publications Inc., 1981).

In the Civil Code of Iran,<sup>168</sup> a contract of sale is defined in Article 338 as “A sale consists of giving ownership of a corporeal [tangible] property for a definite consideration. This provision corresponds to the traditionalists’ concept of property and ownership discussed in the preceding paragraphs. Article 342 of the same Code states that “The quantity, type and qualitative attributes of the subject-matter of the sale must be known; and fixing of the quantity by weight, measure, number, length, area or by inspection is subject to local custom.” It appears that this provision took into account local custom and trade practices in determining the weight, measurement etc. of the goods in question.<sup>169</sup> Article 343 states that “If the subject- matter of sale is sold on the condition that it should be of specific quantity, the sale is effected even though the subject matter has yet to be counted, or measured in volume or length”, giving a notion that the contract is supreme and should be adhered to even without prior determination of the actual quantity of the goods. Article 348 forbids the selling or buying of forbidden goods, where it provides that “Sale of a thing the buying and selling which is forbidden by law, or which does not have market value, or which is not rationally profitable, or which the seller is unable to deliver, is null and void unless the purchaser himself is able to take possession of it.”

Similarly in the Lebanon Code of Obligations and Contracts,<sup>170</sup> Article 372 defines sale as “The sale is a contract by which the seller commits himself to the transfer of the property of a thing and the buyer to pay its price” and Article 373 explains that “The validity of the sale is subject to the agreement of the parties on the nature of the contract, the thing and the price, as well as the general conditions of validity of contractual obligations”. Article 382 further states that “The sale may not involve things that are not items of trade or which

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<sup>168</sup> The Civil Code of Iran, Translated from Persian by M.A.R. Taleghany, (Colorado: Fred B. Rothman & Co, 1995).

<sup>169</sup> The CISG, to a certain extent, recognises usage and practices established between the parties in Article 9.

<sup>170</sup> Business Laws of the Middle East: Lebanon, ed. Nady Tyan, Compiled and Translated by Mohamed Y. Alem, (Kluwer Law International, 2001).

have no appreciable value, or their nature are not susceptible of delivery” and in Article 383, “The sale may involve corporeal or incorporeal goods.” Article 384 further states that “The sale may be a body ascertainable or an undivided or determined right on the ascertainable body. It may also be a thing determined by its kind only. But in this case, the sale is not valid except if the designation of the kind applies to fungible things specified enough to a number, weight, quality or measure, so the contracting parties are well aware of what they are consented to.” And finally, Article 385 provides that “The sale of a thing belonging to another is void, except if:

1. it involves a thing that is determined in type or kind;
2. authorised by the owner;
3. the seller subsequently acquires the right of property over the said thing.

In case the owner refuses to authorise the sale, the seller may be held for damages towards the buyer if he knew that the thing did not belong to him and if the buyer was ignorant of it...”

Again from the above provisions it could be clearly observed the importance placed on the seller’s ownership in the goods to be sold in line with *shari’ah* principles.

In other words, based on the above Articles, it can be understood that the goods must be in existence at the time of the contract of sale was entered into, the seller must have the capacity to transfer the goods to the buyer and that the goods in question must be fit for sale.

### **4.4.3 Delivery**

#### **4.4.3.1 General Obligations**

Article 198 of The Mejlle provides that “It is necessary that the delivery of the thing sold be possible.” In other words, the seller must ensure that the goods sold must be able to be delivered to the buyer. Article 209 further provides that “The sale of a thing, the delivery of which is not possible, is invalid.”<sup>171</sup>

Article 428 of the Civil Code of Egypt states that “The vendor is bound to perform everything necessary to transfer the right to the thing sold to the purchaser, and to abstain from all acts that might render this transfer impossible or difficult.” The obligation of the seller to deliver the goods is found in Article 431, where it is stipulated that “The vendor is bound to deliver the thing sold to the purchaser in the state in which it was at the time of the sale.” Further in Article 432, “Delivery includes delivery of the accessories of the thing sold and of everything which, according to the nature of things, local custom and the intention of the parties, was appropriated permanently for the use of the thing.”

The Civil Code of Egypt further provides in Article 435 that “Delivery consists in placing the thing sold at the disposal of the purchaser in such a way that he can take possession of and enjoy it without hindrance, even if he does not take effective delivery thereof, provided the vendor informs him that the thing is at his disposal. Delivery is effected in accordance with the nature of the thing sold.” The same article additionally provides that “Delivery may be completed by the mere fact of agreement between the parties when the thing sold was in possession of the purchaser prior to the sale or if the vendor retains the things in his possession after the sale by virtue of some reason other than that of ownership.”

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<sup>171</sup> Examples given in the said Article are: The sale of a ship, lying in the sea, and which cannot be raised, and of a runaway animal, which cannot be caught and delivered is invalid (*batil*).

Article 436 of the same Code stipulates that “When the thing sold must be sent to the purchaser, delivery will not be effective, subject to an agreement to the contrary, until the thing reaches him.” Article 448 states that “The vendor is not liable for defects which are customarily tolerated”<sup>172</sup> and in Article 449, “When the purchaser has taken delivery of the thing sold, he must ascertain its condition as soon as he is able to do so in accordance with common usage. If he discovers a defect for which the vendor is answerable, he must give notice thereof to the vendor within a reasonable time, failing which he will be deemed to have accepted the thing sold.” Article 449 further provides that “In the case, however, of defects that cannot be discovered by means of normal inspection, the purchaser shall, upon the discovery of the defect, at once give notice thereof to the vendor, failing which he will be deemed to have accepted the thing sold with its defects.”

Article 367 of the Civil Code of Iran provides that “Delivery means putting the subject-matter of a sale at the disposal of the buyer so that he can dispose of or benefit from it in whatever manner he wishes; and taking delivery means the buyer’s assumption of control over the subject-matter of the sale. Article 368 stipulates that “Delivery is effected when the subject-matter of a sale is placed at the disposal of the buyer even if the latter has not actually taken possession of it.” On the ways that the goods are to be delivered, Article 369 states that “Delivery takes place in various ways depending on the varying nature of the subject-matter of the sale; and it must be done in a way which by common usage is considered delivery.” In Article 70, it is explained that “If the parties to the transaction have fixed a certain date for delivery of the subject matter of the sale, the ability to deliver at that date is considered a condition not the ability to do so at the conclusion of the contract.”

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<sup>172</sup> Customarily tolerated is, however, not defined in the Article.

Still on the issue of delivery, Article 372 of the Civil Code of Iran states that “If the seller has the ability to deliver a part of the subject-matter of a sale and is unable to deliver the remainder, the sale is valid for the part which he can deliver and is null and void in respect of the remainder.” Article 373 stipulates that “if the subject-matter of sale is already in the buyer’s possession, there is no need for delivery to be taken of it; and the same applies to the consideration for the sale.” Further, the Code provides that “The subject-matter of the sale must be delivered in the place where the contract of sale was concluded, unless custom and common usage require delivery at another place or unless a special place for delivery has been specified in the sale.”

Article 401 of the Lebanon Code of Obligations and Contracts states that “The seller is under two main obligations:

1. delivery of the sold thing
2. guarantee of the sold thing.”<sup>173</sup>

The manner of delivery is explained in Article 402 where “Delivery consists of putting the thing sold at the disposal of the buyer by the seller or his representative in such conditions that he will be able to invest without any obstacle.” Delivery of moveable things is specifically dealt with in Article 403(2) where it is provided that it occurs “by actual delivery or by handing over the keys of the buildings or boxes containing such things, or by any other means admissible by practices. Article 403 (3) further states that “delivery occurs, even by mere consent of the contracting parties, if the sold thing cannot be bought at the time of the sale, or if the sold thing is in the hands of the buyer for any other reason.”

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<sup>173</sup> Guarantee will not be discussed in this chapter as the main focus is on the seller’s primary obligation of delivery.

The same Code provides in Article 405 that “Except for any stipulation to the contrary, delivery is to be effected at the place where the thing sold was at the time of concluding the contract. If the deed of sale states that the thing lies in a place other than where it actually is, the seller is bound to carry the thing to the designated place if the buyer requires so.” In Article 406, it states that “If the sold thing is to be dispatched from one place to another, delivery occurs only the moment when the buyer or his representative receives the thing.”

Article 407 of the above Code provides that “Delivery is to be effected at the time stated in the contract, or, otherwise upon the conclusion of the contract without prejudice to the delays required by the nature of the thing sold or by practices.” The same Article further provides that “The seller, who did not grant a delay for payment, is not required to deliver the thing as long as the buyer has not paid its price. Payment may not be substituted by any offer of a guarantee or other surety.”

Additionally, Article 463 of the Civil Code of Egypt provides for the buyer’s obligation to accept delivery of the goods, where it is stated that “In the absence of agreement or usage indicating the place and time of delivery, the purchaser is bound to take delivery of the thing sold at the place where it was at the time of the sale and to remove it without delay, subject to the time necessary for such removal.”<sup>174</sup>

#### **4.4.3.2 Refusal of Delivery**

Provisions on the seller’s refusal to deliver the goods to the buyer is inexplicably not featured in the the Civil Code of Egypt but are embodied in both the Codes of Iran and Lebanon. In Article 377 of the Civil Code of Iran, it states that “Either the seller or the buyer has the right to refuse delivery of the subject-matter of a sale or the consideration for

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<sup>174</sup> A similar provision is not mentioned in either the Iran or Lebanon Codes.

it until the other party is prepared to deliver his part, unless it has been agreed that delivery of the subject-matter of the sale or consideration for it is to take place at a subsequent date, in which case either the subject-matter or the consideration which is not to be delivered at the subsequent date must be delivered at once.”

The Lebanon Code of Obligations and Contract is more detailed in explaining instances where the seller may or may not refuse delivery in Articles 409 – 411. In Article 409, it states that “The seller may not refuse the delivery of the sold thing:

1. if he has authorized third party to receive the price or the due balance;
2. if he has accepted from a third party the payment of the price or the due balance;
3. if subsequently to the contract, he has granted a delay for payment.

Further in Article 410, “The seller is not required to deliver the sold thing, even if he might have granted a delay for payment:

1. if, since the sale, the buyer was in a state of insolvency;
2. if he was already bankrupt or under winding up at the time of the sale, and the seller was not aware of the fact;
3. if he has reduced the sureties he had given for the payment, so that the seller is in jeopardy of losing the price.

And finally in Article 411, it provides that “If the seller exercises the possessory lien provided for in the previous articles, he shall guarantee the thing sold in the same way the pledge stands for his pledge.”<sup>175</sup>

#### **4.4.4 The Price**

Payment of the price of the goods is one of the buyer’s most important obligations. Article 237 of The Mejjelle provides that “It is necessary that the price should be named at the time of the sale (*bey*). It further states that “Therefore, if the price of the thing sold is not mentioned at the time of the sale, the sale is bad (*fasid*). Article 238 states that “It is necessary that the price should be known” and in Article 239 “Knowledge of the price comes by a statement of its description and amount if it does not come by seeing it when it is shewn.”

Article 456 of the Civil Code of Egypt states that “Subject to a clause or custom to the contrary, the price is payable at the place where the delivery of the thing sold is made.” The Article further provides that “If the price is not payable at the time of delivery of the thing sold payment must be made at the domicile of the purchaser on the due date.” In Article 457, it stipulates that “Subject to a clause or custom to the contrary, the price is payable at the time delivery of the thing sold is made.”<sup>176</sup>

In instances where the payment is immediate, Article 459 of the above Code stipulates “When the whole or part of the price is payable immediately, the vendor, unless he grants the purchaser a delay for payment after the date of the sale, may retain the thing sold until

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<sup>175</sup> The discussion of liens and pledges are also outside the scope of this chapter.

<sup>176</sup> This Article further provides that “When a purchaser is disturbed in his enjoyment by a third party invoking a right existing prior to the sale or derived from the vendor, or if he is in danger of being dispossessed of the thing sold, he may, subject to an agreement to the contrary, retain the price until the disturbance in his enjoyment or the danger of dispossession has ceased. The vendor may, however, in such a case, demand payment of the price upon his supplying security.” The Article then further stipulates that “The provisions of the preceding paragraph will also apply if the purchaser has discovered a defect in the thing sold.”

he obtains payment of the amount due, even if the purchaser has offered a mortgage or security. The Article further provides that “The vendor may also retain the thing sold, even if the agreed date of payment has not fallen due, if the purchaser loses the benefit of the term in accordance with the provisions of Art. 273.”<sup>177</sup>

Article 394 of the Civil Code of Iran states that “The purchaser must pay the price at the agreed time, at the place and in accordance with the conditions stipulated in the contract of sale.” Article 395 of the same Code provides that if the purchaser does not pay the price at the agreed time, the seller has the right to rescind the transaction in accordance with the provisions stipulated in the Code or to ask a judge to compel the purchaser to pay the price.

In the Lebanon Code of Obligations and Contracts, Article 386 stipulates that “The sale price is to be set by the parties.<sup>178</sup> It may be left to the assessment of a third party. In this case, if the third party failed or refrained from assessing the price, no sale occurs. Article 387 of the same Code further states that “If the sale contract does not include the terms or the conditions of payment, the sale is a sale for cash and without condition.”

The conclusion that can be drawn from the analysis of the above laws under the *shari'ah* is the importance of the existence of the goods and the goods in question must be able to be delivered. The *shari'ah* does not recognise goods that are yet to exist during the conclusion of the contract or goods that are not being capable of being delivered, in an apparent effort to protect the buyer's interest. The seller's main obligation under the said laws is to deliver the goods in good condition while the buyer remains liable at all times to pay the price for the goods. Generally, all the laws above stipulate that the price must be agreed upon concluding the contract of sale.

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<sup>177</sup> Article 273 of the Code relates to instances where a debtor's benefit will be forfeited.

<sup>178</sup> This Article seems to emphasise on party autonomy unlike the other civil codes discussed in this chapter where emphasis are sometimes given to custom and trade usage in fixing the price of the goods.

## **4.5 Obligations of the Buyer under CISG**

### **4.5.1 Buyer's General Obligations – Making Payment and Taking Delivery**

An international sale of goods is defined as a contract by which the seller agrees to deliver the goods and transfer the property in the goods to the buyer, which for its part agrees to pay the price for the goods and take delivery of them.<sup>179</sup> This is consistent with the understanding that the seller and buyer have reciprocal obligations toward concluding sale contracts. The buyer's obligations under CISG are contained in Articles 53 - 60, and in essence, it can be succinctly summarised as the obligations to pay for and take delivery of the goods. Compared to fifteen Articles on the obligations of the seller in the Convention,<sup>180</sup> there are only eight Articles with regard to obligations of the buyer.<sup>181</sup> Article 53 of the Convention describes the general responsibilities of the buyer in that "The buyer must pay the price for the goods and take delivery of them as required by the contract and this Convention." This section recognises the primacy of the contract in defining the parties' obligations and this Article applies even in the absence of a contractual agreement between the parties to the contrary. Under the CISG, as with any law that governs the sale of goods, the primary obligations of the buyer are those obligations that arise from the contract with other obligations that arise from the underlying substantive law.<sup>182</sup>

Whether or not the buyer's obligations under CISG in international contracts of sale is in fact simpler than that of the seller's is subject to scrutiny. It is also of practical importance to examine if there is any relation between the provisions found in Articles 53 - 60 and the

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<sup>179</sup> Butler, Allison E, *A Practical Guide to the CISG: Negotiations Through Litigation.*, Chapter 4, (Aspen Publishers, 2007 Supplement 2), 16.

<sup>180</sup> The Articles are contained in Part III, Chapter II of the Convention.

<sup>181</sup> These are contained in Part III, Chapter III of the same Convention.

<sup>182</sup> Gabriel, H D, "The Buyer's Performance Under the CISG: Articles 53-60 Trends in the Decisions" (2006). Retrieved on 6 December 2010 from <<http://www.cisg.law.pace.edu/cisg/biblio/gabriel4.html>>.

other provisions in the Convention with regard to obligations of the buyer. It may sometimes be the case that the general provisions of Parts I and III of the Convention and other provisions common to the obligations of the seller and buyer be intertwined with the buyer's specific obligations.<sup>183</sup> Among the general provisions that may be interconnected with the buyer's specific obligations under the Convention are the provisions relating to anticipatory breach of contract, on damages and interest, exemptions and preservation of the goods.<sup>184</sup>

#### **4.5.2 Payment of the Price**

Article 54 of the Convention states that “The buyer's obligation to pay the price includes such steps and complying with such formalities as may be required under the contract or any laws and regulations to enable payment to be made.” Article 54 specifies that the buyer's obligation to pay the price extends beyond the abstraction of owing money. The obligation also includes whatever steps and costs that are necessary to ensure that the payment is actually made. In the absence of a contrary agreement, the buyer must bear the costs for measures necessary to enable him to pay the price.<sup>185</sup> Thus, any costs associated to effect payment are rightfully borne by the buyer and the seller may consider the buyer's failure to such formalities as either an anticipatory breach or as a breach of contract.<sup>186</sup>

In a case involving a German seller and a Russian buyer,<sup>187</sup> the buyer had received the goods but failed to pay the price, arguing that the bank that was responsible for his foreign

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<sup>183</sup> Sevon, L, “Obligations of the Buyer under the Vienna Convention on the International Sale of Goods” (1990). Retrieved 6 December 2010 from <<http://cisgw3.law.pace.edu/cisg/biblio/sevon.html>>.

<sup>184</sup> Sevon, *op. cit.*

<sup>185</sup> Gabriel, *op. cit.* For example, the extra costs may be government tariffs imposed on the sale.

<sup>186</sup> Gabriel, *op. cit.*

<sup>187</sup> CLOUT Case No. 142 decided on 17 October 1995 by the Tribunal of International Commercial Arbitration at the Russian Federation Chamber of Commerce and Industry. Retrieved on 26 May 2011 from <<http://cisgw3.law.pace.edu/cases/951017r1.html>>. Note: CLOUT is the acronym for Case law on UNCITRAL texts. See also Arbitration Proceeding No. 134/200, Russia 22 October 2003 available at <<http://cisgw3.law.pace.edu/cases/031022r1.html>>. Failure to procure a letter of credit, make payment or comply with the terms of the contract was also held as failure by the buyer to meet its obligation to pay the price of the goods under the contract of sale.

currency transactions had been unable to transfer the amounts to the seller. The buyer did not have currency that was freely convertible in his bank account to pay for the goods. The buyer attempted to have the tribunal declare an exemption, based on Article 79 of the CISG<sup>188</sup>, since the situation, according to buyer, constituted *force majeure*, and thus, he should be discharged from performing his contractual obligations. During the proceedings, it was established that the buyer had merely sent instructions to the bank, but had not taken measures to ensure that the payment could in fact be made.<sup>189</sup>

The buyer was found in breach of the sale contract for two reasons. First, the contract had a provision that included an exhaustive list on what constituted *force majeure*, and this situation did not fall within its scope. Second, the buyer limited his conduct to sending instructions to the bank but had not taken measures to ensure that the payment could be made. In this case, the buyer of the goods limited his conduct to sending a letter to his bank asking that payment be made to the seller. He did not make an effort to ensure that he had freely convertible currency to effect payment to the seller, thus falling short of what is expected from a buyer under Article 54. As mentioned before, the commercial steps require that a buyer obtain a specific result, which did not occur. In addition, the buyer may have been required to obtain an authorisation from the Russian government, but the facts of the case suggests that the buyer had simply sent instructions to the bank, conduct that clearly falls short for the purpose of effecting payment.<sup>190</sup>

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See *Downs Investment v Perwaja Steel* decided on 17 November 2000 by the Supreme Court of Queensland, Australia. Available at <<http://cisgw3.law.pace.edu/cases/001117a2.html>>.

<sup>188</sup> Article 79(1) of the CISG states that “A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.”

<sup>189</sup> CLOUT Case No. 142, *supra*.

<sup>190</sup> CLOUT Case No. 142, *supra*.

Questions, and sometimes problems, that usually arise in relation to payment of the price are “what”, “where” and “when”. Normally the parties agree on the price as well as on the time and place for payment. It follows from the non-mandatory character of the Convention that the parties may derogate from the Convention on these points. On the other hand, the Convention does not deal with the validity, in other respects, of the agreed provisions on the price under national law. They may be in conflict, for instance, with rules on the regulation of prices or on foreign exchange. Nor does the Convention provide an answer to the question what effect such rules of law would have invoked in a court outside the country where the provisions have been enacted. The fact that one of the parties has concluded a contract containing provisions on the price which are in conflict, for example, with that party’s national law on foreign exchange does not necessarily preclude a court in another country from deciding in accordance with the provisions of the contract.<sup>191</sup>

#### **4.5.3 Determination of the Price**

The CISG contains two provisions on the calculation of the price. In Article 56, if the price is fixed according to the weight of goods, it shall, in case of doubt, be determined by the net weight.<sup>192</sup> This Article seems to cause few difficulties. Conversely, Article 55 caused considerable difficulties as it deals with the problem on how to calculate the price if a validly concluded contract does not fix the price or make provisions for determining it.<sup>193</sup> Article 55 states that “Where a contract has been validly concluded but does not expressly or implicitly fix or make provision for determining the price, the parties are considered, in the absence of any indication to the contrary, to have impliedly made reference to the price

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<sup>191</sup> Sevon, L, “Obligations of the Buyer under the UN Convention on Contracts for the International Sale of Goods” (1986). Retrieved on 6 December 2010 from <<http://www.cisg.law.pace.edu/cisg/biblio/sevon1.html>>.

