



GOOD FAITH AND FAIR DEALING IN HIRE
PURCHASE CONTRACT: A STUDY ON THE
ISLAMIC AND CONVENTIONAL PRACTICE IN
MALAYSIA

BY

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AHMAD IBRAHIM KULLIYY AH OF LAWS
INTERNATIONAL ISLAMIC UNIVERSITY
MALAYSIA

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ABSTRACT

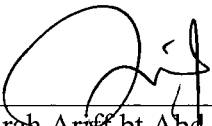
This study examines and analyzes the important of the element of good faith and fair dealing in a hire purchase contract. A hire purchase contract is a contract whereby one party, called “the owner”, lets goods on “hire” to another party the “hirer”, and agrees that the hirer may at his own option, return the goods when he no longer needs them or terminates the hire on completion of the necessary payments agreed in the contract. Good faith is a principle derived from the rules “*pacta sunt servanda*” and other legal rules distinctively and directly related to honesty, fairness and reasonableness. The application of good faith is determined at a particular time by the standard of honesty, fairness and reasonableness prevailing in the communities which are considered appropriate for formulation in new revised legal rules In the 18th century, the concept of fair dealing is an essential concept supporting an efficient and emerged as a governing principle applicable to all Common Law contracts. However, later, the element of good faith was confined mainly to insurance contract. Under the Islamic law, the element of good faith (*Ihsān*) and fair dealing (*‘Adl*) are important and highly emphasized. Furthermore, in Islam, the moral criteria for the legality of any act and honesty of a merchant are clearly imposed as a basis of commercial activity. All bad practices are condemned. One of the conclusion made in this research, is that good faith and fair dealing are two crucial elements in hire purchase contracts both in the conventional and Islamic systems. This is because the attributes of honesty, reasonableness and fairness should be the underlying principles in every distinct hire purchase contract to connote the notion of “fair dealing” transaction whereby the contract’s sanctity is performed thus satisfying the demand of the parties in the contract. The research methodology applied in this research is mainly library research. However, it also includes field study in the form of interviews with respective officers of selected banks in Malaysia which offer both Islamic and conventional hire purchase financing. The law in this research is stated as at 30th April 2005.

ملخص البحث

يتناول هذا البحث دراسة و تحليل أهمية عامل حسن النية والتعامل في عقد الإجارة المنتهية بالتملك. ويقصد بهذا العقد هو أن يقوم الطرف الأول (المالك) بتأجير سلعة للطرف الثاني (المستأجر). ويوافق الطرف الأول على أن للمستأجر خيارا في رد السلعة عندما لا يحتاج إليها أو له خيار في إنهاء الإجارة عندما يكتمل الدفع المتفق عليه في العقد. ويعتبر حسن النية مبدءا مأخوذا من قانون (الاتفاقيات لا بد من المحافظة عليها، والمعاهدات لا بد من الوفاء بها)، ومن قوانين أخرى لها علاقة خاصة ومباشرة بالصدق، والإنصاف، والعدل. ويكون تطبيق عنصر حسن النية الذي يتعين في وقت محدد من خلال مقياس الصدق، والإنصاف، والعدل سائدا في المجتمعات، ويعتبر صيغة مناسبة في قوانين شرعية جديدة ومعدلة في القرن الثامن عشر الميلادي. بينما تعتبر فكرة حسن التعامل منهاجا مهما يدعم فعاليته، ويظهر بوصفه مبدءا ومسيطرنا مناسباً لجميع العقود في القانون الإنجليزي. إلا أنه في الآونة المتأخرة، أصبح عامل "حسن النية" منحصرا بشكل عام في عقد التأمين. أما في الشريعة الإسلامية، فقد حظي عامل حسن النية والتعامل باهتمام كبير. وذلك لأن الإسلام يعتبر معيار الأخلاق لشرعية أي عمل، وصدق البائع مبدءا أساسيا في المعاملات التجارية. وكل المعاملات السيئة منهي عنها في الإسلام. ومن نتائج هذا البحث: أن حسن النية وحسن التعامل عاملان مهمان في عقود الإجارة المنتهية بالتملك في النظام التقليدي والإسلامي على حد سواء. وذلك لأن صفات الصدق، والإنصاف، والعدالة لا بد أن تكون هي مبادئ متبعة في كل هذه العقود سعيا إلى تحقيق فكرة العقد المبني على "حسن التعامل"، وحتى تتحقق قداسة العقد، ومن ثم يكون الوفاء بطلبات أطراف العقد. وبالرغم من أن المنهج المستخدم في هذا البحث بشكل عام هو المنهج المكتبي، إلا أنه تم أيضا استخدام الدراسة الميدانية في شكل مقابلات شخصية مع الموظفين المختصين في بعض البنوك الماليزية التي تتعامل بهذا العقد بكل من النظامين التقليدي والإسلامي. وإن القانون الذي يتناوله هذا البحث هو القانون المقرر في 30 أبريل 2005.

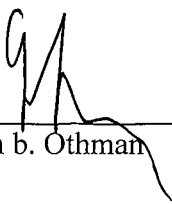
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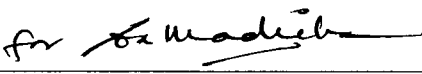
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Supervisor

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Nik Ahmad Kamal bin Nik Mahmud
Dean, Ahmad Ibrahim Kulliyah of Laws

DECLARATION

I hereby declare that this dissertation is the result of my investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Name : Nurhidayah bt. Abdullah

Signature: -Nurhidayah-
.....

Date: 23.1.2006
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STUDY ON THE ISLAMIC AND CONVENTIONAL PRACTICE IN
MALAYSIA**

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United Engineers v Lai Ping Yoon [1968] 1 MLJ 189.
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Civil Law Act 1956 (Act 67)
Hire Purchase Act 1967 (Act 212)
Sales of Goods Act 1957 (Act 382)
Banking and Financial Institutions Act 1989 (Act 372)
Islamic Banking Act 1983 (Act 276)

LIST OF ABBREVIATIONS

AITAB	<i>Al-Ijārah Thumma Al-Bay'</i>
AHPCM	Association of Hire Purchase Companies in Malaysia
app.	Appendix
BAFIA	Banking and Financial Institutions Act 1989 (Act 372)
BMMB	Bank Muamalat Malaysia Berhad
BNM	Bank Negara Malaysia
BMFB	Bumiputra-Commerce Finance Berhad
©	copyright
CLJ	Current Law Journal
CTOS	Credit Tip Off System
CCRIS	Central Credit Information System
CDIS	Credit Data Information System
ed/eds	edition/editions; editor, edited by
e.g	(<i>exempligrana</i>) : for example
etc	(<i>et cetera</i>) ; and so forth
FIS	Financial Information System
HPA	Hire Purchase Act 1967 (Act 212)
IBA	Islamic Banking Act 1983 (Act 278)
ibid	(<i>ibidem</i>) ; in the same place
i.e.	(<i>id est</i>) : that is
JPJ	Jabatan Pengangkutan Jalanraya
Ltd.	Limited
MCL	Master in Comparative Law
MLJ	Malayan Law Journal
MFB	Mayban Finance Berhad
MSc. Acc.	Master of Science in Accounting
n./nn	footnote/footnotes
n.d	no date of publication given
n.p	no place of publication given
no./nos	number/numbers
N.S.R(2d)	Nova Scotia Reports ,Second Series (Can)
p. /pp.	page/pages
PUSPAKOM	Pusat Pemeriksaan Kenderaan Berkomputer Sdn.Bhd
P.B.U.H	Peace Be Upon Him
ROC	Registrar of Company
ROB	Registrar of Business
SGA	Sales of Goods Act 1957 (Act 382)
SWT	Subhanahu wa Ta'ala (Praise be to the Almighty)
sec./secs	section/sections

TRANSLITERATION TABLE

CONSONANTS

أ	a	ر	r	ف	f
أ	'	ز	z	ق	q
ب	b	س	s	ك	k
ت	t	ش	sh	ل	l
ث	th	ص	s	م	m
ج	j	ض	d	ن	n
ح	h	ط	t	و	w
خ	kh	ظ	z	ه	h
د	d	ع	c	ي	y
ذ	dh	غ	gh		

VOWELS

Short:	أ	a	أ	u	إ	i
Long:	أى	a	أو	u	إي	i
Doubled:	-	-	أو	uww	إي	iyy

DIPHTHONGS

أو	aw	إي	ay
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CHAPTER 1

INTRODUCTION

1.1 GENERAL STATEMENT

In Malaysia, hire purchase financing is one the credit sale facilities which is offered by the local bank and financial institutions. At present, there are two types of hire purchase financing which are available in the local market, namely the Conventional hire purchase financing and the Islamic hire purchase financing. This dissertation aims to identify the existence and application of the elements of good faith and fair dealing in both the Islamic and Conventional hire purchase contracts. This research also aims to highlight the importance of these two elements in hire purchase contracts for the benefit of the contracting parties.