<sup>192</sup> Article 56 CISG: “If the price is fixed according to the weight of the goods, in case of doubt it is to be determined by the net weight.”

<sup>193</sup> Sevon (1990), *op. cit.*

generally charged at the time of the conclusion of the contract for such goods sold under comparable circumstances in the trade concerned.”

In most cases, the price will be determined in the contract, be it expressly or implicitly. However, where the contract has been validly concluded but does not expressly or implicitly fix the price or provide a mechanism to determine the price, Article 55 gives a default rule for determining the price. In short, from the wordings of Article 55, the price shall be the usual price for such goods.<sup>194</sup> However, it has been argued that the practical importance of Article 55 will probably be limited as it will only apply if the parties have not expressly or implicitly fixed the price or made provision for determining the price but this will rarely be the case.<sup>195</sup>

It has also been argued that the notion of an implicit agreement on the price should be construed liberally. An implicit agreement on the price can, for instance, result from the previous dealings between the parties or from trade usages concerning the determination of the price.<sup>196</sup> Moreover, if the buyer accepts the goods without objecting to the indicated price, this will usually amount to an implicit acceptance of that price. It has been further suggested that the concept of “fixing” the price or of “making provision for determining it” should also be construed rather liberally.<sup>197</sup> In a decided case, the Austrian Supreme Court has found that a sales contract on a number of Chinchilla furs of medium or superior quality in a price range of 35 to 65 German Marks per fur was sufficiently definite because

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<sup>194</sup> Huber, P and Mullis, A, *The CISG, A New Textbook for Students and Practitioners* (Munich, Germany: Sellier, European Law Publishers, 2007), 304. See Case No. C1 06 95 decided on 27 April 2007 by the Canton Appellate Court Valais, Switzerland. Available at <<http://cisgw3.law.pace.edu/cases/070427s1.html>>.

<sup>195</sup> Huber and Mullis, *op. cit.*, 304.

<sup>196</sup> Past usage and practices are recognised in Article 9 of the CISG. Article 9(1) states that “The parties are bound by any usage to which they have agreed and by any practices which they have established between themselves.”

<sup>197</sup> Huber and Mullis, *op. cit.*, 305.

the parties provided sufficient criteria from which a definite price can be drawn depending on the quality of the delivered furs.<sup>198</sup>

It appears from the above line of reasoning that Article 55 is in contradiction with the Islamic principles where the price of the goods must be determined at the conclusion of the contract of sale. This can be established by a *hadith* as narrated by Anas “*The Prophet said, “O Bani Najjar! Suggest a price for your garden.”* Part of it was a ruin and it contained some date palms.<sup>199</sup> The Mejlle further provides in Article 237 that “It is necessary that the price should be named at the time of the sale (*Bey*). Therefore, if the price of the thing sold is not mentioned at the time of the sale, the sale is bad (*fasid*).<sup>200</sup> The requirement as to determining the price at the time of conclusion of the sale is further strengthened by Article 238 of The Mejlle when it provides that “It is necessary that the price should be known.” It appears that these injunctions are consistent with the Islamic prohibition against uncertainty where it requires that the price must be in existence and determined at the time of the contract and cannot be fixed at a later date with reference to the market price, nor can it be left subject to determination by a third party.

Article 55 of the CISG only applies if the contract has been validly concluded without determining the price. Article 14, on the other hand, provides that the contract is only validly concluded if the parties have determined the price.<sup>201</sup> At first sight, therefore, both provisions seem to be inconsistent with each other and in fact, this predicament has been discussed but not solved during the negotiations on the Convention. However, the

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<sup>198</sup> Case No. 2 Ob 547/93 available at <<http://cisgw3.law.pace.edu/cases/941110a3.html>>.

<sup>199</sup> Translation of Sahih Bukhari, Volume 3, Book 34, Number 314.

<sup>200</sup> Refer to paragraph 4.4.4, *supra*.

<sup>201</sup> Article 14(1) CISG: “A proposal for concluding a contract addressed to one or more specific persons constitutes an offer if it sufficiently definite and indicates the intention of the offeror to be bound in case of acceptance. A proposal is sufficiently definite if it indicates the goods and expressly or implicitly fixes or makes provision for determining the quantity and the price.”

prevailing opinion gives precedence to Article 14.<sup>202</sup> Under this approach, Article 55 can only be applied if the case is such that the parties have concluded a valid contract despite failing to determine the price. It is submitted that there will be primarily two groups of cases which lead to this result, namely:

The first group consist so f those cases in which the parties knew and agreed that they wanted to conclude the contract without (expressly or implicitly) determining the price, thus derogating from the second sentence of Article 14(1).<sup>203</sup>

The second group consists of those cases in which sales contract is governed by the CISG with the exception of Articles 14-24,<sup>204</sup> for instance, as a result of a reservation under Article 92<sup>205</sup> or of a derogation by the parties under Article 6.<sup>206</sup>

Whether there is a third group of cases in which Article 55 will apply, namely those cases in which the contract was not concluded by a clear-cut exchange of offer and acceptance , but, for instance, by a series of communications, is still a matter o debate. All things considered, it is submitted that a contract will only rarely be invalid for a failure to fix a price. In many cases, there will either be an implicit agreement on the price or an implicit derogation of Article 14(1) (second sentence).<sup>207</sup>

#### **4.5.4 Place of Payment**

Article 57 designates the place for payment when the parties fail to do so in the contract and it only applies where the contract neither expressly nor implicitly designates a place

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<sup>202</sup> Huber and Mullis, *op. cit.*, 305.

<sup>203</sup> *Id.* at 305-306.

<sup>204</sup> Articles 14-24 are under Chapter II, Part II of the Convention on 'Formation of the Contract'.

<sup>205</sup> Article 92(1): "A Contracting State may declare at the time of signature, ratification, acceptance, approval or accession that it will not be bound by Part II of this Convention or that it will not be bound by Part III of this Convention."

<sup>206</sup> Huber and Mullis, *op. cit.*, 306. Article 6 states that "The parties may exclude the application of this Convention or, subject to article 12, derogate from or vary the effect of any of its provisions."

<sup>207</sup> Huber and Mullis, *op. cit.*, 306.

for payment.<sup>208</sup> It sets forth a general rule the application of which can only be avoided on the basis of a provision, either legal or contractual, providing for a place of payment other than the seller's place of business. Hence, if the buyer is not bound to pay the price at any other particular place, he must pay the price either at the seller's place of business or if the payment is to be made against the handing over of goods or documents, at the place where the handing over takes place.<sup>209</sup>

It is submitted that Article 57 governs the place of payment by using a three-step test.<sup>210</sup> The prime criterion is the parties' agreement, as the first part of Article 57 makes clear. In the absence of a contractual agreement on the place of payment, the next step will follow from Article 57(b)<sup>211</sup> which provides that if the payment is to be made against the handing over of the goods or of documents, namely if payment and delivery are concurrent conditions, the place of payment shall be at the place where the handing over takes place. However, where payment and delivery are not concurrent conditions, Article 57(a) will apply and the place of payment is the seller's place of business.<sup>212</sup> Article 57(1) respects the parties' agreement on the place of payment. Such an agreement will often be reached by using standardised payment terms. If, for instance, payment is to be made "cash before delivery" then the predominant opinion is that the place of payment is meant to be the seller's place of business.<sup>213</sup> In a decided case, the term "cash against delivery" leads to a place of payment at the place of delivery.<sup>214</sup>

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<sup>208</sup> Article 57(1) CISG: "If the buyer is not bound to pay the price at any other particular place, he must pay it to the seller:

(a) at the seller's place of business; or

(b) if the payment is to be made against the handing over of the goods or of documents, at the place where the handing over takes place."

<sup>209</sup> Butler, *op. cit.*, 20-21.

<sup>210</sup> Huber and Mullis, *op. cit.*, 309.

<sup>211</sup> Butler, *op. cit.*, 20-21.

<sup>212</sup> Huber and Mullis, *op. cit.*, 309.

<sup>213</sup> *Id.* at 309.

<sup>214</sup> Case number IHK O 10820/10 decided on 27 February 2003 by the District Court of Nuernberg-Fuerth, Germany. Retrieved on 27 June 2011 from <<http://www.unilex.info/case.cfm?id=965>>.

In consequence, the term “documents against payment” should lead to the place where the documents have to be handed over. If payment is to be made by letter of credit, the place of payment will usually be at the advising (or confirming) bank in the seller’s country. On the whole, the result will in each individual case depend on the interpretation of the term used by the parties so that generalisations are not possible in this context. The crucial element from the perspective of the CISG is, however, that the parties’ agreement on the place of payment should be respected. Where not determined expressly or impliedly, the place of payment can also be determined through usages or practices under Article 9 of the Convention. In this respect, the first part of Article 57(1) is not limited to contractual agreements but can also cover such usages or practices.<sup>215</sup>

If payment is to be made against the handing over of the goods or of documents, the place of payment is the place where the handing over takes place.<sup>216</sup> This rule, as a result of the word “against” in the Article, presupposes that payment and handing over of goods or documents are concurrent obligations. The concurrent character of these obligations can derive from the contract, from usages and practices or, in the absence of either of these, from Article 58, which stipulates that, as a rule, payment and delivery are concurrent obligations.<sup>217</sup> However, it will be a matter for each individual case to find out whether the relevant obligations are concurrent as maintained in Article 57(1)(b). As a general rule, however, the provision usually requires that the parties (or their representatives) meet at one place in order to exchange their performances there. It will not apply if one party has to perform before the other. If payment and delivery are concurrent obligations in the above-mentioned scenario, the place of payment will then be the place of the actual

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<sup>215</sup> Huber and Mullis, *op. cit.*, 310.

<sup>216</sup> Article 57(1)(b) CISG.

<sup>217</sup> Huber and Mullis, *op. cit.*, 310. Article 58(1) states that “If the buyer is not bound to pay the price at any other specific time, he must pay it when the seller places either the goods or documents controlling their disposition at the buyer’s disposal in accordance with the contract and this Convention. The seller may make such payment a condition for handing over the goods or documents.”

exchange. In practice however, this place will often be determined by the relevant trade terms, in particular the Incoterms.<sup>218</sup>

In cases where there is no contractual agreement, trade usages or practices and if payment and delivery are not concurrent obligations, Article 57(1)(a) provides as a default rule that payment is to be made at the seller's place of business. It is therefore the buyer who bears the risk if payment is delayed or lost.<sup>219</sup>

#### **4.5.5 Time of Payment**

The time of payment is governed by Article 58 and 59 of the CISG. According to Article 58(1) "If the buyer is not bound to pay the price at any other specific time, he must pay it when the seller places either the goods or documents controlling their disposition at the buyer's disposal in accordance with the contract and this Convention." At first sight, this provision seems to oblige the seller to perform first (by putting the goods or documents at the disposal of the buyer) before payment is due. Yet, a closer examination of the provision reveals that delivery and payment will usually be concurrent obligations which have to be performed at the same time with each other. In effect, the second sentence in Article 58(1) and the phrasing of Article 58(2)<sup>220</sup> expressly give the seller the right to make payment a condition for handing over the goods or documents. The overall picture therefore is that the placing of the goods or documents at the buyer's disposal makes payment due. The actual handing over, however, may be refused until payment is made. Ultimately, the seller and buyer will often perform concurrently.<sup>221</sup>

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<sup>218</sup> Huber and Mullis, *op. cit.*, 310-311.

<sup>219</sup> *Id.* at 311.

<sup>220</sup> Article 58(2) CISG states that "If the contract involves carriage of the goods, the seller may dispatch the goods on terms whereby the goods, or documents controlling their disposition, will not be handed over to the buyer except against payment of the price."

<sup>221</sup> Huber and Mullis, *op. cit.*, 307.

Article 58(3) explains that the buyer is not bound to pay until he has an opportunity to examine the goods unless the procedures agreed upon by the parties are inconsistent with such right of examination.<sup>222</sup> It is argued that the examination Article 58(3) envisages is only a short and superficial inspection and not equivalent to the examination dealt with in Article 38.<sup>223</sup> If the buyer has the right of examination, the time of payment will then be postponed accordingly. As the provision clearly states, however, the buyer will not have a right to examine the goods, if this would be inconsistent with the payment or delivery procedures agreed upon in the contract.<sup>224</sup> Thus, at the time when payment becomes due, the buyer must effect payment without any further request by the seller, as Article 59 clearly states.<sup>225</sup> The buyer will therefore be in breach of his obligations without there being any notice requirement on the part of the seller. As a consequence, the seller may be entitled to remedies under Article 61 *et seq.* of the CISG, in particular to damages under Article 61(1)(b) and Article 74 *et seq.*<sup>226</sup> Furthermore, irrespective of the fact that the buyer will be in breach, the seller will have the right to claim interest under Article 78 from the moment payment was due.<sup>227</sup>

#### **4.5.6 Taking Delivery**

The general provision in Article 53 of the CISG provides that the buyer must take delivery of the goods. As per Article 60, “taking delivery” consists in taking the physical presence of the goods and in doing all acts which could reasonably be expected of him in order to enable the seller to make delivery.<sup>228</sup> It is suggested that these duties to cooperate will

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<sup>222</sup> The buyer is not bound to pay the price until he has had an opportunity to examine the goods, unless the procedures for delivery or payment agreed upon by the parties are inconsistent with his having such an opportunity.

<sup>223</sup> Refer to paragraph 4.2.5, *supra*.

<sup>224</sup> Huber, P. and Mullis, A. (2007) at p. 308

<sup>225</sup> Article 59 CISG: “The buyer must pay the price on the date fixed by or determinable from the contract and this Convention without the need for any request or compliance with any formality on the part of the seller.”

<sup>226</sup> Remedies will be discussed in Chapter 5 of this dissertation.

<sup>227</sup> Huber and Mullis, *op. cit.*, 308. Article 78 of the CISG will be discussed in Chapter 6 of this dissertation.

<sup>228</sup> Article 60 CISG: “The buyer’s obligation to take delivery consists:

(a) in doing all the acts which could reasonably be expected of him in order to enable the seller to make delivery; and  
(b) in taking over the goods.”

often be specified in the contract, in particular where the parties have agreed to the Incoterms.<sup>229</sup> Thus, if the buyer refuses to take delivery of the goods, this amounts to a non-performance which will entitle the seller the remedies specified in Article 61 *et seq.* unless the buyer was justified in refusing to take delivery. Such a justification can result from Article 52 in cases where delivery was too early or of excess quantity.<sup>230</sup>

It has also been argued that in case of other breaches, in particular for late delivery and non-conformity of the tendered goods, the buyer should be entitled to refuse to take delivery if the seller's breach is fundamental.<sup>231</sup> The reason for this is that the buyer would in that case be entitled to avoid the contract under Article 49(1)(a)<sup>232</sup> or to claim substitute delivery under Article 46(2) in any case.<sup>233</sup> However, it has further been argued that despite his right to reject the goods, the buyer may be under an obligation to take provisional possession of them under Article 86.<sup>234</sup> Nevertheless, if the seller's breach does not amount to a fundamental breach, the buyer will, as a rule, not be justified to refuse to take delivery. It is, however, sometimes argued that there may be exceptional situations where Article 7(1) of the CISG,<sup>235</sup> in particular the good faith principle, may justify refusal. By way of an example, a refusal to take delivery would be justified in a case where the buyer claims repair of the goods which requires the goods to be transported back to the

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<sup>229</sup> Huber and Mullis, *op. cit.*, 319.

<sup>230</sup> *Ibid.* Article 52(1) states that "If the seller delivers a quantity of goods before the date fixed, the buyer may take delivery or refuse to take delivery" while Article 52(2) further explains that "If the seller delivers a quantity of goods greater than that provided for in the contract, the buyer may take delivery or refuse to take delivery of the excess quantity. If the buyer takes delivery of all or part of the excess quantity, he must pay for it at the contract rate."

<sup>231</sup> Huber and Mullis, *op. cit.*, 319. Article 25 states that "A breach of contract committed by one of the parties is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result."

<sup>232</sup> Article 49(1): "The buyer may declare the contract avoided:

(a) if the failure by the seller to perform any of his obligations under the contract amounts to a fundamental breach of contract."

<sup>233</sup> Article 46(2) CISG: "If the goods do not conform with the contract, the buyer may require delivery of substitute goods only if the lack of conformity constitutes a fundamental breach of contract and a request for substitute goods is made either in conjunction with notice given under article 39 or within a reasonable time thereafter."

<sup>234</sup> Huber and Mullis, *op. cit.*, 319. Article 86(1) CISG explains that "If the buyer has received the goods and intends to exercise any right under the contract or this Convention to reject them, he must take such steps to preserve them as are reasonable in the circumstances. He is entitled to retain them until he has been reimbursed his reasonable expenses by the seller."

<sup>235</sup> Refer to paragraph 2.7.1.1 and 2.7.1.2 of Chapter 2 of this dissertation on the discussion of Article 7.

seller. Though exceptions to the general rule are possible, they should, it has been argued, be limited to strictly exceptional cases.<sup>236</sup>

#### 4.5.7 Risk

The concept of risk and the party who bears the risk is an issue of extreme importance which preoccupies both parties in a contract of sale.<sup>237</sup> The reason of its importance is due to its peculiar nature, which may lead to certain harsh and unjust effects resulting in the buyer being obliged to pay the price for the goods even though the goods have been lost or damaged by a cause unrelated to the party's act or omission.<sup>238</sup> The meaning of risk in a sales contract can include, among others, physical loss, deterioration or damage of the goods sold. The common characteristic in the above circumstances is that the loss or damage must be accidental and not caused by an act or omission of one of the parties. Hence, situations like theft, seawater or overheating affecting the quality of the goods, confusion of the goods (especially liquid) with other goods, spoilage, evaporation, improper stowage or careless handling can be categorised as risk.<sup>239</sup>

It is submitted that the rules on the passing of risk are closely linked to the buyer's obligation to pay the purchase price. In effect, Article 66 of the CISG provides that "Loss of or damage to the goods after the risk has passed to the buyer does not discharge him from his obligation to pay the price, unless the loss or damage is due to an act or omission of the seller." The time at which the risk passes from the seller to the buyer will often be determined by the contract. However, in the absence of any agreement, or usage or practice under Article 9, the passing of the risk is governed by Articles 66 to 70 of the CISG. It is

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<sup>236</sup> Huber and Mullis, *op. cit.*, 319-320.

<sup>237</sup> Only the concept of risk from the conventional aspect of sale will be explained in this paragraph and the following sub-paragraphs as the concept of risk under the *shari'ah* requires further investigation and in depth discussion and is outside the scope of this chapter. Some aspects of risk are explained in paragraph 7.4 of Chapter 7 of this dissertation in relation to the concept of *gharar*.

<sup>238</sup> Valiotti, Z, Passing of Risk in International Sale Contracts: A Comparative Examination of the Rules on Risk under the United Nations Convention on Contracts for the International Sale of Goods (Vienna 1980) and INCOTERMS 2000 (2003). Retrieved 5 July 2011 from <<http://www.cisg.law.pace.edu/cisg/biblio/valiotti1.html>>.

<sup>239</sup> Valiotti, *op. cit.* The CISG does not define the meaning of risk in any of its Articles.

suggested that as the interpretation of these provisions gives rise to a number of difficult questions, it may be advisable for the parties to provide specifically for the passing of risk in their contract, for instance, by using the Incoterms. In practice, many international contracts do make provisions for the passing of risk and therefore the practical importance of Article 66-70 is rather limited.<sup>240</sup>

#### **4.5.7.1 Time of Passing of Risk**

Articles 67-69 of the CISG distinguish between several types of sales contract. In general, the rules on the passing of risk, will, to a large extent, mirror the rules on the place of delivery under Article 31.<sup>241</sup> Essentially, the basic principles are as follows:

Firstly, if the contract of sale involves carriage of the goods, in the sense of Article 31(a), and the seller is not bound to hand them over at a particular place, the risk, in principle, passes to the buyer when the goods are handed over to the first carrier for transmission to the buyer.<sup>242</sup>

Secondly, if the goods are sold in transit, Article 68 provides a rather complicated set of rules.<sup>243</sup> The first sentence of this Article states that the risk passes at the time of the conclusion of the contract. However, this rule can lead to problems in practice as it will often be difficult to determine the exact time when during the course of the carriage, that is to say, before or after the conclusion of the contract, the goods were damaged. To deal with this problem, the second sentence of Article 68 provides that the risk is assumed by

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<sup>240</sup> Huber and Mullis, *op. cit.*, 314-315.

<sup>241</sup> Refer to paragraph 4.2.2, *supra*, on the discussion of Article 31.

<sup>242</sup> Huber and Mullis, *op. cit.*, 315. Refer Article 67(1) which states "If the contract of sale involves carriage of the goods and the seller is not bound to hand them over at a particular place, the risk passes to the buyer when the goods are handed over to the first carrier for transmission to the buyer in accordance with the contract of sale. If the seller is bound to hand the goods over to a carrier at a particular place, the risk does not pass to the buyer until the goods are handed over to the carrier at that place. The fact that the seller is authorized to retain documents controlling the disposition of the goods does not affect the passage of the risk."