1.2 SUMMARY

The first chapter of this dissertation includes discussion the objective of the research, statement of problem, summary on content of each chapter, hypotheses, literature review, scope and limitation of the study and research methodology which concentrates on the element of good faith and fair dealing in hire purchase contract from the Malaysian and Islamic law perspectives.

In Chapter Two, the discussion concentrates on the definition, scope and types of hire purchase contract under the Malaysian Law and the Islamic Law.

In Chapter Three, the discussion focuses on the element of good faith and fair dealing and its application in general contracts. This chapter also highlights the significance of disclosure requirement in relation to the element of good faith and fair dealing.

In Chapter Four, the practical aspects of entering into hire purchase contracts in Malaysia are analyzed. The discussions comprise both the Islamic hire purchase perspective and the Conventional practice.

Chapter Five of the dissertation states the observation of the writer on the implementation of good faith and fair dealing in hire purchase contract. This chapter also provides the conclusion and suggestions from the writer to improve the present hire purchase contract in Malaysia in relation to the element of good faith and fair dealing.

1.3 STATEMENT OF PROBLEM

The legal problem in this study is to observe to what extent the element of good faith and fair dealing are implemented in hire purchase contracts in Malaysia.

1.4 HYPOTHESES

1. The Conventional hire purchase contract is lack of element of good faith and fair dealing compared to the Islamic hire purchase contract.
2. The Conventional hire purchase contract can implement the element of good faith and fair dealing without changing the structure and content of the transaction.
3. The element of good faith and fair dealing benefits both parties in a hire purchase contract.

1.5 LITERATURE REVIEW

In all contracts, the elements of good faith and fair dealing are essential to conclude a fair and just contract. Unfortunately, they play a limited role in Common Law contracts. Thus, parties in a contract sometimes claim that they are not dealt with fairness, honesty and reasonableness as expected. Under the Common Law the element of good faith and fair dealing is mainly confined to insurance contracts under the new invented concept known as “*uberrimae fidei*”.

G.Teubner, in his article, “Legal Irritants: Good Faith in British Law or How unifying Law Ends Up in New Divergences”,¹ states that English courts have marginalized or even rejected the principle of good faith, treating it as a ‘contagious disease of alien origin’. Thus, it has led to one of the major divisions between the Civil Law and Common Law Systems.

Holdsworth, in his book entitled ‘A History of English Law’² took the view that it was the Canon Law that inserted into the legal form, the religious and moral ideas which colored the economic thoughts of all the nations of Europe, and thus contributed to the enforcement of those high standards of good faith and fair dealing.

In the same book, Holdsworth³ highlighted that, by the 18th century, under the influence of Lord Mansfield, good faith emerged as a governing principle applicable to all contracts with an express moral content to guide the development of contract law rather than create piecemeal solutions which appear relatively technical. However, later on, the position changed and good faith was merely confined to insurance contracts, which are referred as “*uberrimae fidei*” contracts.

¹ [1998] 61 Modern Law Review 11.

² Holdsworth, W.S, *A history of English Law*, Methuen, 1956 at 19-81.

³ Ibid.

J.F.O, Connor in his book ‘Good Faith in English Law’⁴ defines good faith as the fundamental principle derived from the rules “*pacta sunt servanda*” , and other legal rules, distinctively and directly related to honesty, fairness and reasonableness prevailing in the community, which are considered appropriate for formulation in new or revised legal rules.

Chris Willet,⁵ in his article evoked one question, which seems to be relevant to all contracts, that is how to understand the connection between good faith and fair dealing as an organizing principle and issue of contractual justice. He pointed out that a major question for a modern contract theory is how to justify interference with the promises, which are made by the parties. This has particular relevance in relation to consumer contracts. In the classical model, justice lies in the fact that we enforce what both parties voluntarily agreed to. However, with the consumer law and contract law are now heavily regulated, how can the application of the principle of *laissez faire* be justified? According to the Chris Willet, the application of good faith should be a concrete rule in consumer contract laws.