<sup>243</sup> Huber and Mullis, *op. cit.*, 315. Article 68 CISG: "The risk in respect of goods sold in transit passes to the buyer from the time of the conclusion of the contract. However, if the circumstances so indicate, the risk is assumed by the buyer from the time the goods were handed over to the carrier who issued the documents embodying the contract of carriage. Nevertheless, if at a time of the conclusion of the contract of sale the seller knew or ought to have known that the goods have been lost or damaged and did not disclose this to the buyer, the loss or damage is at the risk of the seller."

the buyer from the time the goods were handed over to the carrier, that is, for the entire carriage period, if “the circumstances so indicate”. It is still a matter of dispute when this is the case. Many authors argue that this provision should at any rate be applied if the whole carriage period is covered by a transport insurance, for instance under a CIF contract. On the other hand, it would probably extend the scope of the exception in this provision too far if one applied it to every case in which there is doubt as to the exact date of the damage to the goods. Finally, the third sentence of Article 68 places the risk on the seller if he knew or ought to have known that the goods had been lost or damaged and did not disclose this to the buyer.<sup>244</sup>

And thirdly, in all other cases, the risk will pass according to the rules in Article 69 of the CISG which distinguishes between two types of contract.<sup>245</sup> If the buyer is bound to take over the goods at the seller’s place of business, the risk passes when he takes over the goods, or, if he does not do so in due time, from the time when the goods are placed at his disposal and he commits a breach of contract by failing to take delivery.<sup>246</sup> However, if the buyer is bound to take over the goods at a place other than a place of business of the seller, the risk passes when delivery is due and the buyer is aware of the fact that the goods are placed at his disposal there.<sup>247</sup>

It is submitted that in any of the abovementioned cases, the risk will not pass to the buyer until the goods are clearly identified to the contract - for instance, by marking of the goods, by shipping documents, by notice to the buyer et cetera.<sup>248</sup> This rule is expressly provided

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<sup>244</sup> Huber and Mullis, *op. cit.*, 315.

<sup>245</sup> Huber and Mullis, *op. cit.*, 316.

<sup>246</sup> Article 69(1) CISG.

<sup>247</sup> Article 69(2) CISG.

<sup>248</sup> Huber and Mullis, *op. cit.*, 316.

for in Article 67(2) and in Article 69(3).<sup>249</sup> It is further submitted, however, that it can also apply to cases which fall under Article 68 as a general principle of the CISG under Article 7(2).<sup>250</sup>

#### **4.5.7.2 Consequences and Exceptions**

It is argued that the most important effect of the passing of risk is that the buyer will not be freed from his obligation to pay the price if the goods are lost or damaged after risk has passed to him. This is clearly stated in Article 66.<sup>251</sup> Although this provision only names loss and damage explicitly, it is submitted that it should be interpreted in a broad sense as a general principle under Article 7(2). By way of example, therefore, after the passing of risk, the buyer will also have to bear the consequences of shrinkage of the goods, of the emergence of defects (provided these are not due to a breach by the seller of his obligation to deliver conforming goods and in particular to deliver goods that are fit to endure a normal transit), of emergency unloading, of the carrier's negligence and so forth.<sup>252</sup>

Finally, to the general rule that where the risk has passed to the buyer he must pay the price notwithstanding that the goods has been lost or damaged, Article 66 provides an exception. In the final part of the provision, it is provided that the buyer will not be obliged to pay the price where "the loss or damage is due to an act or omission of the seller." It is proposed that mere causality cannot be sufficient to trigger that exception, otherwise the mere fact that the seller has concluded the contract would suffice, which would obviously lead to

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<sup>249</sup> Article 67(2) states that "Nevertheless, the risk does not pass to the buyer until the goods are clearly identified to the contract, whether by marking the goods, by shipping documents, by notice given to the buyer or otherwise" whilst Article 69(3) provides that "If the contract relates to goods not then identified, the goods are considered not to be placed at the disposal of the buyer until they are clearly identified to the contract."

<sup>250</sup> Huber and Mullis, *op. cit.*, 316. The authors are of the opinion that such cases will be rare as sales of goods in transit usually relate to specific goods. It is however put forward that it is conceivable, for instance, if an undivided bulk is sold to several buyers as a collective assignment. Refer to paragraph 4.5.7.1 *supra*, on the discussion of Article 68 and paragraphs 2.7.1.1 and 2.7.1.2 in Chapter 2 of this dissertation on the discussion of Article 7.

<sup>251</sup> Huber, and Mullis, *op. cit.*, 316. Refer to paragraph 4.5.7, *supra*, on the explanation of Article 66 of the CISG.

<sup>252</sup> *Id.* at 316.

unreasonable results.<sup>253</sup> It is further proposed that only those acts or omissions are sufficient which amount to a breach of an obligation of the seller (be it one of the main obligations or any ancillary obligations) and which are not justified; where for instance the seller exercises a right of stoppage in transit, he is justified and does not fall under the exception in Article 66, so that the buyer is still bound to pay the price.<sup>254</sup>

A further exception to the general rule is stipulated in Article 70.<sup>255</sup> This Article provides that “If the seller has committed a fundamental breach of contract, articles 67, 68 and 69 do not impair the remedies available to the buyer on account of the breach.” It is suggested that this provision has given rise to a considerable amount of uncertainty as it does not cover those cases where the seller’s fundamental breach has caused loss of or damage to the goods which only manifests itself some time after delivery. Such cases, in fact, are nonetheless not dealt with by Article 66 *et seq*, as it becomes apparent from the second sentence of Article 66. It is further suggested that they will have to be dealt with under the normal provisions for breaches by the seller, namely under Article 45 *et seq* of the CISG.<sup>256</sup>

Having considered the above discussion, then it is suggested that the purpose of Article 70 is to make sure that accidental loss or damage which occurs after the risk has passed to the buyer will not deprive him of his remedies. Hence, for instance, the buyer will not be barred from avoiding the contract for fundamental breach simply because the goods were accidentally lost while he had them in possession. Article 70 will in such cases operate as an

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<sup>253</sup> *Id.* at 317.

<sup>254</sup> *Id.* at 317.

<sup>255</sup> *Id.* at 318.

<sup>256</sup> *Id.* at 318. Article 45 of the CISG will be discussed in Chapter 5 of this dissertation.

exception to the rule in Article 82(1) or in other words, the buyer's remedies for fundamental breach takes priority over the risk provisions.<sup>257</sup>

#### **4.6 Concluding Remarks**

From the above discussion, it can be concluded that, in essence, the rights and obligations of the seller and buyer under the CISG and the *shari'ah* are somewhat similar apart from each of the system seem to place different emphasis on distinct matters. It can be understood the *shari'ah's* core principle in conducting trade is honesty in business where deceitful dealings and illegal profits are denounced. While the seller under both the CISG and the *shari'ah* is obliged to deliver conforming goods to the buyer, the one concept that is of utmost importance under *shari'ah* is that the concept of *milkiyyah* or ownership in the goods where, in order to trade, the seller must be the owner of the goods. Such a concept is not mentioned anywhere in the CISG, where the only requirements are for the seller deliver the goods, deliver documents relating to the goods and transfer the property in the goods. Considering that the CISG placed no emphasis on the seller being the owner of the goods, the requirement that the seller has to transfer property in the goods seems like an anomaly in such a circumstance.

Another aspect to note in this comparison is whist the CISG requires the buyer to examine the goods, albeit rather vaguely, "within a short period as is practicable in the circumstances, the *shari'ah* allows the buyer to refuse delivery of the goods even if the goods were purchased without inspection. This rather permissive stance may be open to abuse by unscrupulous buyers. The *shari'ah* also requires that the goods must be in existence at the time of conclusion of the sale, however, in international sales where the

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<sup>257</sup> *Ibid.* Article 82(1) states that "The buyer loses the right to declare the contract avoided or to require the seller to deliver substitute goods if it is impossible for him to make restitution of the goods substantially in the condition in which he received them."

goods are traded via documentary transactions only and which may change ownership many times over during transit, this requirement may not be met in certain situations and therefore the contracting parties may have to rely on the principle of *qabd hukmi* to ensure the validity of the sale.

Both the requirements that the buyer must pay the price and take delivery of the goods are analogous under the CISG and *shari'ah*. Although both systems compels that the price should be fixed in the contract, the CISG, should no price being fixed when the contract is concluded, allows for the price to be determined through previous dealings. Conversely, under the *shari'ah*, when no price is fixed, the sale is considered as *fasid*, or a 'bad' sale. This requirement is in line with the tenets of *shari'ah* for the need to eliminate uncertainty in a transaction.

Whist the CISG specifically provides for the passing of risk in a sale transaction, this matter is not dealt with under the *shari'ah*. Having said that, contracts of sale under the *shariah* must be analysed with a broad concept of *insaf* (justice), *ihsan* (magnanimity) as it promotes the concept of “*ta'auanu ala birri wa't-taqwa*” which means mutual cooperation for the cause of goodness or piety.





## CHAPTER SEVEN

### A THEORETICAL CONSTRUCT OF THE NEW MODEL LAW

#### 7.1 Introduction

Islamic law of transactions is one of many translations for *fiqh al-muamalat* and terms associated with it are, generally and particularly, devoted for the discussion on conceptions of ownership, contracts and related procedure laid down in literature on the science of law. Properties, it is argued, are the basis of material transactions and due to this fact, it is an obligation for every man to understand the types of transactions, their rules and conditions and to abide by those conditions and acts upon them in order to attain the integrity in the dealings between him and other individuals.<sup>1</sup>

With regard to the philosophy of transactions, it could be said that Allah has created man as a social being, which means that every person needs each other for exchanging benefits in matters such as commerce, agriculture or marriage. This interrelation, it is indicated, will bring men together and associate for their special or collective benefit, for, if every man isolates and excludes himself from others, he may face difficulties in obtaining his needs in life. This interrelationship between mankind, however, must be regulated to ensure fairness to all and Allah the Lawgiver has ordained the law of transactions and the restriction for disposition in order that a person will not seize the other person's property and he in turn, will not lose his right over said property.<sup>2</sup> Such regulations are for the benefit of mankind and with these basic concepts of *fiqh al-muamalat*, this chapter aims to devise a fitting *shari'ah* model for the sale of goods.

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<sup>1</sup> Abdurrahman Raden Aji Haqqi, *The Philosophy of Islamic Law of Transactions*, (Kuala Lumpur: CERT Publications Sdn Bhd, 2009), 29-31.

<sup>2</sup> *Id.* at 31.

## 7.2 Customary Source of Islamic Law of Transactions

Custom or *'urf* is the norm or rule of action recognised by the society. It is a means by which a faction of society adjusts to its environment. The customs of any faction or tribe depend upon the situations to which it has to regulate itself during its history and it is due to this reason that the customs of various factions or tribes differ from one another. The elements of a custom are, in general, a constant way of behaviour, social in character and of normative value. By its social character and normativeness, it is distinguished from a mere habit.<sup>3</sup>

It is put forward that customs which do not contravene the principles of *shar'iah* is valid and authoritative and they must be observed and upheld by the court of law.<sup>4</sup> Thus, it can be understood that custom is an important instrument of interpretation, which is further supported by an ancient dictum *consuetude est legume interpres*, which means that custom is the best interpreter of law. The customs prevailing at the time of the Prophet Muhammad (pbuh) which were not abrogated by the Qur'an and the *Sunnah* amounted to recognition on the point of their validity.<sup>5</sup> It prevails that the Arabian customary laws operative within the Muslim community were retained as a major part of the Islamic legal system, however, some were either modified or abrogated. It is argued that the process of abrogation, modification and formation of new laws were based on Divine Revelation in addition to the *ijtihad*<sup>6</sup> of the Prophet (pbuh) but only a small segment of the of the Islamic legal system established during the lifetime of the Prophet (pbuh) emanated from the divine source of legislation, namely the Qur'an. Islam has, thus, retained many of the pre-Islamic

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<sup>3</sup> *Id.* at 31-32.

<sup>4</sup> *Id.* at 32. For the purpose of this chapter, it is to be assumed that the court of law is the *shariah* courts.

<sup>5</sup> *Ibid.*

<sup>6</sup> The exercise of reason in order to find an appropriate ruling on a matter not directly ruled upon the Qur'an or to ake use of principles, similarities and comparisons. Ruqaiyyah Waris Maqsood, A Basic Dictionary of Islam, (New Delhi: Goodworks Books, 2008), 103.

Arabian customs while it has, at the same time, overruled the oppressive and corrupt practices of the Arab society. Islam also attempted to improvise and regulate some of the Arab customary laws with a view to bringing them corresponding to the principles of the *shari'ah*.<sup>7</sup>

History has established that the advent of Islam occurred in the Arabian peninsular and it was, therefore, natural, for the Islamic reforms to incorporate the values of the Arabian society as a model law. It was found that pre-Islamic customs of Arabia have influenced the *shari'ah* in its formative stages of development and even in the verbal and practices of the *Sunnah*, there are instances where Arabian custom have been upheld and incorporated within the *Sunnah* of the Prophet (pbuh).<sup>8</sup> It is argued that Islam did not appear to diminish the former culture but it arrived as a restoration, reformation and establishment of such culture and the criterion of acceptance or rejection in Islam is not the oldness or newness of any law. Instead, it has been put forward that the standard of acceptance was the expediency or usefulness of the law for humanity and concurrence with divine laws, whilst the criteria for rejection were the laws are damaging or detrimental for humanity and opposition to the laws of God.<sup>9</sup>

### **7.3 Mu'amalat – An Adaptable Shari'ah Model**

It is a universal trait of Islam that, except in matters concerning its fundamental beliefs and principles of its code of practices, is not limited to one type of thinking or specific legislative method. Islam is a tolerant religion which authorises and permits liberality. As it has been demonstrated throughout the Muslim world, Islam fits into all major cultures and constructive civilisations and it is argued that it will continue to do so perpetually. In other

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<sup>7</sup> Abdurrahman Raden Aji Haqqi, *op. cit.*, 32.

<sup>8</sup> *Id.* at 33.

<sup>9</sup> *Id.* at 33-34.

words, the Islamic institutions set down the principles of belief, worship, transactions, penal affairs and family organisation, to name a few. The *shari'ah* principles are concerned with the system of consultative government and obligations of the ruler to restrict himself within the Islamic directions for human welfare; to enjoin justice, good deeds, equality, human rights and brotherhood; to forbid aggression and provide defence thereto; to improve the status of the fairer sex and the weak; to uphold the sanctity of private ownership; to fulfil contracts and outlaw deceit and to distinguish the public and personal rights in criminal matters.<sup>10</sup>

It is maintained that, transactions, according to the *shari'ah*, are systems for a fulfilled life on the basis of the needs of the people. Islam has laid down principles for each of its division, thus, the rules and methods have been enunciated relating to people, state affairs and so forth. And such principles provide a degree of solidarity. There is freedom and right to work, to own property and to enjoy other property rights. Nevertheless, it is argued that these principles are bound by the larger interests of the community in Islam. In fact, the right to private ownership under the *shari'ah* is owned by God whilst men are to enjoy its benefits. In other words, a man's title is limited to the benefits accruing on the property but the legal title vests in God. The exercise of this right is circumscribed by the larger interests of the community and thus, the principles of social solidarity prohibit exploitation under which the economic system of the *shari'ah* exists. It appears from the above assertion that it indicates the Islamic law of transactions in acquiring such a significant role as a system of a fulfilled life on the basis of the needs of the people ought to always be in harmony and conformity with circumstances which occur at every place and time. It also

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<sup>10</sup> *Id.* at 34.

means that the Islamic law of transactions could also be adapted or modified in accordance with any situation provided that it does not contravene its principles and originality of state. It has been argued that these principles could be confined to several bases as follows:-<sup>11</sup>

### 7.3.1 The Originality in Islamic Law of Transactions is Ratiocination and Analogy

It is underlined that Al-Shatibi<sup>12</sup> has stated that “the originality in dealings is consideration in meanings”. In other words, it can be understood that the originality in Islamic law of transactions (dealings) is ratiocination and analogy. In linguistic sense, *ta’lil* (ratiocination) means causation, or search for the causes and it refers to the logical relationship between the cause and effect. But the scholars of Islamic jurisprudence tend to use *ta’lil* and its derivative *‘illah* for different purposes.<sup>13</sup> The question then arises as to whether the incidence of *ta’lil* in Islamic teachings gives the *mujtahid*<sup>14</sup> the permission to inquire into the causes and reasons behind its injunctions or merely to facilitate a better understanding of the text. It is argued that the *ulama* (scholars of Islamic law and jurisprudence) are in disagreement over this matter.<sup>15</sup>

The majority of the *ulama* have held that the *ahkam*<sup>16</sup> of the *shari’ah* contemplate certain objectives and when such an objective can be identified, it is our duty to make an effort to

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<sup>11</sup> *Id.* at 35.

<sup>12</sup> Imam Abu Ishaq al-Shatibi was an Andalusian Sunni Islamic legal scholar following the Maliki madhab. He died in 1388 (8th Shabaan 790 H) in Granada, Spain. The date and place of his birth are unknown. Imam Shatibi's full name was Ibrahim bin Mosa bin Muhammad al-Shatibi al-Gharnati. He learned from very prominent scholars of his time. He became master in Arabic language and Ijtihad and research at a very early age. Among his well known books are *Al-Aitesaam* and *Al-Muwafaqaat fi Usool al-Sharia*. Retrieved on 12 September 2012 from <[http://en.wikipedia.org/wiki/Abu\\_Ishaq\\_al-Shatibi](http://en.wikipedia.org/wiki/Abu_Ishaq_al-Shatibi)>.

<sup>13</sup> Abdurrahman Raden Aji Haqqi, *op. cit.*, 35. The author further explains that in its juridical usage, *‘illah* (effective cause) does not exactly refer to causal relationship between two phenomena but it significantly means the ratio of the law, its value and purpose. Generally, *‘illah* refers to the rationale of an injunction and in this sense, it is synonymous with *hikmah*, that is the purpose and the objective of the law.

<sup>14</sup> A *mujtahid* is one who has reached the level of *ijtihād* (obtaining a proof for a religious ruling) in understanding religious laws. This means that he has the ability to deduct religious rulings from the Qurān and traditions. Retrieved on 18 September 2012 from <<http://www.al-islam.org/the-basics-of-islamic-jurisprudence/4.htm>>.

<sup>15</sup> Abdurrahman Raden Aji Haqqi, *op. cit.*, 35-36.

<sup>16</sup> In Islamic law, a *hukm* is a judicial ruling or decision made by one with authority. The term's plural form, *ahkam*, refers more specifically to rules derived from *fiqh*, or Islamic jurisprudence. Retrieved on 19 September from <<http://financial-dictionary.thefreedictionary.com/Hukm>>.

identify and to implement them. It is argued that since the realisation of the objectives of the *shari'ah* necessitates identification of the cause or rationale of the *ahkam*, it becomes a man's duty to discover these in order to be able to pursue the general objectives of the Lawgiver. Hence, it is the duty of the *mujtahid* to identify the proper causes of divine injunctions, especially, in the event where more than one *'illah* can be attributed to a particular injunction. It is put forward that the majority view on *ta'lil* takes into account the analysis that the rules of the *shari'ah* have been introduced in order to realise particular objectives and that the Lawgiver has enacted the detailed rules of *shari'ah* not as an end by themselves but as a means to realising those objectives. Any attempt to implement the law ought to take into account not only the externalities of the law but also the rationale and intent behind it.<sup>17</sup>

It has been contended that Al-Shatibi<sup>18</sup> in supporting his assertion that the originality in dealings is consideration of meanings or ratiocination has put forward three arguments as follows:-<sup>19</sup>

### **7.3.1.1 The Investigation of the Texts**

It has been asserted that the Lawgiver had intended benefits for mankind yet the ruling of dealings runs with such benefit wherever the latter exists. It could be established that a thing is forbidden in a situation where there is no benefit from it but it is allowed when a benefit is present. For instance, an exchange of one *dirham* for another *dirham* with delay

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<sup>17</sup> Abdurrahman Raden Aji Haqqi, *op. cit.*, 36-37. The author further explains the opposite views of the Zahiris (is a school of thought in Islamic jurisprudence and Aqida. The school is named after one of its early prominent jurists, Dawud ibn Khalaf al-Zahiri (d. 270/883) and is known for its insistence on sticking to the manifest (*zahir*) or apparent meaning of expressions in the Qur'an and the Sunnah. Retrieved on 19 September 2012 from <<http://en.wikipedia.org/wiki/Zahiri>> where they maintain that divine injunctions embodied in the clear text have no causes unless the lawgiver provided us with clear indications to the contrary.

<sup>18</sup> *Id.* at note 12, *supra*.

<sup>19</sup> Abdurrahman Raden Aji Haqqi, *op. cit.*, 38.

is forbidden in sale but it is not so in borrowing. This ruling is not found in worship or *ibadat*.<sup>20</sup>

In support of this contention, Allah the Almighty has decreed in the Qur'an "*In the law of Equality there is (saving of) Life to you. O ye men of understanding; that ye may restrain yourselves*" (Al-Baqarah: 179).

Further, it is also stated in the Qur'an that "*And do not eat up your property among yourselves for vanities, nor use it as bait for the judges, with intent that ye may eat up wrongfully and knowingly a little of (other) people's property*" (Al-Baqarah:188)

It is argued that the above rulings indicate the consideration of the benefits for mankind (in such rulings) that the permission flows within such benefits whenever they exist as it is explained by the ways of the identification of *'illah*. Consequently, it is proved that the Lawgiver depended in legalising the dealings on the consideration of meanings.<sup>21</sup>

### **7.3.1.2 Explanation of the Effective Causes**

It has also been asserted that the Lawgiver has widened the scope in explaining the effective causes and wisdom in legalising the dealings and the majority of such effective causes are by observing the corresponding dealing which will be accepted when they are displayed to the reason. For this reason, it is understood that Allah the Lawgiver means in which (dealings) the following of meanings not only standing with the texts in contrary to the worship matters (*sic*). Thus, Imam Malik<sup>22</sup> has extended the application in this division

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<sup>20</sup> *Ibid.*

<sup>21</sup> Abdurrahman Raden Aji Haqqi, *op. cit.*, 39.

<sup>22</sup> Imam 'Abdullah Malik ibn Anas b. Malik b. Abi 'Amir (93-179 H) was born in Medina and was an accomplished man of learning and has the combined qualities of a religious leader, a public teacher and a judge. He studied the *hadith* and learnt earlier legal opinions or *fatawa* and also learnt the Qur'an by heart. He occupied a conspicuous place in the teaching of the *hadith* and is arguably one of the

by formulating the principle of *maslahah al-mursalah* (public interest) and *al-istihsan* (juristic equity).<sup>23</sup>

### 7.3.1.3 Consideration of Meanings

A final assertion would be that the consideration of meanings was known from time to time and the scholars have depended on this consideration so long as their benefit continues with it.<sup>24</sup>

Based on the above arguments, it could therefore be concluded that the application of *qiyas* or ratiocination in commercial transactions is wider than in other branches of Islam. Notwithstanding the fact that the jurists have disagreed on the application of *qiyas* in penalties, it is to be noted that the *ulama'* in general have discouraged recourse of *qiyas* in the field of criminal law and worship (*ibadat*). Consequently, there is very little of *qiyas* to be found in these disciplines. This is also the situation in modern law, which discourages analogy in respect of penalties. The standpoint is somewhat different with regard to the law of transactions or *muamalat* where *qiyas* is generally permitted.<sup>25</sup>

It is to be noted that the nature of rulings on commercial transactions is rather different from the nature of those on worship, the methods and forms of which were bestowed by the Prophet (pbuh) directly under the guidance of Allah. The methods which were not in practice earlier have their details either in the Qur'an or preserved in the *Sunnah*. One practical consequence of this difference in nature is that the amount of detail as to the forms of worship is to be found in the primary sources of Islamic jurisprudence<sup>26</sup> is far

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most reliable chain of transmission of the *hadith*. The most well known book written by him is the *Muwatta*. Anwar A. Qadri, (Islamic Jurisprudence in the Modern World, 2<sup>nd</sup> ed., (Lahore, Pakistan: Sh. Muhammad Ashraf, 1973), 111-113 and 121.

<sup>23</sup> Abdurrahman Raden Aji Haqqi, *op. cit.*, 39.

<sup>24</sup> *Ibid.*

<sup>25</sup> *Ibid.*

<sup>26</sup> Refer to Chapter 3 of this dissertation.

greater than that about routine affairs. Furthermore, worship is related to human activities that are not very much influenced by changes of time and circumstances. The forms and means of transactions, do, however, change with the forward movement in time, culture and technology. It is therefore suggested that this essential fact with regard to transactions and the injunctions of the *shari'ah* must be always kept in view.<sup>27</sup>

### **7.3.2 The Originality in Islamic Law of Transactions is Permissible Unless there is Prohibition**

It is asserted that Muslim jurists have constantly maintained that the originality in Islamic law of transactions is permissible unless there is a prohibition. It signifies that when a new transaction occurred which is not previously known in Islamic law, then, such a transaction is considered permissible unless there is an implication from a text which prohibits it whether explicitly or implicitly. Thus, it can be deduced that the Islamic law of transactions also contain the rules of Allah in which He gives such permission and He is “silent on many things without forgetfulness (in regulating the rule) as a mercy”. Therefore, the permissible becomes *ibadat* which deserves reward when it is intended to approach Allah as it is known in Islamic law. Such *ibadat* appears from what have been regulated by Allah in the state of permissibility. It can be argued that this principle is in accordance with a maxim which provides that “permissibility is the original state of things” and this maxim is discussed under *istishab* (presumption of continuity) in Islamic jurisprudence.<sup>28</sup> For the Shafi’is and the Hanbalis, *istishab* denotes “continuation of that is which is proven and the negation of that which had not existed” and it only applies when

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<sup>27</sup> Abdurrahman Raden Aji Haqqi, *op. cit.*, 39-40.

<sup>28</sup> *Id.* at 40.

no other evidence (*dalil*) is available, which is not applicable when there is a clear text that could be invoked.<sup>29</sup>

It is contended that the Hanbalis have given the permissibility greater prominence in that they validate it as a basis of commitment (*iltizam*) unless there is a text to the contrary. Under the Hanbali doctrine, the norm in *ibadat* is that they are void (*batil*) unless there is an explicit command to validate them. But the norm with regard to transactions and contracts is that they are valid unless there is a *nass* to the contrary. It is also further contended that the principle of original absence of liability is undoubtedly an important feature of *istishab* which is widely upheld not only in the field of criminal law but also in constitutional law and civil litigation in general. This is perhaps equally true of the principle of *ibahah* which is essential component of the principle of legality, also known as the principle of the rule of law. This feature of *istishab* is once again in harmony with the modern concept of legality in that permissibility is the norm in areas where the law imposes no prohibition.<sup>30</sup>

### **7.3.3 The Originality in Islamic Law of Transactions is Dependent on the Existence of Legalising or Illegalising Injunctions from the Lawgiver**

It is asserted that Islamic law is quite expressive of the purpose, reason, objective, benefit, reward and advantage of its injunctions. Since Islamic law addresses the conscience of the individual with a view to persuade and convince a person of the truth and divine origin of its message, it is often combined with an allusion to the benefit that may accrue from the observance of its commands or the harm that is prevented by its prohibitions. This is a feature of legislation in Islamic law which is closely associated with ratiocination and

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<sup>29</sup> Mohamad Hashim Kamali, *Principles of Islamic Jurisprudence*, 2<sup>nd</sup> ed., (Kuala Lumpur: Ilmiah Publishers, Kuala Lumpur, 2007), 297-298.

<sup>30</sup> Abdurrahman Raden Aji Haqqi, *op. cit.*, 40-41.

provides the *mujtahid* with a basis on which to conduct further enquiry into ratiocination.<sup>31</sup> As a characteristic feature of legislation in Islamic law, it may be affirmed that legalising and illegalising are expressed in a variety of forms which are often open to interpretation and *ijtihad* (personal reasoning) - as the question as to whether a particular injunction in the sources of Islamic law amounts to a binding command or to a mere recommendation or even permissibility cannot always be determined from the words of the texts alone.<sup>32</sup>

It is asserted that when Allah explicitly declares something permissible or grants a permission in respect of doing something, or when it is said that there is “no blame” or “no sin” accruing from doing something, or when Allah denies the prohibition of something, or when the believers are reminded of the bounty of Allah in respect of objects that are created for their benefits, all such expressions are indicative of permissibility and option in respect of the conduct or object in question. However, when Allah demands avoidance of a certain conduct, or when He denounces a certain act, or identifies it as a cause for punishment, or when a certain conduct is cursed and regarded as the work of *syaitan*, or when its harmful effects are emphasised, or when something is proclaimed unclean, a sin or a deviation – all such expressions are indicative of prohibition which partakes in abomination (*karahah*). It is for the *mujtahid* to determine the precise value of such injunctions in light of both language of the text in addition to the general objectives and principles of the *shari’ah*.<sup>33</sup>

Consequently, in the Islamic law of transactions, the originality is the existence of their rules whether for legalising or illegalising from the Lawgiver. It means that sale is lawful

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<sup>31</sup> *Id.* at 42.

<sup>32</sup> It has been argued that *ijtihad* is the most important source of Islamic law next to the Qur’an and the *Sunnah*. The main difference between *ijtihad* and the revealed sources of the *shari’ah* lies in the fact that *ijtihad* is a continuous process of development whereas divine revelation and Prophetic legislation discontinued upon the demise of the Prophet. In this sense, *ijtihad* continues to be the main instrument of interpreting the divine message and relating it to the changing conditions of the Muslim community in its aspiration to attain justice, salvation and truth. Mohamad Hashim Kamali, *op. cit.*, 366.

<sup>33</sup> Abdurrahman Raden Aji Haqqi, *op. cit.*, 42.

since Allah the Lawgiver has permitted it whereas usury is unlawful because it is prohibited by Him.<sup>34</sup> The standpoint of the Lawgiver towards the field of transaction differs from His standpoint towards the field of belief and worship. Thus, a *mujtahid* who deduces the law especially the transaction from a given text must be adequately familiar with the language of the sources of Islamic law and must understand that the *ahkam* are not only expressed in the imperative but that a praise, promise of a reward may in effect be equivalent to a command. Similarly, a mere denunciation, a threat of punishment in the hereafter, or a reference to the adverse consequences of conduct may be equivalent to a prohibition. The distinction as to whether a command in the sources of Islamic law conveys an obligation, a recommendation or mere permissibility must be determined in light of the objectives of the *shari'ah* as well as by delving into the meaning of the words of such sources. This is also equally true of a prohibitory text.<sup>35</sup>

It can be argued that one of the major differences between *ibadat* and *muamalat* is on which type of *dalil* that they are based on.<sup>36</sup> The *dalil* pertaining to *ibadat* are by and large based *dalil qat'i* (definitive) whilst that of *muamalat* are usually based on *dalil zanni* (speculative) interpretation. This division of *dalil shar'i* contemplates the proofs of *shari'ah* not only in their entirety but also in respect of the detailed rules which they contain. In this way, the Qur'an, *Sunnah* and *ijma'* are definitive proofs in the sense that they are decisive and binding. However, each of these sources contains speculative rules which are open to interpretation.<sup>37</sup> It is this flexibility which lends an element of fluidity to Islamic commercial transactions which allow it to move forward with modern times and changing circumstances.

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<sup>34</sup> For the explanation on the prohibition of usury see Chapter 6 of this dissertation.

<sup>35</sup> Abdurrahman Raden Aji Haqqi, *op. cit.*, 43.

<sup>36</sup> Literally, *dalil* means proof, indication or evidence. Technically, it is an indication in the sources from which a practical rule of *shari'ah* or a *hukm* (ruling) is deduced. Mohamad Hashim Kamali, *op. cit.*, 9.

<sup>37</sup> *Id.* at 11.

#### 7.4 Definition of *Gharar* (Uncertainty, Speculation, Risk)

*Gharar*, unlike *riba*<sup>38</sup>, has in process of time had its field of application greatly widened. Concern for protecting human beings from their own folly and extravagance is an important feature of the Qur'an, and it consequently proscribed games of hazard, thus providing religious grounds for suspicion of *gharar*.<sup>39</sup>

Allah has decreed in the Holy Qur'an "*They ask thee concerning wine and gambling. Say: "In them is great sin, and some profit, for men, but the sin is greater than the profit."*" (Al-Baqarah: 219).

*"On those who believe and do deeds of righteousness there is no blame for what they ate (in the past), when they guard themselves from evil, and believe, and do deeds of righteousness, - then again, guard themselves from evil and believe,- then again, guard themselves from evil and do good. For Allah loveth those who do good."* (Al-Maidah: 93).

Tradition added to this the result of the Prophet's (pbuh) vast experience as a merchant and his deep knowledge of human nature, for it did not escape him that it is not uncommon, in secular transactions, for one of the parties to be stronger than the other, or perhaps cleverer or more experienced; so the disadvantaged party is in need of some kind of protection and guidance before an agreement is concluded or bargain is struck. This was even more the case during the Prophet's (pbuh) time, when a substantial difference in terms of enlightenment and development existed between the Bedouins and the townsmen, and even between townsmen belonging to different settlements.

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<sup>38</sup> The concept of *riba* was explained in Chapter 6 of this dissertation.

<sup>39</sup> Nabil A. Saleh, *Unlawful Gain and Legitimate Profit in Islamic Law*, 2<sup>nd</sup> ed., (London: Graham & Trotman Ltd, 1992), 62.

A *hadith* to this effect reads: “*Abu Huraira (Allah be pleased with him) reported it directly from Allah's Apostle (may peace be upon him): The townsman should not sell for a man from the desert (with a view to taking advantage of his ignorance of the market conditions of the city). And Zuhair reported from the Holy Prophet (may peace be upon him) that he forbade the townsman to sell on behalf of the man from the desert.*”<sup>40</sup>

Other *hadiths* which forbid uncertainty in sales are: “*Abu Huraira (Allah be pleased with him) reported that Allah's Messenger (may peace be upon him) forbade a transaction determined by throwing stone, and the type which involves some uncertainty.*”<sup>41</sup>

“*Ibn ‘Umar (Allah be pleased with them) reported that the people of pre-Islamic days used to sell the meat of the slaughtered camel up to habal al-habala. And habal al-habala implies that a she-camel should give birth and then the (born one should grow young) and become pregnant. Allah’s Messenger (may peace be upon him) forbade them that (this transaction).*”<sup>42</sup>

This idea of protecting the weak against exploitation by the strong led to the elaboration of a rule of general application, commanding that any transaction should be devoid of uncertainty and speculation, and this, according to learned men and legal scholars, could only be secured by the contracting parties having perfect knowledge of the countervalues intended to be exchanged as a result of their transaction, otherwise there is an unacceptable degree of *gharar*. Thus, what was intended to be a religious precept was transformed into a worldly rule which affects a great proportion of secular transactions. Far from having its scope narrowed by a change of circumstances, the question of *gharar* pervades a number

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<sup>40</sup> Translation of Sahih Muslim, The Book of Transactions (Kitab Al-Buyu’), Book 010, Number 3628.

<sup>41</sup> Translation of Sahih Muslim, The Book of Transactions (Kitab Al-Buyu’), Book 010, Number 3614.

<sup>42</sup> Translation of Sahih Muslim, The Book of Transactions (Kitab Al-Buyu’), Book 010, Number 3616.

of contemporary operations which were not contemplated or at any rate not common during the Prophet's (pbuh) time. This is to say that transactions and contracts relating to insurance and assurance, life annuity, stock exchange market and generally speaking a gamut of transactions where the subject-matter, the price or both, are not determined and fixed in advance, are under suspicion of *gharar* according to *shari'ah* standards.<sup>43</sup>

It has been argued that most cases of *gharar* brought to the attention of early Muslim jurists are drawn from sales contract, whether real or hypothetical. This is because the sale contract is regarded by *fiqh*<sup>44</sup> as the typical contract, the one on which other contracts are modeled. Nevertheless, it is further argued that rules and principles derived from sale examples are also relevant, *mutatis mutandis*, to secular transactions in general. Few traditional authors have felt the need to define *gharar* or to outline its ambit in precise words. Even an outstanding jurist such as Ibn Qayyim described *gharar*, rather briefly, as being the subject-matter that the vendor is not in a position to hand over to the buyer, whether the subject-matter is in existence or not. However, it is only fair to say that Ibn Qayyim was concerned only to challenge those who had mistaken *gharar* for non-existence (*'adam*) and who erroneously saw the reason for the prohibition of *gharar* as the non-existence of the subject-matter, rather than the risk of uncertainty which casts a shadow on the subject-matter.<sup>45</sup>

It has also been put forward that another author, al-Qarafi, equated *gharar* with an uncontrolled subject-matter, such as a bird in the air or fish in the water. But here again the definition was an answer to those who had confused *gharar* with the unknown (*majhul*) and *majhul* is itself described by the same author as being an existing subject-matter whose

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<sup>43</sup> Nabil A. Saleh, *op. cit.*, 62-63.

<sup>44</sup> *Fiqh* is the study of Islamic law and jurisprudence.

<sup>45</sup> Nabil A. Saleh, *op. cit.*, 63-64.

characteristics are unknown, such as selling what is hidden in one's sleeve. A more elaborate definition of *gharar* by Sanhuri added an essential element of want of knowledge (*jahl*), stating that *jahl* brings about *gharar* in the following circumstances, namely – when it is not known whether the subject-matter exist, or if it exists, whether it can be handed over to the buyer, or when want of knowledge affects the identification of the genus or species to which the subject-matter belongs to or its characteristics, quantum, identity or condition remain unsatisfactory. Want of knowledge with regard to the date of future performance, if any, also generates *gharar*.<sup>46</sup>

It has been emphasised that, Ibn Juzay, a Maliki author, obviously aware of the difficulty in defining *gharar*, gave a list of ten cases which constitute, in his view, a forbidden *gharar*. These cases are described as follows:<sup>47</sup>

- (i) Difficulty in putting the buyer in possession of the subject-matter, such as the sale of stray animal or the young still unborn when the mother is not part of the sale;
- (ii) Want of knowledge (*jahl*) with regard to the price of the subject-matter, such as the vendor saying to the potential buyer: “I sell you what is in my sleeve.”;
- (iii) Want of knowledge with regard to the characteristics of the price or of the subject-matter, such as the vendor saying to the potential buyer: “I sell you a piece of cloth which is in my home” or the sale of an article without the buyer inspecting or the seller describing it;
- (iv) Want of knowledge with regard to the quantum of the price or the quantity of the subject-matter, such as an offer to sell “at today's price” or “at the market price”;

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<sup>46</sup> *Id.* at 64.

<sup>47</sup> *Id.* at 64-65.

(v) Want of knowledge with regard to the date of future performance, such as an offer to sell when a stated person enters the room or when a stated person dies;

(vi) Two sales in one transaction, such as selling one article at two different prices, one for cash and one for credit, or selling two different articles at one price, one for immediate remittance and one for a deferred one;

(vii) The sale of what is not expected to revive, such as the sale of a sick animal;

(viii) *Bay' al-hasah* which is a type of sale whose outcome is determined by the throwing of a stone;

(ix) *Bay' munabadha* which is a sale performed by the vendor throwing a cloth at the buyer and achieving the sale transaction without giving the buyer the opportunity for properly examining the object of the sale; and

(x) *Bay' mulamasa*, where bargain is struck by touching the object of the sale without examining it.

While the (viii), (ix) and (x) type of sale may not be relevant in this day and age, examples (i) –(vii) may involve international sale contracts as most sales these days are conducted through the sale of documents, for example a CIF (Cost Insurance Freight) contract and there is always a possibility of *gharar* occurring when the buyer only relies on the description of the goods on paper and may not have the opportunity to physically examine it. *Gharar* in sale transactions is to be avoided as it causes the buyer to suffer damage (*ghubn*), according to Ibn Rushd, another Maliki author. Ibn Rushd is also of the opinion that *gharar* is the result of want of knowledge (*jahl*) which affects either the price or the

subject-matter and it can be averted if both the price and the subject-matter are known to be in existence, if their characteristics are known, if their amount is determined, if the parties have such control over them as to make sure that the exchange shall take place and finally, if the date of future performance, if any, is defined.<sup>48</sup>

Coming to modern times, renowned author Nabil Saleh has, based on the traditional definitions given, emphasised on three rules to avert *gharar* in any given transaction, namely:<sup>49</sup>

- (i) There should not be want of knowledge (*jahl*) regarding the existence of the exchanged countervalues;
- (ii) There should be no want of knowledge (*jahl*) regarding the characteristics of the exchanged countervalues or the identification of their species or knowledge of their quantities or of the date of future performance, if any; and
- (iii) Control of the parties over the exchanged countervalues should be effective.

In other words, a fair and just sale transaction must be precise in the determination of the goods, price, time of performance and both parties are to mutually benefit from the sale.

#### **7.4.1 Avoidance of *Gharar* of the Price and Subject-Matter in a Sale Contract**

Under the *shari'ah* both the price and subject-matter of a sale must be in existence at the time the contract of sale is concluded, otherwise the contract is void.<sup>50</sup> However, in today's international trade transactions where sale are conducted through the exchange of documents (as in a CIF contract) where the goods are not physically available when a sale

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<sup>48</sup> *Id.* at 65.

<sup>49</sup> *Id.* at 66.

<sup>50</sup> *Id.* at 79.

is concluded and when payment can, and is usually made, at a later date, it is necessary to examine the exceptions to the above rule and how to avoid incidences of *gharar* in such transactions.<sup>51</sup>

#### **7.4.1.1 The Price**

It has been argued that when the price for the goods is in the form of currency, it should be in circulation (*mutadawal*) and its species and quantum should be well specified. If figures and kinds of coins are indicated but not features of the coins, such as “ten dinars” with no other specifications, the Hanafis, Malikis and Shafi’is teach that the type of dinar most frequently circulating in the country where the sale was concluded is to be retained. The Hanbalis, on the other hand advocate that the average currency is the one to be chosen. And when, in a given country, different currencies have the same value and the same degree of circulation, a sale contract which fails to indicate the characteristics of the coins representing the price is still valid, and the purchaser is entitled to settle the price in any of the circulating coins, according to the Hanafis and some Malikis. However, this is not the view of the Hanbalis and some other Malikis, who teach that the sale contract would be invalid unless the parties agree on the disputed issue; nor is it the view of the Shafi’is, who teach that the magistrate is the one to determine the kind of coins with which payment should be made.<sup>52</sup>

#### **7.4.1.2 Payment Unavailable at the Parties’ Meeting**

One of the reasons for the non-availability of the payment at the meeting of the contracting parties<sup>53</sup> occurs when the performed transaction is a credit sale. Credit sale is the contract

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<sup>51</sup> As the scope of *gharar* is wide, this chapter will only focus on the aspect of price and subject-matter of a sale.

<sup>52</sup> Nabil A. Saleh, *op. cit.*, 79-80.

<sup>53</sup> In this day and age, the contracting parties may not even meet face to face as transactions can be done via electronic mail.

of sale which credit is given for the whole or a material part of the price. It is submitted that property in the articles which are the subject of the sale passes at once to the buyer, the seller being only a personal creditor for the unpaid price. This is in contrast with *bay salam* where payment of the price is made forthwith, despite the fact that the object of sale is to be delivered at a later stage. In a credit sale where the price is represented by currency, the exchange of the two countervalues can be deferred with or without gain, even though the object of the sale is a property susceptible of *riba (mal ribawi)*, provided such an object is not currency.<sup>54</sup>

It is put forward that the Maliki school of law, which more than any other *sunni* school recognises the validity of a deferred transaction, considers credit sale as a valid and lawful transaction whether or not the price is inflated provided it is not used as a stratagem or device in order to circumvent the prohibition of *riba* as is the case when an apparent credit sale is, in reality, a cover for a loan agreement, with the lender having secured for himself some advantage from the loan. This limitation is also shared by the Hanbalis.<sup>55</sup>

On the other hand, it is argued that it may happen that the payment of the price is deferred not because credit is given to the purchaser but for the reason that the price is not determined during the meetings of the contracting parties (*majlis al-'aqd*) and is to be determined afterwards. This is unacceptable by *shari'ah* standards. Even when the price is to be determined either by a decision to be taken by a given person or by reference to market price or by analogy with a sale performed by a third party, Islamic schools of law, with perhaps a slight exception advocated by the Hanbali school, resist such practices on

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<sup>54</sup> If both countervalues were currencies then the transaction would amount to an exchange, that is *sarf*, and as such different rules would apply. Nabil A. Saleh, *op. cit.*, 82.

<sup>55</sup> *Ibid.*

the ground that these sales entail *gharar*. *Gharar* can be dispelled only by the determination of the price during the meeting of the vendor and the purchaser whether or not such a price is to be disbursed forthwith or at a later stage. For instance, the Hanafis consider the sale of a slave at his market value for a price to be fixed by a third party or by the purchaser himself as being unlawful. For the Shafi'is, a sale with an unfixed price or a price to be determined by the purchaser is invalid; nevertheless, a sale for a price indicated on the article proposed for sale or for a price similar to the one for which a sale transaction was concluded is lawful, provided the contracting parties know the price to which they refer.<sup>56</sup>

It has been further argued that if only one of the contracting parties knows such a price, there are conflicting views on the validity of the transaction; the prevailing tendency is to bar it on the ground of *gharar*. In the Maliki view, the price is subject to want of knowledge (*jahl*), causing *gharar*, when it is to be determined according to today's price or to market price or by a decision to be taken by a given person. The Hanbalis stress that the price, being one of the two countervalues, should be known in the same way as the object of the sale. It is put forward that sale with reference to the price normally paid is invalid, owing to the uncertainty it imports. More flexibility, however, is shown in other circumstances; thus the sale either for the price affixed on the proposed article or for a price similar to the one for which a given person concluded a transaction is valid, not only when the two contracting persons are aware of the referred price but also, apparently, when only one of them is aware of the price. As a conclusion, for all Islamic schools of law, a

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<sup>56</sup> Nabil A. Saleh, *op. cit.*, 83.

term in a credit sale giving time for payment should be defined, leaving no room for uncertainty.<sup>57</sup>

Based on the above arguments, in today's international trade transactions where most goods are traded on credit terms and prices are fixed based on market price, examples being commodities such as palm oil, corn, wheat, sugar and so forth, elements of *gharar* or uncertainty is most likely prevalent and one of the best ways to curb such uncertainty is to conduct such transactions founded on *shari'ah* principles.

#### **7.4.1.3 Subject-Matter Unavailable at the Parties' Meeting (*Bay' Gha'ib*)**

*Bay gha'ib* is sale of what is not visible at the meeting of the parties. The vendor in a *bay' gha'ib* has title over the subject-matter but that subject-matter is not apparent at the meeting of the contracting parties; for either it is elsewhere, or it is present but out of sight, or at least out of the potential purchaser's sight. Islamic schools of law have different approaches in their assessment of *bay' gha'ib* in its dual aspects. Their views range from the prohibition of selling what has not been actually inspected by the potential purchaser, as the Shafi'is hold, to the lawfulness of a sale concluded by either the vendor pointing out the place where the subject-matter is hidden or by the vendor describing the subject-matter, as the Hanafis hold. It is argued that the conflicting views of the different schools of law stem most probably from their disagreement over what is called *khiyar al-ru'ya* or the "option after inspection", which means that the purchaser enjoys the option of rejecting the object of the sale after sight and consequently of rescinding the sale.<sup>58</sup>

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<sup>57</sup> Nabil A. Saleh, *op. cit.*, 83-84.

<sup>58</sup> *Id.* at 85.

The Shafi'is do not acknowledge that a purchaser has the "option after inspection" (*khiyar al-ru'ya*) and consequently the purchaser in this case ought to be very vigilant and aware of what he is buying before entering sale contract. The Hanafis, on the contrary, were in a position to lay down less stringent conditions for the conclusion of *bay' gha'ib*, for the reason that the buyer in their view always has the right to repudiate the sale once he is in a position to inspect the object of the sale. Moreover, the Hanafis, contrary to the Malikis and the Hanbalis (who none the less acknowledge the legality of the purchaser's "option of inspection" but with more restrictive effects than the Hanafis), do not deprive the purchaser of the "option after inspection" even when the the object of the sale is in perfect conformity with the description which induced the purchaser to enter a sale of contract. This limited specimen of the differences found in the views of the schools of law with respect to *bay' ghai'b* prompts a closer investigation of this kind of sale.<sup>59</sup>

**(i) Shafi'is**

It is submitted that according to the Shafi'is widely accepted teaching, they regard as invalid the sale of what is invisible at the meeting of the contracting parties (*majlis al-'aqd*) owing to the *gharar* it involves, whether the subject-matter is actually not present at the meeting of the contracting parties, or, on the contrary, present at their meeting but out of their sight or at least out of the sight of the prospective buyer. However, it is not a requisite that the object of the sale be inspected at the very moment the contract is concluded. A prior inspection is sufficient, provided that the object is of a kind which does not undergo a change between the date of inspection and the date when the contract is concluded, for example an iron copper. Moreover, it is not necessary that the prospective purchaser sees all the subject-matter if seeing part of it gives an indication of the remaining

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<sup>59</sup> *Ibid.*

parts, presupposing that all the subject-matter's parts are alike. For example, when a buyer examines a measure of wheat he can validly buy the remaining wheat of the same quality. In this matter, a sale according to sample or specimen is allowed, provided it obeys the same rules.<sup>60</sup>

## (ii) Hanafis

The Hanafis have a more liberal view on *bay' ghai'b* because of their interpretation of the technique "option after inspection" (*khiyar al-ru'ya*), which successfully reduces the risk inherent in an imperfect knowledge of the subject-matter. For the Hanafis, it is valid to sell an object by pointing out its location, so as to dispel a material want of knowledge (*jahl*).<sup>61</sup> When the object of sale is not present at the meeting of the parties, the vendor ought to particularise it by indicating the place where it is located provided that there is no similar subject-matter in that particular place, otherwise the vendor ought to describe the subject-matter in such a way so as to dispel a material want of knowledge. It is put forward that an immaterial want of knowledge does not invalidate contract (which is dictated by the technique of *khiyar al-ru'ya*) as this is open to the purchaser even though not stipulated as a sale requisite and even though the subject-matter turns out to be in conformity with the description. However, once the buyer has seen the subject-matter, he is thereby precluded from exercising the "option after inspection" for that option is open only to the buyer who has not inspected the object of the sale by the time the contract is concluded. Seeing part of the subject-matter which is indicative of the remaining parts, when all the subject-matter's

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<sup>60</sup> Nabil A. Saleh, *op. cit.*, 85-86.

<sup>61</sup> An example of such sale is when the vendor announces "I sell you an object which is in this box".

parts are alike, is sufficient to deprive the buyer of the “option of inspection”, therefore sale according to sample or specimen is binding and not subject to *khiyar al-ru'ya*.<sup>62</sup>

### **(iii) Malikis**

It is argued that when the object of the sale is available at the meeting of the parties, the Malikis are of the opinion that no valid sale can take place unless the purchaser has laid eyes on it (*bi'l-ru'ya*). If the object of the sale is not present, or if present but not apparent, then it can be sold according to description or, even in place of description with the “option after inspection”, as one isolated Maliki opinion teaches. In any event, when the sale is performed according to description, it cannot be accompanied by the “option after inspection” (*khiyar al-ru'ya*) for, contrary to the Hanafis, the Malikis do not combine description and “option after inspection”. Either an article is sold according to description, or with no description but with the “option after inspection”. When a sale is concluded according to description and when the object of the sale is in conformity with the description, the sale is binding. It appears that this opinion is contrary to the Hanafis, who allow the buyer to repudiate the sale even though the object of the sale perfectly matches its description. Inspecting the subject-matter before the date of concluding the contract is valid, provided that such subject-matter is not in a remote place so as to undergo a change between inspection date and closing date. Fungible articles, namely those that are measurable or weighable or accounted by number when alike, can be sold according to sample or according to a descriptive *pro forma* (*barnamij*).<sup>63</sup>

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<sup>62</sup> Nabil A. Saleh, *op. cit.*, 86-87.

<sup>63</sup> *Id.* at 87.

#### **(iv) Hanbalis**

It is argued that the Hanbalis allow *bay' ghai'b* under two conditions – firstly, the subject-matter should be of a kind which can be sold *bay' salam*<sup>64</sup> that is, it should be a weighable or measurable article such as wheat or articles that can be described precisely (precious stones are not included in this category nor is jewellery); and secondly the subject-matter should be described in a way which enables its precise identification. When the object of sale is in conformity with the description or even better than the description, the purchaser is not in a position to rescind the contract. Sale with prior inspection of the subject-matter is lawful, provided that the object of the sale is not of a kind which necessarily undergoes a change between inspection date and closing date. Sale according to sample or specimen is not lawful, for the purchaser has not seen the actual subject-matter. On the other hand, when the purchaser has seen one element of the subject-matter, and that is indicative of the remaining similar elements, that is deemed acceptable and the sale is lawful.<sup>65</sup>

In today's international trade transactions where in most probability there is no meeting of the contracting parties and the buyer is not in a position to physically examine the goods, it can be assumed that most transactions are *bay' ghai'b*. Therefore, it is of utmost importance to avoid *gharar* in such transactions and the above principles from the four schools of thought are to be taken into account to ensure fairness to both parties.

### **7.5 The Myth of the Free Market and Speculation in International Trade**

It has been argued that most market economies operate on a very basic principle, that is, if we trade for things that we want, both parties tend to feel good about how things work

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<sup>64</sup> *Bay' salam* is sale with advance payment for future delivery. Nabil A. Saleh, *op. cit.*, 89.

<sup>65</sup> Nabil A. Saleh, *op. cit.*, 87-88.

out.<sup>66</sup> In other words, trade started off with the barter system. It appears that barter soon proved to be difficult and to solve this dilemma, it was necessary to introduce another “commodity” into the equation, namely, money. Eventually, a basic economy works in a way that if we want something, we need to have something that others want. This facilitates trade. Or, we can work and earn money to purchase the goods that we want. It has also been found that if others want the same thing that we want, and there is not enough of the goods to go around, the price of that goods will escalate. Then there is also the role of money in a free economy. It has also been further argued that money was more fluid, where everyone recognised its value and it is a very convenient medium of exchange. Money’s value was universally understood and helped solved a problem that economists call a “coincidence of wants” that is, if someone doesn’t want our goods, there is no trade. In this manner, introducing money into the economy enhances trade and economic activity by allowing transactions to be based on established prices and value rather than on fleeting tastes and needs.<sup>67</sup>

However, allowing trade in a free market without any form of check and balances may result in dire consequences, one of which is speculation. Speculation, for the purpose of this discussion, may be defined as the purchase (or sale) of goods with a view to re-sale (re-purchase) at a later date, where the motive behind such action is the expectation of a change in the relevant prices relatively to the ruling price and not a gain accruing through their use, or any kind of transformation effected in them or their transfer between different markets. It is asserted that what distinguishes speculative purchases and sales from other

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<sup>66</sup> Martinez, Mark A, *The Myth of the Free Market: The Role of the State in a Capitalist Economy*, (Sterling, VA, USA: Kumarian Press, United States of America, 2009), xi.

<sup>67</sup> Martinez, *op. cit.*, xii.

kinds of purchases and sales is the expectation of an impending change in the ruling market price as the sole motive of action.<sup>68</sup>

In “*A Short History of Financial Euphoria*”, John Kenneth Galbraith discusses the famous case of “Tulipomania” in Amsterdam at the beginning of the seventeenth century. It appears that what started as simple prestige for those who possessed novel tulip bulbs turned into wild speculation over successive price increases throughout 1636. Specifically, competition over tulips turned into mania, with single bulbs being traded for new carriages and homes fetching as much as \$25,000 to \$50,000 each. Demand reached such heights that the Amsterdam Stock Exchange developed a futures market for the bulb. This market, as well as the dreams of many speculators, collapsed under the weight of its own nonsense and spectacular avarice. As sellers demanded that their tulip contracts be enforced, they were disappointed when their petitions fell on the deaf ears of the courts. Because the market had little to do with the production of actual goods and services, the courts viewed “Tulipomania” as little more than a gambling operation. As is the case throughout these histories, panic, default and bankruptcy followed. Galbraith wrote that “no one knows for what reason” the speculation and mania ended however, there is little doubt that common sense finally prevailed in a market that had spun out of control by deluded buyers and sellers.<sup>69</sup>

More recent instances of speculation involve global food shortage. It has been written that food prices around the world have already risen in 2011 to within touching distance of the 2008 food crisis – and in October of the same year, the world’s population is expected to hit 7 billion people. The burning question is will there be enough food to feed the world?

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<sup>68</sup> Kaldor, N, “Speculation and Economic Stability”, *The Review of Economic Studies*, Vol. 7, No. 1 (Oct.1939), 1-27 at 1.

<sup>69</sup> Martinez, *op.cit.*, 78.

In 2008, surging food costs sparked protests and riots in more than 30 countries. Many media reports have blamed food price hikes on climate change and Asia's increasing wealth. It is true that severe droughts in Russia and China and floods in Australia, Europe, India, and Pakistan have affected crops. And yes, the other reason touted – often by the Western world – for rising food costs, Asia's increasing wealth, might be borne out by the fact that increasingly affluent consumers in China and India are eating more meat; 7kg of grain are fed to cows to produce 1kg of beef for human consumption, thus diverting supplies of corn and wheat from feeding people to feeding livestock.<sup>70</sup>

However, the writer mentioned that environmentalist and author George Monbiot has pointed out that the supply of meat has already trebled since 1980: farm animals now take up 70% of all agricultural land and eat one-third of the world's grain. It was also mentioned that climate havoc and meat-eating are just part of the explanation. Olivier de Schutter, the United Nations Special Rapporteur on the Right to Food, underlined at a media briefing that while the “initial sparks” of food price hikes may have been caused by such issues of supply and demand, the deeper reason is speculation on food commodities by powerful investors, such as hedge funds and investment banks. For instance, de Schutter noted that in July 2010, Armajaro, a London-based hedge fund, purchased US\$1bil (RM3.06bil) worth of futures contracts for 241,000 tonnes of cocoa, equivalent to almost all the cocoa in Europe's warehouses. In the same article, de Schutter was quoted as saying that “that such hoarding is permitted in this day and age stretches belief.” He added

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<sup>70</sup> Sia, Andrew, “Food, Food, Everywhere and Not Enough to Eat”, *Starmag*, The Star, March 6, 2011. Retrieved on 5 August 2012 from <<http://thestar.com.my/lifestyle/story.asp?file=/2011/3/6/lifefocus/8168530>>.

that such speculation also caused the price of rice to leap by 165% between April 2007 and April 2008, something that could not be explained by supply and demand factors.<sup>71</sup>

On Feb 15 2011, World Bank president Robert Zoellick warned that the rising cost of food around the globe had pushed about 44 million people into poverty since the middle of last year, with wheat prices doubling between June 2010 and January 2011, while corn prices rose 73% in the same period. Yet, as David Dapice, associate professor of economics at America's Tufts University points out, the world is actually producing more food. Logically speaking, an increased supply of a commodity should drive prices downwards and not upwards. In a Feb 18 2011 *YaleGlobal* article, Dapice notes that from 2006/07 to 2010/11, the US Department of Agriculture estimates global production of rice, wheat, corn, soya and other grains rose from 1.78 to 1.96 billion tonnes, an increase of 10%. "World population grew less than 5% in those years, so output is rising more than twice as fast as population. (So) it's hard to argue that bad weather has driven food prices up when the world has more food per capita than before."<sup>72</sup>

A Jan 23 2011 article in British newspaper *The Observer* summed it up: "Food speculation – people die from hunger while banks make a killing on food." The article explained that, following heavy lobbying by banks, hedge funds, and free market politicians in America and Britain, regulations on commodity markets have been steadily abolished in the past decade. Contracts to buy and sell food items were turned into "derivatives" that could be bought and sold among traders who have nothing to do with agriculture. In 2006, driven by the US sub-prime mortgage banking disaster, banks and traders around the globe stampeded to move billions of dollars into "safe commodities" such as food. In another

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<sup>71</sup> Sia, Andrew, *op. cit.* A futures contract is an agreement to buy or sell a particular commodity at a pre-determined price in the future and this can involve an element of *gharar* which is prohibited under the *shari'ah*.

<sup>72</sup> Sia, Andrew, *op. cit.*

article, Aseambankers senior economist Suhaimi Ilias was quoted as saying that said “the increasing number of new commodity-linked funds worldwide, including in Malaysia, reflected the direct investment interest in commodities versus equity. Fund managers are building up the demand in commodities not based on consumption alone but also for investment,” he said, adding that “third world countries were the hardest hit by the global food crisis.”<sup>73</sup>

It is this manner of speculation or *gharar* that Islam abhors and it takes more than common sense to prevent such occurrences from happening. As it can be seen, a so called free market not only creates an imbalance in demand and supply in the world economy but it can cause serious social repercussions such as food shortages around the world. It takes a wholesome and fair approach to trade which only the *shari'ah* may be able to provide a solution.

## **7.6 Islamic Economics and Global Capitalism**

It has been argued that by any measure, the scriptural and early historical legacy of Islam is among the most market-friendly of all the world religions. In contrast to other religions, the Prophet Muhammad (pbuh) was a trader, and the Qur'an abounds with commercial imagery. Islam's holy book enjoins believers to engage in trade in a spirit of goodwill, “*O ye who believe! Eat not up your property among yourselves in vanities: but let there be amongst you traffic and trade by mutual good-will*” (An-Nisaa: 29), faithfully fulfil contractual obligations “*O ye who believe ! fulfil (all) obligations*” (Al-Maidah: 1), “*Fulfill the Covenant of Allah when ye have entered into it*” (An-Nahl: 91), and behave in a manner that recognises the importance of private property and uncoerced exchange. The first three centuries of the great Islamic expansion are recognised as having been an age of

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<sup>73</sup> Hanim Adnan, “Speculation Wreaking Havoc on Food Prices”, Starbiz, The Star, Thursday May 22, 2008. Retrieved on 5 August 2012 from <<http://biz.thestar.com.my/news/story.asp?file=/2008/5/22/business/21321147&sec=business>>.

unprecedented commercial growth. By the tenth century, Muslim merchants and jurists had developed bookkeeping, credit and investment institutions that were among the most advanced in Eurasia.<sup>74</sup>

Although the late Middle Ages (1250-1500) saw a decline in the Middle East's economic dynamism, the period was followed by a commercial boom in the Muslim-dominated Indian ocean. There, Muslim merchants created the world's largest and most lucrative trade emporium, a vast network that tied coastal east Africa, southern Arabia, South Asia and Southeast Asia into a vast trading network. In the Southeast Asian wing of this trade oecumene, the fifteenth and centuries saw the development of an independent merchant class that, like its counterpart in Renaissance Europe, patronised the arts, promoted individualised styles of religiosity, and in a few settings, even sought to curb the authority of rulers. However, in the late eighteenth and nineteenth century, three powerful Muslim empires, namely, the Ottomans, Safavid-Iran and Mughal India were challenged by the Europeans and their once self-sufficient societies had fallen behind those of the West.<sup>75</sup>

It is also argued that long central to the stewardship of Islamic traditions, Muslim jurists have also long insisted that social and political institutions must be based on Islamic norms. In modern times, these cultural legacies have made Muslims' recognition of their growing lag *vis-a-vis* the West all the more disquieting. It has also deepened some Muslim' ambivalence about a global economic order which bears the all-too-clear imprint of having "made in the West." Although Muslim-majority lands like Malaysia, Indonesia, Turkey and Qatar have made use of new technologies and financial instruments to catapult themselves into the forefront of modernising Muslim nations, some Muslim scholars have

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<sup>74</sup> Hefner, R W, "Ambivalent Embrace: Islamic Economics and Global Capitalism" in Jonathan B. Imber ed., *Markets, Morals and Religion*, (New Brunswick, New Jersey: Transaction Publishers, 2008), 141-155 at 141.

<sup>75</sup> Hefner, *op. cit.*, 141-142.

continued to feel that these practical accommodations threaten Muslim values. Rather than diminishing, concerns like these have grown in recent years, in response both to the Islamic resurgence that swept Muslim lands from the late 1960s on, and to the steady advance of a Western-dominated globalisation. With these rising disquiet, hence the emergence of a subgroup of Muslim intellectuals concerned with the compatibility of modern capitalism and Islam. As an expression of that concern, these intellectuals have sought to devise an alternative economic model that has come to be known as “Islamic economics.” It is put forward that the central premises of Islamic economics are, first, that Islam provides an all-encompassing model for social, economic and political life, and second, recent political and economic influences emanating from the West have undermined the Muslim legacy. Islamic economics aims to reverse this trend and construct an alternative economic system organised around ostensibly Islamic values. Although not all Muslims have been convinced of the merits of Islamic economics, the field’s concepts provide a fascinating point of entry into the thoughts of Muslim leaders on global capitalism, and into the depth of the ideological schisms that run through public opinion in the modern Muslim world.<sup>76</sup>

### **7.6.1 The Third Way**

It is argued that Islamic economics is not an ancient intellectual tradition, but a modern movement that asserts that Islamic traditions of organisation and finance provide a more just and equitable model for economic growth than do the rival systems of Western capitalism and socialism. Indeed, the first and most striking fact about Islamic economics is its unquestionable modernity. The central claim of Islamic economics is that it offers a middle way between the individualist excesses of Western capitalism and the repressive

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<sup>76</sup> *Id.* at 142-143.

centralisation of socialism. The former economic system, it is said, has been capable of great dynamism and expansiveness but its achievements have been premised on gross inequality and the exploitation of workers by capitalist. By contrast, the Islamic economist avers, socialist economies have placed greater emphasis on equity and social justice, virtues also highlighted in Islamic economics. But socialists, the Islamic economist laments, have highlighted these values while also suppressing commercial traditions of which Islam approves. In principle, Islamic economics presents a salutary third way, namely, avoiding the inegalitarian excesses of modern capitalism while unleashing the energies of entrepreneurs and merchants.<sup>77</sup>

### **7.7 The Making and Expected Arrival of a *Shari'ah* Compliant Model Law**

It is contended that for Western sceptics inclined to gloat in the face of Islamic economics' limited capacity to challenge global capitalism, it is worth remembering that the tensions that lead some Muslims to dream of an alternative economies are far from resolved. Many Muslim countries (save for a small number) suffer from high rates of poverty and staggering economic inequality. Many too have yet to discover the means to jump-start their economies. This final problem has become all the more disquieting as dynamic and locally owned capitalist enterprises have taken root in non-Western countries like China and India. All of these tensions are in turn compounded by a simple but compelling cultural-economic fact, namely, that many observant Muslims see the lifestyle and consumption habits conveyed by global markets and media as antithetical to Muslim ethical traditions.<sup>78</sup>

It is also reasoned that libertarians may dismiss this last concern, on the grounds that ethical questions are not a matter for economic policy makers, and are best left to the

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<sup>77</sup> *Id* at 143.

<sup>78</sup> *Id* at 151.

discretion of private individuals rather than social groups. But it can be further argued that the libertarian claim has always been more a normative prescription than a settled social fact. It should be borne in mind that at the heart of most versions of Islamic ethics lies deeply un-libertarian injunction that urges believers, both singularly and collectively, to command what is right and forbid what is wrong under the principle of *al-amr bi'l-ma'ruf wa'l-nahy 'an al-munkar*. It is contended that all religions change, and the content of this injunction has been understood differently in different times and places. But the injunction's underlying impulse, that ethics must be treated as a compelling public good, continues to resonate powerfully across the Muslim world, in a manner that has serious implications for public ethical debates over capitalism.<sup>79</sup>

Based on the above arguments, perhaps the time is ripe for the world economy to embrace a *shari'ah* compliant international sale of goods model law. It is suggested that there is very little mandatory law in international commercial law, and even the CISG is not mandatory, and the courts will almost always enforce party autonomy.<sup>80</sup> Based on this premise, perhaps it can initially be suggested that contracting parties establish their sale of goods contract as a model contract, namely, contracts that are based on a standard model incorporating the *shari'ah* elements to facilitate international trade.<sup>81</sup> Perhaps a model similar to the International Trade Centre's Model Contract for the International Commercial Sale of Goods<sup>82</sup> could be employed as an initial guide to the *shari'ah* based model. The alternative *shari'ah* model contract should contain, among others, the substantive rules for an international sales contract, that is, the main rights and obligations

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<sup>79</sup> Hefner, *op. cit.*, 151-152.

<sup>80</sup> Camilla Baasch Andersen (PhD), Senior Lecturer, School of Law, University of Leicester, United Kingdom, based on a discussion with the writer at the School of Law, University of Leicester on 30<sup>th</sup> November, 2010.

<sup>81</sup> This idea was mooted by Professor Vivienne Bath, Professor of Chinese and International Business Law, Sydney Law School, The University of Sydney, Australia, based on a discussion with the writer at the National University of Singapore on 1<sup>st</sup> June, 2012.

<sup>82</sup> Retrieved on 1 November 2012 from <[http://www.intracen.org/uploadedFiles/intracenorg/Content/Exporters/Exporting\\_Better/Templates\\_of\\_contracts/3%20International%20Commercial%20Sale%20of%20Goods.pdf](http://www.intracen.org/uploadedFiles/intracenorg/Content/Exporters/Exporting_Better/Templates_of_contracts/3%20International%20Commercial%20Sale%20of%20Goods.pdf)>.

of the parties, the remedies for breach of contract by the seller and buyer, and the general rule that apply equally to both parties. Bearing in mind its international character, it should also contain the boilerplate clauses broadly accepted in international commercial contracts.<sup>83</sup>

In essence, the salient features of the *shari'ah* compliant model contract ought to include, *inter alia*:

- (i) Rules on the goods – description of the goods; delivery; payment conditions and documents to be provided;
- (ii) Remedies, conformity and transfer of property – remedies of the seller in case of non-payment at the agreed time; remedies of the buyer in case of non-delivery of goods at the agreed time; lack of conformity of the goods; transfer of property (which is silent under the CISG) and legal defects;
- (iii) Termination of contract and damages – grounds for termination of contract, termination procedure, effects of termination in general together with rules on restitution, damages and mitigation of harm; and finally
- (iv) Boilerplate clauses – for example, jurisdiction clauses, notices and dispute resolution.

Once the *shari'ah* compliant model contract has gained acceptance among the international business community, it is not too implausible in the not too distant future for Muslim-majority countries which are members of UNIDROIT (INTERNATIONAL INSTITUTE

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<sup>83</sup> Adapted from <[http://www.intracen.org/uploadedFiles/intracenorg/Content/Exporters/Exporting\\_Better/Templates\\_of\\_contracts/3%20International%20Commercial%20Sale%20of%20Goods.pdf](http://www.intracen.org/uploadedFiles/intracenorg/Content/Exporters/Exporting_Better/Templates_of_contracts/3%20International%20Commercial%20Sale%20of%20Goods.pdf)>, *supra*.

FOR THE UNIFICATION OF PRIVATE LAW) to propose a an alternative *shari'ah* compliant model law for the uniform application of the international sale of goods law.<sup>84</sup>

UNIDROIT is an independent intergovernmental Organisation with its seat in the Villa Aldobrandini in Rome. Its purpose is to study needs and methods for modernising, harmonising and co-ordinating private and in particular commercial law as between States and groups of States and to formulate uniform law instruments, principles and rules to achieve those objectives. Set up in 1926 as an auxiliary organ of the League of Nations, the Institute was, following the demise of the League, re-established in 1940 on the basis of a multilateral agreement, the UNIDROIT Statute. Membership of UNIDROIT is restricted to States acceding to the UNIDROIT Statute. UNIDROIT's 63 member States are drawn from the five continents and represent a variety of different legal, economic and political systems as well as different cultural backgrounds.<sup>85</sup>

## **7.8 The Role of UNIDROIT**

UNIDROIT's official website<sup>86</sup> has listed down several pertinent details with regard to its Legislative Policy and Working Methods which may be relevant in proposing an alternative *shari'ah* compliant sale of goods model law in the future, namely:

### **7.8.1 Legislative Policy**

#### **(i) Nature of instruments drawn up by UNIDROIT**

UNIDROIT's basic statutory objective is to prepare modern and where appropriate harmonised uniform rules of private law understood in a broad sense. However,

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<sup>84</sup> This idea was mooted by Camilla Baasch Andersen (PhD), Senior Lecturer, School of Law, University of Leicester, United Kingdom, based on a discussion with the writer at the School of Law, University of Leicester on 30<sup>th</sup> November, 2010.

<sup>85</sup> <<http://www.unidroit.org/dynasite.cfm?dsmid=103284>>. Retrieved on 2 November 2012.

<sup>86</sup> *Ibid.*

experience has demonstrated a need for occasional incursion into public law, especially in areas where hard and fast lines of demarcation are difficult to draw or where transactional law and regulatory law are intertwined. Uniform rules prepared by UNIDROIT are concerned with the unification of substantive law rules; they will only include uniform conflict of laws rules incidentally.

**(ii) Technical approach to harmonisation or unification favoured by UNIDROIT**

UNIDROIT's independent status amongst intergovernmental Organisations has enabled it to pursue working methods which have made it a particularly suitable forum for tackling more technical and correspondingly less political issues.

**(iii) Factors determining eligibility of subjects for uniform law treatment**

New technologies and international commercial practices call for new, harmonised and widely acceptable solution (emphasis added). Generally speaking, the eligibility of a subject for harmonisation or even unification will to a large extent be conditional on the willingness of States to accept changes to domestic law rules in favour of a new international solution on the relevant subject. Legal and other arguments in favour of harmonisation have accordingly to be weighed carefully against such perception. Similar considerations will also tend to determine the most appropriate sphere of application to be given to uniform rules, that is to say, whether they should be restricted to truly cross-border transactions or extended to cover internal situations as well. While commercial law topics tend to make for most of the international harmonisation initiatives, the broad mandate given to UNIDROIT allows the organisation to deal with non-commercial matters as well.

#### **(iv) Factors determining choice of instrument to be prepared**

The uniform rules drawn up by UNIDROIT have, in keeping with its intergovernmental structure, generally taken the form of international Conventions, designed to apply automatically in preference to a State's municipal law once all the formal requirements of that State's domestic law for their entry into force have been completed. However, alternative forms of unification have become increasingly popular in areas where a binding instrument is not felt to be essential. Such alternatives may include model laws which States may take into consideration when drafting domestic legislation or general principles which the judges, arbitrators and contracting parties they address are free to decide whether to use or not. Where a subject is not judged ripe for uniform rules, another alternative consists in the legal guides, typically on new business techniques or types of transaction or on the framework for the organisation of markets both at the domestic and the international level (emphasis added). Generally speaking, "hard law" solutions (i.e. Conventions) are needed where the scope of the proposed rules transcends the purely contractual relationships and where third parties' or public interests are at stake as is the case in property law .

#### **7.8.2 Working Methods**

##### **(i) Preliminary stage**

Once a subject has been entered on UNIDROIT's Work Programme, the Secretariat, where necessary assisted by experts in the field, will draw up a feasibility study and/or a preliminary comparative law report designed to ascertain the desirability and feasibility of law reform. Where appropriate and funding permitting, an

economic impact assessment study is also carried out. The report, which may include a first rough draft of the relevant principles or uniform rules, will then be laid before the Governing Council which, if satisfied that a case has been made out for taking action, will typically ask the Secretariat to convene a study group, traditionally chaired by a member of the Council, to prepare a preliminary draft Convention or one of the alternatives mentioned above. The membership of such study groups, made up of experts sitting in their personal capacity, is a matter for the Secretariat to decide. In doing so, the Secretariat will seek to ensure as balanced a representation as possible of the world's different legal and economic systems and geographic regions.

**(ii) Intergovernmental negotiation stage**

A preliminary draft instrument prepared by the study group will be laid before the Governing Council for approval and advice as to the most appropriate further steps to be taken. In the case of a preliminary draft Convention, the Council will usually ask the Secretariat to convene a committee of governmental experts whose task it will be to finalise a draft Convention capable of submission for adoption to a diplomatic Conference. In the case of one of the alternatives to a preliminary draft Convention not suitable by virtue of its nature for transmission to a committee of governmental experts, the Council will be called upon to authorise its publication and dissemination by UNIDROIT in the circles for which it was prepared. Full participation in UNIDROIT committees of governmental experts is open to representatives of all UNIDROIT member States. The Secretariat may also invite such other States as it deems appropriate, notably in light of the subject-matter

concerned, as well as the relevant international Organisations and professional associations to participate as observers. A draft Convention finalised by a committee of governmental experts will be submitted to the Governing Council for approval and advice as to the most appropriate further steps to be taken. Typically, where it judges that the draft Convention reflects a consensus as between the States represented in the committee of governmental experts and that it accordingly stands a good chance of adoption at a diplomatic Conference, the Council will authorise the draft Convention to be transmitted to a diplomatic Conference for adoption as an international Convention. Such a Conference will be convened by one of UNIDROIT's member States.

### **(iii) Co-operation with other international Organisations**

UNIDROIT maintains close ties of co-operation with other international Organisations, both intergovernmental and non-governmental, which in many cases take the form of co-operation agreements concluded at inter-Secretariat level. The Hague Conference on Private International Law, UNIDROIT and the United Nations Commission on International Trade Law (UNCITRAL), the three private-law formulating agencies, are quite appropriately referred to as “the three sisters”.

By reason of its expertise in the international unification of law, UNIDROIT is moreover at times commissioned by such other Organisations to prepare comparative law studies and/or draft Conventions designed to serve as the basis for the preparation and/or finalisation of international instruments in those Organisations.

#### **(iv) Network of correspondents**

UNIDROIT's ability to obtain up-to-date information on the state of the law in all the various countries is essential to the pursuit of its statutory objectives. Such information can be difficult to obtain and UNIDROIT therefore maintains a network of correspondents in both member and non-member States, who are appointed by the Governing Council from amongst academic and practising lawyers.

From the above elucidation, worth noting under the heading "Factors determining eligibility of subjects for uniform law treatment" is the alertness by UNIDROIT that "...new technologies and international commercial practices call for new, harmonised and widely acceptable solutions..." (emphasis added) and a *shari'ah* compliant model law on international sale of goods would positively fall under this category. Further, under the heading "Factors determining choice of instrument to be prepared", UNIDROIT is indeed aware that "...alternative forms of unification have become increasingly popular in areas where a binding instrument is not felt to be essential..." and that "such alternatives may include model laws which States may take into consideration when drafting domestic legislation or general principles which the judges, arbitrators and contracting parties they address are free to decide whether to use or not..." (emphasis added).

By virtue of these arguments and taking into consideration the benefits and growing popularity of *shari'ah* based transactions such as Islamic banking and *takaful*, it is not entirely unfeasible that a *shariah* compliant sale of goods model law would make its way into the international business atmosphere in the not too distant future.

## 7.9 Concluding Remarks

A close examination of the history, principles and adaptability of Islamic commercial transactions clearly shows its edge over western capitalism. From the time of the Prophet Muhammad (pbuh) who was a trader himself, up until the modern times, the principles of doing trade in a fair and just manner and devoid of *gharar* or speculation has stood the test of time and will continue to flourish given the encouragement and opportunity to do so. It has been illustrated that western capitalism and even socialism have their particular drawbacks. Speculation has been shown to create imbalance in the world economy, even social injustice.

As a foundation, resorting to the principles of “command what is right and forbid what is wrong under the principle of *al-amr bi'l-ma'ruf wa'l-nahy 'an al-munkar*” may provide a solution to curb greed and speculation currently dominating the world economy. With the right amount of awareness among the international traders, a *shari'ah* compliant model contract could be introduced to facilitate trade and perhaps later, with the political wills of Muslim-majority countries, UNIDROIT could conceivably formulate a *shari'ah* compliant model law which will be universally acceptable by the international business community in the near future.



## CHAPTER EIGHT

### A *SHARI'AH* COMPLIANT MODEL CONTRACT FOR THE INTERNATIONAL SALE OF GOODS

#### 8.1 Introduction

This model contract contains the substantive rules for an international sales contract, namely, the main rights and obligations of the parties, the remedies for breach of contract by the buyer and seller and the general rules that apply equally to both parties. It also contains boilerplate clauses that are broadly accepted in international commercial contracts. This model contract is modelled after the International Trade Centre's Model Contract for the International Commercial Sale of Goods<sup>1</sup> which, optimistically, can be viewed as a general framework for a *shari'ah* compliant sales contract in international trade. Nevertheless, it is to be noted that in implementing this model contract, the parties ought to adapt it to the nature of each particular sales transaction in addition to the specific requirements of the applicable law, where such requirements exist.

In accordance with the *shari'ah*, one of the fundamental aspects of sale is that the seller must have ownership of the goods and that the goods must be free from any third party rights and that no person must deal with the property of another unless by his permission or acting as his trustee. The concept of *milk* or ownership is a very significant concept in an Islamic contract of sale. Thus, it is of utmost importance that the seller, is the owner of the goods, and that the goods is free from any third party rights, before selling the goods to the buyer.<sup>2</sup> Further, the object of sale must be in existence and the contract of sale must

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<sup>1</sup><[http://www.intracen.org/uploadedFiles/intracenorg/Content/Exporters/Exporting\\_Better/Templates\\_of\\_Contracts/3%19International%19Commercial%19Sale%19of%19Goods.pdf](http://www.intracen.org/uploadedFiles/intracenorg/Content/Exporters/Exporting_Better/Templates_of_Contracts/3%19International%19Commercial%19Sale%19of%19Goods.pdf)>.

<sup>2</sup> Refer to paragraph 4.3.2 of Chapter 4 of this dissertation.

contain the description of the goods sold.<sup>3</sup> Hence, the clause on the description, quantity and inspection of the goods is of particular importance as in accordance with the *shari'ah*, a sale without a proper description of the goods such as quantity, type, its condition and qualitative attributes is invalid.

Delivery of the goods is also an essential part of a *shari'ah* sale contract where generally, it is effected by the vendor performing everything necessary to transfer the right of the goods sold to the purchaser and to abstain from all acts that might render the transfer impossible or difficult. When the goods sold is to be delivered to the purchaser, the *shari'ah* stipulates that delivery will not be effective, subject to agreement to the contrary, until the goods reaches the purchaser. Thus, it is essential that the above details are required to effect a successful delivery under the *shari'ah*.<sup>4</sup> Although the traditionalists and the Civil Code of Egypt did not elaborate on the issue of refusal of delivery, it is nevertheless provided for in the Civil Codes of Iran and Lebanon. Essentially, it is stipulated that either the seller or buyer has the right to refuse delivery of the subject-matter of a sale or the consideration for it until the other party is prepared to deliver his part, unless it has been agreed that delivery of the subject-matter of the sale or consideration for it is to take place at a subsequent date, in which case either the subject-matter or the consideration which is not to be delivered at the subsequent date must be delivered at once.<sup>5</sup>

Payment of the price of the goods is considered one of the buyer's important obligations under the *shari'ah*. If the price of the goods is not mentioned at the time of sale, the sale is considered *fasid* (invalid). It is also stipulated in the Civil Codes discussed earlier that the

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<sup>3</sup> Refer to paragraph 4.4.2 of Chapter 4 of this dissertation.

<sup>4</sup> Refer to paragraph 4.4.3.1 of Chapter 4 of this dissertation.

<sup>5</sup> Refer to paragraph 4.4.3.2 of Chapter 4 of this dissertation.

price can either be paid immediately upon delivery of the goods or in any other manner subject to a clause or custom to the contrary.<sup>6</sup>

In case of non-performance of a contract by either the seller or the buyer, the *shari'ah* allows for an option for the parties to make it a condition of the sale, either to fix a time to make valid the sale by assenting to it or to annul (terminate) it. Among the reasons for termination of a sale contract are, failure to deliver the goods by the seller, failure to pay the price by the buyer or when there is a defect in the goods or when the subject-matter of the contract is no longer available or becomes unsuitable for the purpose it was intended for.<sup>7</sup>

Damages, under the *shari'ah*, may be awarded in addition to or in lieu of performance when a breach of contract occurs and to some extent similar to conventional law, its purpose is to put the innocent party in the position he would have been in had the contract been performed. It is put forward that the entitlement of the innocent party to receive damages is founded on the legal principle of *la dharar* (no harm) where no abuse of right and no causing of harm or damage is allowed in any situation.<sup>8</sup>

Whilst the conventional law allows for the imposition of interest on late payment, the *shari'ah* abhors interest (usury) or *riba* and prohibits it as it signifies excess, exploitation and unjust enrichment.<sup>9</sup> As such, in this model contract, the seller is not allowed to charge interest on any late payment of the purchase price by the buyer. Alternatively, the seller may claim a fixed compensation in the form of damages should the buyer is late in making payment for the goods delivered.

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<sup>6</sup> Refer to paragraph 4.4.4 of Chapter 4 of this dissertation.

<sup>7</sup> Refer to paragraphs 5.5.2.1 (a)(i) and 5.5.3(b) of Chapter 5 of this dissertation.

<sup>8</sup> Refer to paragraph 5.5.2.2 (c) of Chapter 5 of this dissertation.

<sup>9</sup> Refer to paragraph 6.4.1 of Chapter 6 of this dissertation.

Finally, no model contract would be complete without the boilerplate clauses, amongst others, on jurisdiction, notices and dispute resolution. With regard to dispute resolution, the Kuala Lumpur Regional Centre for Arbitration (KLRCA) has launched KLRCA i-Arbitration Rules at the Global Islamic Finance Forum 2012 (GIFF) on 20 September 2012. The KLRCA i-Arbitration Rules is the first set of rules that adopts the UNCITRAL Arbitration Rules, while allowing for the resolution of disputes arising from any contract that may contain *shari'ah* issues. The Rules updates and supersedes the 2007 KLRCA Rules for Islamic Banking and Financial Services Arbitration. Arbitral awards under the KLRCA i-Arbitration Rules will be enforceable in the 146 countries that are signatories to the New York Convention.<sup>10</sup>

Based on the 2010 version of the UNCITRAL arbitration rules, the i-arbitration rules allow for the resolution of disputes arising from any contract that may contain *shari'ah* issues – the prefix “i” being the accepted norm in modern Islamic commerce to identify *shari'ah*-compliant products. The rules introduce modifications to the conventional 2010 KLRCA international arbitration rules, most notably a new provision providing for tribunals to outsource *shari'ah* issues to a specialist council or expert agreed by the parties. Mr Sundra Rajoo, director of the KLRCA, was quoted as saying “With the advent of globalisation and increasing cross-border transactions, the centre decided to come up with a set of rules that provide for international commercial arbitration that is suitable for commercial transactions premised on Islamic principles, and that would be recognised and enforceable internationally”. He was also of the opinion that the i-Arbitration Rules can also be used to resolve disputes arising from the growing number of *shari'ah* compliant contracts relating

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<sup>10</sup> Retrieved on 20 December 2012 from <[www.rcakl.org.my/scripts/list-posting.asp?recordid=288](http://www.rcakl.org.my/scripts/list-posting.asp?recordid=288)>. The Convention on the Recognition and Enforcement of Foreign Arbitral Awards also known as “The New York Arbitration Convention” or “The New York Convention” applies to the recognition and enforcement of foreign arbitral awards and the referral by a court to arbitration. Retrieved on 20 December 2012 from <<http://www.newyorkconvention.org/>>.

to other sectors, such as construction, maritime, oil and gas.<sup>11</sup> It is interesting to note that with these possibilities, it is possible that a *shari'ah* compliant model contract on international sale of goods will be included in the ever expanding list of *shari'ah* compliant contracts.

## 8.2 The Model Contract

### ***SHARI'AH* COMPLIANT MODEL CONTRACT FOR THE INTERNATIONAL SALE OF GOODS<sup>12</sup>**

#### **PARTIES:**

##### *Seller*

**Name of Company: .....**

**Country of Incorporation: .....**

**Address: .....**

**Represented by: .....**

##### *Buyer*

**Name of Company: .....**

**Country of Incorporation: .....**

**Address: .....**

**Represented by: .....**

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<sup>11</sup> Retrieved on 20 December 2012 from <[www.rcakl.org.my/userfiles/File/\(GAR\)%2017-9-12%20KLCA%20Islamic%20arbitration.pdf](http://www.rcakl.org.my/userfiles/File/(GAR)%2017-9-12%20KLCA%20Islamic%20arbitration.pdf)>.

<sup>12</sup> These proposed provisions are primarily based on the explanation and discussion of the relevant issues in Chapters 3, 4, 5, 6 and 7 of this dissertation.

The Seller and Buyer shall hereinafter be referred to as “the Parties”.

**1. Goods**

- 1.1 Subject to the terms agreed in this contract, the Seller shall deliver the following goods(s) (hereinafter “the Goods”) to the Buyer.
- 1.2 Description of the Goods (details necessary to define/specify the Goods which is the object of the sale, including the required quality, description, certificates, country of origin and other necessary details).
- 1.3 Quantity of the Goods (including unit of measurement)
  - 1.3.1 Total quantity .....
  - 1.3.2 Per delivery instalment (in case of a contract for delivery of the Goods by instalments) .....
  - 1.3.3 Tolerance percentage: Plus or minus ..... % (if appropriate)
- 1.4 Inspection of the Goods (where an inspection is required, specify, as appropriate, details of organisation responsible for inspecting the quality and/or quantity, place and date and/or period of inspection, responsibility for inspection costs etc.).
- 1.5 Packaging .....
- 1.6 Other specification ..... (for example the intended use of the goods could be specified)

## **2. Delivery**

2.1 To incorporate the International Chamber of Commerce's (hereinafter referred to as ICC) Incoterms rules 2010.

2.1.1 Place of delivery .....

2.1.2 Date or period of delivery ..... (where there is delivery by instalments, the Parties should indicate every date of delivery for each instalment).

2.1.3 Carrier (where applicable) (name and address of carrier, contact person) .....

2.1.4 Other delivery terms (if any) .....

2.2 Refusal of Delivery

Either the seller or buyer has the right to refuse delivery of the subject-matter of a sale or the consideration for it until the other party is prepared to deliver his part, unless it has been agreed that delivery of the subject-matter of the sale or consideration for it is to take place at a subsequent date, in which case either the subject-matter or the consideration which is not to be delivered at the subsequent date must be delivered at once.

## **3. Price**

3.1 Total price .....

3.2 Price per unit of measurement (if appropriate) .....

- 3.3 Amount in numbers .....
- 3.4 Amount in letters .....
- 3.5 Currency .....
- 3.6 Method for determining the price (if appropriate) .....

**4. Payment Conditions**

- 4.1 Means of payment (e.g. cash, cheque, bank draft, transfer) .....
- 4.2 Details of Seller's bank account (if appropriate) .....
- 4.3 Time for payment (specify the time) .....

The Parties may choose a payment arrangement among the possibilities set out below, in which case they should specify the arrangement chosen and provide the corresponding details:

- Payment in advance

Amount to be paid (total price or part of the price and/or percentage of the total price) .....

Latest date for payment to be received by the Seller's bank .....

Special conditions applying to this payment (if any) .....

- Payment by documentary collection

Amount to be paid (total price or price per delivery instalment) .....

Latest date for payment .....

Means of payment: (i.e. documents against payment - D/P or documents against acceptance - D/A) hereafter: .....

The documents to be presented are specified in Article 5 of this contract.

Payment by irrevocable documentary credit

The Buyer must arrange for an irrevocable documentary credit in favour of the Seller to be issued by a reputable bank, subject to the Uniform Customs and Practice for Documentary Credits published by the International Chamber of Commerce (ICC). The issue must be notified at least 13 days before the agreed date for delivery, or before the beginning of the agreed delivery period specified at Article 2 of this contract, as appropriate, unless the Parties agree otherwise as specified hereafter:

(The date on which the documentary credit is issued must be notified to the Seller) .....

The credit shall expire 13 days after the end of the period or date of delivery specified in Article 2 of this contract, unless otherwise agreed hereafter:

.....

The documentary credit does not have to be confirmed, unless the Parties agree otherwise, as specified hereafter: .....

All costs incurred in relation to confirmation shall be borne by the Seller, unless the Parties agree otherwise, as specified hereafter: .....

The documentary credit shall be payable at sight and allow partial shipments and trans-shipments, unless the Parties agree otherwise, as specified hereafter: .....

- Payment backed by bank guarantee

The Buyer shall provide, at least 30 days before the agreed date of delivery or the beginning of the agreed delivery period specified at Article 2 of this contract, unless the Parties specify hereafter some other date: ..... either a first demand bank guarantee subject to the Uniform Rules for Demand Guarantees published by the ICC, or a standby letter of credit subject either to such rules or to the Uniform Customs and Practice for Documentary Credits published by the ICC, in either case issued by a reputable bank.

- Other payment arrangements .....<sup>13</sup>

## 5. Documents

5.1 The Seller shall make available to the Buyer (or shall present to the bank specified by the Buyer) the following documents (tick corresponding boxes and indicate, as appropriate, the number of copies to be provided):

- Commercial invoice .....
- The following transport documents (specify any detailed requirements).
- Packing list .....
- Insurance documents .....
- Certificate of origin .....

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<sup>13</sup> The payment arrangements for transacting *ribawi* items are discussed in general in paragraphs 6.4.3.1, 6.4.3.2, 6.4.3.3 and 6.4.3.4 of this dissertation.

- Certificate of inspection .....
- Customs documents .....
- Other documents .....

5.2 In addition, the Seller shall make available to the Buyer the documents indicated in the Incoterms 2010 rules the Parties have selected under Article 2 of this contract.

## **6. Non-performance of the Buyer's obligation to pay the price at the agreed time**

6.1 If the Buyer fails to pay the price at the agreed time, the Seller shall fix to the Buyer an additional period of time of ..... days for performance of payment. If the Buyer fails to pay the price at the expiration of the additional period, the Seller may declare this contract terminated in accordance with Article 11 of this contract or the Seller may refuse delivery of the Goods if the Goods have not been delivered to the Buyer.

6.2 If the Buyer fails to pay the price at the agreed time, the Seller shall not, in any event, be entitled, to charge interest on the outstanding amount but is entitled to claim damages for the loss suffered for the late payment.<sup>14</sup>

## **7. Non-performance of the Seller's obligation to deliver the Goods at the agreed time**

7.1 If the Seller fails to deliver the Goods at the agreed time, the Buyer shall fix to the Seller an additional period of time of ..... days for performance of delivery. If the Seller fails to deliver the Goods at the expiration of the

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<sup>14</sup> The principles of *ta'widh* and *gharamah* are explained in paragraph 6.4.3.6 of this dissertation.

additional period, the Buyer may declare this contract terminated in accordance with Article 11 of this contract and claim damages for the loss.

## **8. Lack of conformity**

8.1 There is a lack of conformity where the Seller has delivered:

8.1.1 Part only or a larger or a smaller quantity of the Goods than specified in Article 1 of this contract;

8.1.2 The Goods which are not those to which this contract relates or goods of a different kind;

8.1.3 The Goods which lack the qualities and/or characteristics specified in Article 1 of this contract and/or which lack the qualities of a sample or model which the Seller has held out to the Buyer;

8.1.4 The Goods which do not possess the qualities and/or characteristics necessary for their ordinary or commercial use;

8.1.5 The Goods which do not possess the qualities and/or characteristics for any particular purpose expressly or impliedly made known to the Seller at the time of the conclusion of this contract;

8.1.6 The Goods which are not contained or packaged in the manner specified in Article 1 of this contract.

8.2 The Seller shall not be liable under paragraph 8.1 of this Article for any lack of conformity if, at time of the conclusion of this

contract, the Buyer knew or could not have been unaware of such lack of conformity.

8.3 The Buyer shall examine the Goods, or cause them to be examined, within as short period as is practicable in the circumstances. The Buyer shall notify the Seller of any lack of conformity of the Goods, specifying the nature of the lack of conformity, within ..... days after the Buyer has discovered or ought to have discovered the lack of conformity. In any event, the Buyer loses the right to rely on a lack of conformity if he fails to notify the Seller thereof at the latest within a period of ..... from the date on which the Goods were actually handed over to the Buyer.

8.4 Where the Buyer has given due notice of non-conformity to the Seller, the Buyer may at his option:

8.4.1 Require the Seller to deliver any missing quantity of the Goods, without any additional expense to the Buyer;

8.4.2 Require the Seller to replace the Goods with conforming goods, without any additional expense to the Buyer;

8.4.3 Require the Seller to repair the Goods, without any additional expense to the Buyer;

8.4.4 Declare this contract terminated in accordance with Article 11 of this contract.

8.4.5 The Buyer may also claim damages as provided for in Article 12 of this contract.

8.5 The Seller shall be liable to the buyer for lack of conformity of the Goods if he does not perform his obligation either in Article 8.4.1, 8.4.2 or 8.4.3 (as the case may be) upon receipt of such notice from the buyer.

## **9. Transfer of Property**

9.1 The Seller must deliver to the Buyer the Goods specified in Article 1 of this contract free from any right or claim of a third person.

9.2 If the Goods specified in Article 1 of this contract are subject to a right or claim of a third person, the Buyer shall notify the Seller of such right or claim and request that the other goods free from all rights and claims of third persons be delivered to it by the Seller without any additional expense to the Buyer.

9.3 If the Seller complies with a request made under paragraph 9.2 of this Article, and the Buyer nevertheless suffers a loss, the Buyer may claim damages in accordance with Article 12 of this contract.

9.4 If the Seller fails to comply with a request made under paragraph 9.2 of this Article, the Buyer may declare this contract terminated in accordance with Article 11 of this contract and claim damages in accordance with Article 12 of this contract. If the Buyer does not declare this contract

terminated he shall have the right to claim damages in accordance with Article 12 of this contract.

9.5 The Buyer shall lose his right to declare this contract terminated if he fails to notify the Seller as provided in paragraph 9.2 of this Article within ..... days from the moment when he became aware or ought to have become aware of the right or claim of the third person in respect of the Goods.

9.6 The Seller shall not be liable under this Article if the existence of right or claim of a third person on the Goods was notified to the Buyer at the time of the conclusion of this contract and the Buyer agreed to take the Goods subject to such right or claim.

## **10. Termination of the contract**

10.1 Either the Seller or the Buyer is entitled to terminate the contract if there is a breach of contract where a party fails to perform any of its obligations under this contract, including defective, partial or late performance.

10.2 In a case of a breach of contract according to paragraph 10.1 of this Article, the aggrieved party shall, by notice to the other party, fix an additional period of time of ..... days for performance. During the additional period of time the aggrieved party may withhold performance of its own reciprocal obligations and may claim damages but may not declare this contract terminated. If the other party fails to perform its obligation within the additional period of time, the aggrieved party may declare this contract terminated.

10.3 A declaration of termination of this contract is effective only if made by notice to the other party.

## **11. Effects of termination in general**

11.1 Termination of this contract releases both parties from their obligation to effect and to receive future performance, subject to any damages that may be due.

11.2 Termination of this contract does not preclude a claim for damages for non-performance.

11.3 Termination of this contract does not affect any provision in this contract for the settlement of disputes or any other term of this contract that is to operate even after termination.

## **12. Damages**

12.1 Any non-performance gives the aggrieved party a right to damages either exclusively or in conjunction with any other remedies except where the non-performance is excused under *force majeure* as provided for in Article 15 of this contract.

12.2 Where this contract is not terminated, damages for a breach of this contract by one party shall consist of a sum equal to the loss, including loss of profit, suffered by the other party. Such damages shall not exceed the loss which the Party in breach ought to have foreseen at the time of the conclusion of this contract, in the light of the facts and matters which then were known or

ought to have been known to it, as a possible consequence of the breach of this contract.

12.3 Damages are to be paid in a lump sum unless otherwise specified by the parties.

12.4 Damages are to be assessed in the currency in which the monetary obligation was expressed (the Parties may specify the other solution, e.g. in the currency in which the harm was suffered)

### **13. Mitigation of harm**

A party who relies on a breach of this contract must take such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach. If it fails to take such measures, the party in breach may claim a reduction in the damages in the amount by which the loss should have been mitigated.

### **14. Change of circumstances (hardship)**

14.1 Where the performance of this contract becomes more onerous for one of the Parties, that party is nevertheless bound to perform its obligations subject to the following provisions on change of circumstances (hardship).

14.2 If, however, after the time of conclusion of this contract, events occur which have not been contemplated by the Parties and which fundamentally alter the equilibrium of the present contract, thereby placing an excessive burden on one of the Parties in the performance of its contractual

obligations (hardship), that party shall be entitled to request revision of this contract provided that:

14.2.1 The events could not reasonably have been taken into account by the affected party at the time of conclusion of this contract;

14.2.2 The events are beyond the control of the affected party;

14.2.3 The risk of the events is not one which, according to this contract, the Party affected should be required to bear;

14.2.4 Each party shall in good faith consider any proposed revision seriously put forward by the other party in the interests of the relationship between the Parties.

**15. *Force majeure* – excuse for non-performance**

15.1 “*Force majeure*” means war, emergency, accident, fire, earthquake, flood, storm, industrial strike or other impediment which the affected party proves was beyond its control and that it could not reasonably be expected to have taken the impediment into account at the time of the conclusion of this contract or to have terminated or overcome it or its consequences.

15.2 A party affected by *force majeure* shall not be deemed to be in breach of this contract, or otherwise be liable to the other, by reason of any delay in performance, or the non-performance, of any of its obligations under this contract to the extent that the delay or non-performance is due to any *force majeure* of which it has notified the other party in accordance with Article

15.3. The time for performance of that obligation shall be extended accordingly, subject to Article 15.4.

15.3 If any *force majeure* occurs in relation to either party which affects or is likely to affect the performance of any of its obligations under this contract, it shall notify the other party within a reasonable time as to the nature and extent of the circumstances in question and their effect on its ability to perform.

15.4 If the performance by either party of any of its obligations under this contract is prevented or delayed by *force majeure* for a continuous period in excess of three months, the other party shall be entitled to terminate this contract by giving written notice to the Party affected by the *force majeure*.

## **16. Entire agreement**

16.1 This contract sets out the entire agreement between the Parties. Neither party has entered into this contract in reliance upon any representation, warranty or undertaking of the other party that is not expressly set out or referred to in this contract. This Article shall not exclude any liability for fraudulent misrepresentation.

16.2 This contract may not be varied except by an agreement of the Parties in writing.

## **17. Notices**

17.1 Any notice under this contract shall be in writing and may be served by leaving it or sending it to the address of the other party as specified in

Article 17.2 below, in a manner that ensures receipt of the notice can be proved.

17.2 For the purposes of Article 17.1, notification details are as follows unless otherwise specified in writing by the Parties: –

.....

**18. Effect of invalid or unenforceable provisions**

If any provision of this contract is held by any court or other competent authority to be invalid or unenforceable in whole or in part, this contract shall continue to be valid as to its other provisions and the remainder of the affected provision, unless it can be concluded from the circumstances that, in the absence of the provision found to be null and void, the Parties would not have concluded this contract. The Parties shall use all reasonable efforts to replace all provisions found to be null and void by provisions that are valid under the applicable law and come closest to their original intention.

**19. Dispute resolution**

Any dispute, controversy or claim arising out of or relating to this contract, including its conclusion, interpretation, performance, breach, termination or invalidity, shall be finally settled under the rules of the i-Arbitration Rules of the Kuala Lumpur Regional Centre for Arbitration (KLRCA) by (specify the number of arbitrators, e.g. sole arbitrator or, if appropriate, three arbitrators) appointed in accordance with the said rules. The place of arbitration shall be (specify). The language of the arbitration shall be (specify).

**20. Applicable law and guiding principles**

20.1 Questions relating to this contract that are not settled by the provisions contained in the contract itself shall be governed by: (to specify)

The applicable national law of the country where the Seller has his place of business,

or;

The applicable national law of the country where the Buyer has his place of business,

or;

The applicable national law of a third country (specify the country).

20.2 This contract shall be performed in a spirit of mutual co-operation for the cause of goodness and piety in accordance with the concept of *ta'auanu ala birri wa't-taqwa*.

**DATE AND SIGNATURE OF THE PARTIES**

Seller

Buyer

Date .....

.....

Name .....

.....

Signature

Signature

### **8.3 Concluding Remarks**

It is to be noted that this model contract is only intended to be used as a guide for any future *shari'ah* compliant international sale of goods contract. Further, this model contract is to be read together with Chapters 4 and 5 respectively of this dissertation, with regard to the obligations of the seller and buyer in a contract of sale and also the remedies available to them in the event of a breach of contract. The general principles of *shari'ah* discussed in Chapters 3, 6 and 7 of this dissertation are also applicable, where relevant. It is hoped that some day in the not too distant future, a *shari'ah* compliant model contract or model law will be extensively used in international trade as an alternative to the existing conventional model, namely the CISG.



## CHAPTER NINE

### CONCLUSION

#### 9.1 Recapitulation

Sales and trade have been an integral part of the economy since the early civilisation of men, pioneered by the barter trade, followed by the introduction of currency and gradually making progress alongside the advancement of technology with the introduction of, amongst others, electronic commerce (e-commerce) in this modern day and age. Whilst the conventional or secular method of conducting sales had somewhat gained worldwide acceptance in the form of uniform rules and conventions, the Islamic approach or a *shari'ah* compliant harmonised rules on the sale of goods has yet to make its international debut,<sup>1</sup> lagging behind in the areas of Islamic banking and insurance. This dissertation is an earnest but humble endeavour to investigate the rights and obligations of sellers and buyers in international contracts of sale, the remedies available to the contracting parties, the strengths and weaknesses of the conventional uniform international sale of goods regime, and possibly exploring the prospect of introducing a *shari'ah* compliant model sales contract to be employed in international business in the near future.

#### 9.2 Reiteration

##### 9.2.1 The CISG

The CISG is arguably the most successful uniform international sales law to date. Promulgated in 1980 which then became effective on 1<sup>st</sup> January 1988, it is now ratified and adopted by 78 countries from across the globe. With the intention of unifying international sales law, the CISG has to some extent succeeded in achieving such aim,

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<sup>1</sup> Correct at the time of writing this dissertation.

considering that it now accounts for three quarters of world trade. The CISG covers most aspects of sale, including, formation of the contract, obligations of the seller and buyer, remedies for breach of such obligations and several other general provisions such damages, interest as its scope of application.

Despite the CISG's noble intentions, the very issue of its applicability has plagued the CISG with difficulties from its conception. One of the most common predicaments in deciding the applicability of the CISG is in Article 1(1)(b) where the Convention leaves it to "the rules of private international law" to decide whether the CISG applies when one or both parties to the contract do not reside in any of the CISG contracting States. Regrettably, the Article does not state whose rules of private international law would trigger the application of the CISG and it is contended that leaving the interpretation to the rules of private international law would more often than not gives rise to ambiguity than certainty. Perhaps in an attempt to contain the impact of Article 1(1)(b), the CISG, by virtue of Article 95, allows for a Contracting State to make a reservation by declaring it not to be bound by Article 1(1)(b) but by allowing Contracting States to do so, it not only causes more confusion on the issue of interpretation, not to mention allowing some Contracting States to successfully extricate themselves out of a contract, as demonstrated in the case of *Impuls I.D. Internacional, S.L. v. Psion-Teklogix*.<sup>2</sup>

A further obliteration to uniformity can also be found in Article 6, where the parties to a contract may "exclude the application" of the Convention or (subject to Article 12) "derogate from or vary the effect of any of its provisions." This has led to a possible conclusion that even where all the CISG's requirements of applicability, namely, international, substantive, temporal and personal/territorial are met, the CISG does not

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<sup>2</sup> Refer to paragraph 2.2.2.1 of this dissertation on the explanation of the case.

necessarily apply if it has been excluded by the parties. There have been suggestions that ultimately party autonomy prevails but too wide an autonomy given to the contracting parties would undermine the underlying principle of the CISG in the first place, namely a uniform international sale of goods regime.

The primary obligations of the seller under the CISG include, under Article 30, to deliver the goods, hand over any documents relating to the goods and also to transfer the property in the goods to the buyer. With regard to the transfer of property in the goods, it seems like an anomaly that this should be made an obligation of the seller when, in fact, Article 4(b) of the CISG specifically states that “the Convention is not concerned with the effect which the contract may have on the property in the goods sold”. This is one aspect of the CISG which could be considered as a flaw and which is perhaps best addressed by an alternative solution such as a *shari’ah* compliant sale of goods law which stresses on the importance of *milkiyat* or ownership of the goods, hence ensuring that the property in the goods is rightfully transferred to the buyer upon completion of the contract of sale.

In summary, the buyer’s main obligations under the CISG are to pay for the price of the goods and to take delivery of them, under Article 53. Although payment of price may appear like a straightforward obligation, Article 55 poses some complication as it allows for a situation where a contract which has been validly concluded but which does not expressly or impliedly make a provision for determining the price. In such an instance, the said Article further allows for reference to be made to the price generally charged at the time of the conclusion of the contract “for such goods sold under comparable circumstances in the trade concerned.” This may be easier in theory than in practice and would put additional burden on the parties to determine the price in such a way. This type

of ambiguity is frowned upon by the *shari'ah* as a sale where the price of the goods which are not determined during the conclusion of the contract is considered as invalid or *fasid*.

Remedies for breach of obligations under the CISG include damages, specific performance and avoidance<sup>3</sup> (termination) of the contract. However, for a party to seek any of these remedies, in particular avoidance of the contract as of right, the breach of contract has to be a fundamental breach in accordance with Article 25 of the Convention. Unfortunately, nowhere in the CISG is the word “fundamental” defined. Article 25 does not provide any examples of events that constitute such a fundamental breach. Instead, general terms and phrases are used to define fundamental breach, such as “detriment,” “substantial deprivation,” and “foreseeability.” These terms hardly allow the parties to a sales contract, in case of dispute, to determine *ex ante* (before one of the parties deems the contract avoided) whether a breach was fundamental.<sup>4</sup> Considering the fact that fundamental breach plays a crucial role within the remedial system of the CISG, failure to define such an important term depicts another failing of the CISG.

The CISG has also failed to define ‘sale’, ‘goods’ or ‘contract for the sale of goods’ which is rather perplexing considering that this is a Convention dealing specifically with sale of goods. Since there are no definitions of these essential terms in the CISG, it appears that one can only construct the meanings of these terms from the other Articles of the CISG, for example, Articles relating to the obligations of the sellers and buyers.

It is perhaps acknowledged that no codification is ever perfect and thus the need for general interpretation and gap-filling measures arises. Article 7 of the CISG, arguably one

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<sup>3</sup> The CISG used the term ‘avoidance’ instead of “termination” of the contract.

<sup>4</sup> Koch, R, “The Concept of Fundamental Breach of Contract under the United Nations Convention on Contracts for the International Sale of Goods (CISG)”. Retrieved on 12 January 2013 from <<http://cisgw3.law.pace.edu/cisg/biblio/koch.html>>.

of the most important provisions of the CISG, is intended to fill the said roles. Whilst Article 7(1) appears rather straightforward by stating that in interpreting the Convention, regard has to be given to “its international character and to the need to promote uniformity” and also “observance of good faith in international trade”, it is not without its controversies as firstly, practitioners and scholars alike tend to understand words and concepts of the Convention according to their familiar domestic law. Further, in the interest of promoting uniformity, a court in a Contracting State may take into account another Contracting State’s court’s decision but distinguishing it at the same time, creating a somewhat unclear system of precedents.

Finally, the requirement to observe good faith could be a much disputed and misunderstood phrase as it only applies to the interpretation of the Convention and not in fact applied to contractual agreements, despite a considerable number of legal writers advocating for it. There have also been tendencies to adopt the concept of good faith in accordance with certain Contracting State’s domestic law instead of analysing it autonomously by taking into account practices, standard forms and value judgments of courts and arbitration tribunals in international cases.

It is noted that if interpretation under Article 7(1) fails to adjust the Convention, then a gap-filling measure under Article 7(2) has to be considered. Article 7(2) specifically states that questions concerning matters governed by the Convention which are not expressly settled in it are to be settled in conformity with “the general principles on which it is based”, or, in the absence of such principles, “in conformity with the law applicable by virtue of the rules of private international law.” The conundrum posed by this provision is that the general principles are not explicitly stated in the Convention therefore, they have to be derived from an analysis of concrete provision so to unearth the general principles

underlying them. Once again, as in Article 1(1)(b), there is no indication of whose rules of private international law will be applicable, leaving the interpretation of matters pertaining to this Convention back to the domain of Contracting States' domestic law.

It can be argued that a prominent example of a gap in the CISG is the subject of interest in Article 78. The Article provides that a right to interest arises in the event of non-payment of the purchase price or other sums in arrears without mentioning when such interest begins to run, what the rate is and whether it is simple or compounded interest. This particular issue has produced much litigation under the Convention and the courts had to had recourse to, amongst others, other provisions in the CISG, UNIDROIT principles and yet again, Contracting States' domestic law to determine the rate.

Even though the CISG can be considered as a worldwide success, the failings mentioned above have somewhat defeated its very purpose of promoting certainty and uniformity in international trade. Since amending the provisions of the CISG is an unlikely mission considering it will be a mammoth effort to put in order another diplomatic conference to achieve such objective, perhaps the time has come for an alternative model to be introduced to rectify the weaknesses and to promote an enhanced model for the international business community.

### **9.2.2 The Incoterms**

The Incoterms are rules devised by the International Chamber of Commerce (ICC) which explain standard terms that are used in contracts for the international sale of goods. Incoterms rules are essential tools that assist traders to avoid misunderstandings by clarifying the costs, risks and responsibilities of both buyers and sellers in transporting the goods. First introduced in 1936, the Incoterms have been updated regularly, the latest

being the Incoterms rules 2010. This latest version of the Incoterms rules have been officially endorsed by the United Nations Commission on International Trade Law (UNCITRAL), confirming its position as the global standard for international business transactions.

Although the Incoterms rules are customarily incorporated into the contract of sale, its function is primarily as rules for the interpretation of terms of delivery and not of other terms of the contract of sale. Thus, the Incoterms rules do not, amongst others, deal with the transfer of property in the goods, relief from obligations and exemptions from liability in case of unexpected or unforeseen circumstances or consequences of breach of contract. There are eleven (11) rules in the Incoterms rules 2010 (as opposed to 13 in the previous edition), the most commonly recognised are the CIF (Cost, Insurance, Freight) and the FOB (Free on Board). The 2010 version of the Incoterms rules can be used for both the unimodal and multimodal modes of transport.

Perhaps the most significant improvement introduced by the Incoterms rules 2010 is the abolishment of the “ship’s rail” concept in the FOB term. The concept of the imaginary ship’s rail has caused considerable difficulties in the past, in particular where the division of risks between the seller and buyer is concerned. However, this has changed since the introduction of the new phrase “on board the vessel”. The Incoterms rules 2010, defined the FOB term as “the seller delivers the goods *on board the vessel* nominated by the buyer at the named port of shipment or procures the goods already so delivered. The risk of loss of or damage to the goods passes when the goods are on board the vessel, and the buyer bears all costs from that moment onwards” as opposed to “the seller delivers when the goods *pass the ship’s rail* at the named port of shipment” in the Incoterms rules 2000.

To sum up, in international trade transactions, the Incoterms rules are generally used as a supplement to the main sales contract where key obligations of the seller and buyer are already defined. It is commonly used alongside the CISG as they complement each other in defining the roles of the parties in a sales contract. International sales contract do not exist in a vacuum and it is therefore necessary to avoid rigidity in dealing with overseas sales law.

### **9.2.3 The General Principles of Contract and the Contract of Sale under the *Shari'ah***

The *shari'ah* literally means the road to the watering place or the straight path to be followed. However, as a technical term, it is defined as the 'the sum total of Islamic teaching and system, which was revealed to Prophet Muhammad (pbuh) recorded in the Qur'an as well as deducible from the Prophet's divinely guided lifestyle called the *Sunnah*. One of the most important components of the *shari'ah* is *fiqh*, which represents the whole science of jurisprudence as it implies the exercise of intelligence in deciding a point of law in the absence of a binding text (*nas*) of the Qur'an or *Sunnah*. Thus, it is evident that the *shari'ah* is an all-encompassing notion which permeates every aspect of life, as it is not confined only to *fiqh al-ibadah* (rulings that govern the relationship between man and Allah) but also to *fiqh al-muamalah* (rulings that govern the relationship between man and man which includes commercial transactions).

The primary sources of the *shari'ah* are the Qur'an (the Holy Book) and the *Sunnah* (normative practice or established conduct of Prophet Muhammad (pbuh)) whilst the secondary sources include, amongst others, *ijma* (consensus of opinions), *qiyas* (analogical deduction), *istihsan* (equity), *marsalah mursalah* (consideration of public interest), '*urf* (custom) and *istishab* (presumption of continuity).

With regard to the principles of contract, it is argued that Islamic law has no general theory of contract based firstly, on the method of development of the system of Islamic contracts by the Muslim jurists who categorised each contract into classes of nominate contracts<sup>5</sup> with their own distinctive rules and secondly, by reason of the primary sources of the law formulated based only on the very broadest of principles applicable to all classes of contracts, namely by the principle of “*aufu bi al-uqud*” which means “fulfil your obligations” (Al-Maidah:1).

However, in recent times, works have been produced, mostly by academicians, which impose a continually increasing importance on general theories, derived in abstract hindsight from the series of specific contracts and their regulations formulated by the early jurists and that the contract of sale provided a premise for analogy. The majority of legal treatises all contain a chapter on *bay'*, in which important ground rules are provided for contracts in general. It can therefore be concluded that the contract of sale or *bay'* is one of the most important concepts in Islamic commercial law as it formed the prototype contract around which other classes of contract were analogously developed.

The contract of sale is permitted in Islam and proof of its legitimacy is in the following verse of the Qur'an, namely “*O ye who believe ! eat not up your property among yourselves in vanities: but let there be amongst you traffic and trade by mutual good-will.*” (An-Nisa: 29). The elements of a contract of sale include, an agreement, consent and intention to contract, contracting parties with capacity to contract, an object of sale and consideration. The guidelines in conducting trade and business activities are clear in Islam and any elements of interest (usury or *riba*), gambling, misappropriation of another's person's property in an unlawful manner, unlawful monopoly, bribery and uncertainty

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<sup>5</sup> The contract of *bay'* (sale) is one of the nominate contracts in Islamic law.

(*gharar*) are all considered unlawful elements according to the *shari'ah*, which must be avoided at all costs in any sale contract. The *shari'ah* also stresses on the concept of *milk* or ownership and property in the goods.<sup>6</sup>

### 9.2.3.1 Riba (Usury)

*Riba*, in its bare context, signifies excess, addition and expansion. In the *shari'ah* context denotes an addition to or increase of a particular thing over and above its original size or amount and it becomes immoral and against the will of Allah when it signifies unlawful addition, by way of interest, to money or goods lent by one person or group to another.<sup>7</sup> The *shari'ah* permits trade but prohibits *riba* as illustrated by the following Qur'anic injunction "... *but Allah has permitted trade and forbidden usury.*" (Al-Baqarah:275).

Traditionally, usurious transactions can be classified into two categories, namely *riba al-fadl* and *riba al-nas'ia*.<sup>8</sup> Jurists from the four major schools of Islamic thought, namely, the Hanafis, Malikis, Shafi'is and Hanbalis generally agree on the prohibition and classification of *riba*, their differences of opinions only stems from the categorisation on what constitutes an excess and also when does a deferment of a transaction occurs.

The CISG allows for the imposition of interest under Article 78 and its implementation in Islamic countries which are signatories to the CISG have given rise to some debate. One argument that has been put forward is that Article 78 should not pose a dilemma as no true Islamic state exists but the stronger argument seems to be the fact that no Islamic country made any reservation to Article 78 when they ratified the CISG. Unless and until there is a clear judicial decision on this matter, it will for now remain as a moot point to be analysed and pondered upon.

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<sup>6</sup> Article 4 of the CISG is in direct contrast with this principle.

<sup>7</sup> Ruqaiyyah Waris Maqsood, A Basic Dictionary of Islam, (New Delhi: Goodword Books, 2008), 183-184.

<sup>8</sup> *Riba al-fadl* denotes *riba* by way of an excess whilst *riba al-nasi'a* occurs when there is a deferment in transaction.

### 9.2.3.2 *Gharar* (Uncertainty or Speculation)

Another significant prohibition in trade under the *shari'ah* is *gharar*, that is, uncertainty or speculation. Concern for protecting human beings from their own folly and extravagance is an important feature of the Qur'an, and it consequently proscribed games of hazard, thus providing religious grounds for suspicion of *gharar*. Thus, Allah has decreed in the Qur'an "*They ask thee concerning wine and gambling. Say: "In them is great sin, and some profit, for men, but the sin is greater than the profit."*" (Al-Baqarah: 219). Further, Tradition added to this the result of the Prophet's (pbuh) vast experience as a merchant and his deep knowledge of human nature, for it did not escape him that it is not uncommon, in secular transactions, for one of the parties to be stronger than the other, or perhaps cleverer or more experienced; so the disadvantaged party is in need of some kind of protection and guidance before an agreement is concluded or bargain is struck.

In order to avoid *gharar*, it is suggested that a fair and just sale transaction must be precise in the determination of the goods, price, time of performance and both parties are to mutually benefit from the sale. Under the *shari'ah* both the price and subject-matter of a sale must be in existence at the time the contract of sale is concluded, otherwise the contract is void. However, in today's international trade transactions where sale are conducted through the exchange of documents (as in a CIF contract) and the goods are not physically available when a sale is concluded and when payment can, and is usually made, at a later date, it is necessary to examine the exceptions to the above rule and how to avoid incidences of *gharar* in such transactions.

One of the reasons for the non-availability of the payment at the meeting of the contracting parties occurs when the performed transaction is a credit sale. One way of circumventing

*gharar* in this instance is by adopting the principles of the Maliki school of thought, which more than any other Sunni school recognises the validity of a deferred transaction. The Maliki jurists consider credit sale as a valid and lawful transaction whether or not the price is inflated provided it is not used as a stratagem or device in order to circumvent the prohibition of *riba* as is the case when an apparent credit sale is, in reality, a cover for a loan agreement, with the lender having secured for himself some advantage from the loan.

When the subject-matter of a sale is not visible during the conclusion of the sale contract, the *shari'ah* recognises it as *bay' ghaib*. Among the four leading schools of Islamic thought, the Hanafis have a more liberal view on *bay' ghai'b* because of their interpretation of the technique “option after inspection” (*khiyar al-ru'ya*), which successfully reduces the risk inherent in an imperfect knowledge of the subject-matter. For the Hanafis, it is valid to sell an object by pointing out its location, so as to dispel a material want of knowledge (*jahl*).

When the object of sale is not present at the meeting of the parties, the vendor ought to particularise it by indicating the place where it is located provided that there is no similar subject-matter in that particular place, otherwise the vendor ought to describe the subject-matter in such a way so as to dispel a material want of knowledge. It is suggested that an immaterial want of knowledge does not invalidate contract (which is dictated by the technique of *khiyar al-ru'ya*) as this is open to the purchaser even though not stipulated as a sale requisite and even though the subject-matter turns out to be in conformity with the description.

## 9.4 Final Remarks

### 9.4.1 A *Shari'ah* Compliant Uniform International Sale of Goods Contract - The Way Forward

Most economies today operate on a free market basis but recent happenings in the world<sup>9</sup> have shown us that by allowing trade in a free market without any form of checks and balances could result in dire consequences, one of which is speculation.<sup>10</sup> This dissertation submits that one of the means to curb such overindulgence is by introducing, initially, a *shari'ah* compliant model contract and subsequently, a uniform model law for the international business community to further fuel the international community's interest in acknowledging and appreciating the benefits of the principles of the *shari'ah*, earlier scenarios of which were put in place by the banking and insurance industry.

It is a universal trait of Islam that, except in matters concerning its fundamental beliefs and principles of its code of practices, is not limited to one type of thinking or specific legislative method. Islam is a tolerant religion which authorises and permits liberality. As it has been demonstrated throughout the Muslim world, Islam fits into all major cultures and constructive civilisations and it is argued that it will continue to do so perpetually. In other words, the Islamic institutions not only set down the principles of belief and worship but also of transactions, penal affairs and family organisation, to name a few.

A number of weaknesses of the CISG have been exposed in this dissertation, whilst strengths of the *mu'amalat* or Islamic commercial transactions highlighted. The *mu'amalat*, although having its roots since the era of the Prophet Muhammad (pbuh), is adaptable and is constantly changing to meet the demands of modern sales and trade. It is a

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<sup>9</sup> Two prominent examples include the near collapse of the United States of America's economy and the Euro currency crisis.

<sup>10</sup> Refer to paragraph 7.5 of this dissertation on some examples of the evils of speculation.

known fact that the Prophet Muhammad (pbuh) was a trader and the Qur'an abounds with commercial imagery. Muslim jurists have constantly maintained that the originality in Islamic law of transactions is permissible unless there is a prohibition. It signifies that when a new transaction occurred which is not previously known in Islamic law, then, such a transaction is considered permissible unless there is an implication from a text which prohibits it whether explicitly or implicitly. Thus, it can be deduced that the Islamic law of transactions also contain the rules of Allah in which He gives such permission and He is "silent on many things without forgetfulness (in regulating the rule) as a mercy".

To reflect the rising international sentiment in recognising and appreciating the benefits of *shari'ah* compliant transactions, the Kuala Lumpur Regional Centre for Arbitration (KLRCA) has launched KLRCA i-Arbitration Rules at the Global Islamic Finance Forum 2012 (GIFF) on 20 September 2012 which is the first set of rules that adopts the UNCITRAL Arbitration Rules, while allowing for the resolution of disputes arising from any contract that may contain *shari'ah* issues. Arbitral awards under the KLRCA i-Arbitration Rules will be enforceable in the 146 countries that are signatories to the New York Convention. These Rules, which is recognised and enforceable internationally, is suitable for transactions premised on Islamic principles and which would undeniably complement the *shari'ah* compliant model sales law proposed in this dissertation.<sup>11</sup>

Therefore, this dissertation further submits that Islamic economics is not an ancient intellectual tradition, but a modern movement that asserts that Islamic traditions of organisation and finance provide a more just and equitable model for economic growth than the rival systems of Western capitalism and socialism. Indeed, the first and most striking fact about Islamic economics is its unquestionable modernity. The central claim of

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<sup>11</sup> Refer to paragraph 8.1 of Chapter 8 of this dissertation.

Islamic economics is that it offers a middle way between the individualist excesses of Western capitalism and the repressive centralisation of socialism. To conclude, it is put forward that in principle, Islamic economics presents a salutary third way, namely, avoiding the inegalitarian excesses of modern capitalism while unleashing the energies of entrepreneurs and merchants and it ought to be adopted as an international model for sale of goods.



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## **APPENDICES**

# **APPENDIX I**

## **THE CISG**

## **APPENDIX II**

### **THE INCOTERMS RULES 2010 (FOB AND CIF)**

## **APPENDIX III**

### **THE MEJELLE (THE BOOK ABOUT BEY’)**

**APPENDIX IV**

**EXCERPT FROM THE CIVIL CODE OF EGYPT**

## **APPENDIX V**

### **EXCERPT FROM THE LEBANON CODE OF OBLIGATIONS AND CONTRACTS LAW**

**APPENDIX VI**

**EXCERPT FROM THE CIVIL CODE OF IRAN**