Chris Willet in the above article also contended that there is a need for a more comprehensive moral justification.⁶ According to him, in rationalizing the regulation of any contractual relationship there are several dimensions, which must be explored. For example, what are the interests of each of the parties and how should the law balance these interests? However, a comprehensive view of micro-contractual justice must take account of the position of the seller/supplier. Indeed, if this has been

⁴ J.F.O,Connor, *Good faith in English law*, Dartmouth,1990 at 102.

⁵ Chris Willet, “Good Faith and Consumer Contract Terms” in *Good faith in Contract, concept and context* edited by Roger Brownsword, Norma J.Hird &Geraint Howells, Ashgate: England, 1999 at 68-89.

⁶ Ibid.

forgotten then we are reminded of it by the introduction of good faith as an important element of the unfairness test in the Unfair Terms and Regulations. Terms used by sellers and suppliers are subject to a requirement of good faith.

According to Chris Willet,⁷ the focus here is on what a seller or supplier does. They must act in good faith. If the law asks a contractor to act in good faith the necessary implication is that failure to meet the standard set by the law involves something approaching bad faith, or at least something less than good faith. Indeed, when English lawyers think of good faith they will often think of the sort of honesty standard involved in the 'good faith purchaser' scenario. Here, there is good faith, unless the purchaser has reasonable grounds to believe that the seller of goods is not the true owner. The association of good faith with fairly basic standards of propriety also applies where doctrines such as duress and undue influence are concerned.

Roger Brownsword in his articles entitled 'Good Faith in Contracts'⁸ observed;

“My own larger view is that we should, if anything, go further—that consideration of critical morality dictate that it would be rational to adopt good faith as the cornerstone of a systematic co-operative ethic in contract”.

He further added that, on the other hand, a good faith regime, if carefully prescribed, is not an easy target for the negative lobby; and if such a regime can be developed in insurance contracts (and perhaps also in employment contracts), why not in contracts more generally?

In the context of the Malaysian law, Nurretina Ahmad Shariff and Zainal Amin

⁷ Ibid.

⁸ Revisited (1996) 49 Current Legal Problems 111.

Ayub in their article entitled “Unconscionable contract: The courts’ approach towards substantive fairness”,⁹ stated that the law gives relief where there is an active abuse by one party of his bargaining position vis-à-vis the other party. Such abuse of bargaining position is dealt with under the doctrines of duress, undue influence, fraud and misrepresentation, all of which are concerned with the procedural aspects of contractual fairness. However, outside these doctrines, there are other cases where a contract may be vitiated. The ones we are concerned with here are on the issue of unconscionability and unfairness, where the relative position of the party is also crucial to determine the validity of the contract.

Meanwhile, Shaik Mohd Noor Alam, in his article entitled “ Implying Good Faith in Contract: Some recent Developments”,¹⁰ took the view that the Malaysian Contract Act 1950, is similar to the Common Law, whereby it has no explicit provision for good faith or unconscionability. Nonetheless, in the writer observation the Malaysian courts have shown some judicial activism in going beyond the Common Law, insisting on good faith in contractual dealings. To highlight this issue, the writer refers to two Malaysian cases, *Perbadanan Kemajuan Ekonomi Negeri Johor v Lim Shee Pin & Anor Sdn Bhd*¹¹ and *Ho Shee Jan v Stephens Property Sdn Bhd*¹².

Under the Malaysian Hire Purchase Act (HPA) 1967,¹³ a misrepresentation could be made either orally or in writing, and could be made either by the owner, dealer or any person acting on their behalf. Where such a misrepresentation has been made “in the course of negotiations leading to the entering of a hire purchase

⁹[2003] 4 MLJ clxv.

¹⁰[1993] 3 CLJ xii.

¹¹[1986] 1MLJ 184

¹²[1986] 2 MLJ 43.

¹³ Sect. 8(1).

agreement” by any one of the above mentioned persons, the Act provides that the hirer may, if he so desires-

- (a) as against the owner, rescind the agreement
- (b) as against the person who made the misrepresentation or his principal take an action in damages

The HPA 1967 also provides that any provision in the hire purchase agreement or any other document purporting to exclude, limit or modify the effect of the above or to preclude any right of action “shall be void”.¹⁴

Under the Islamic law, the principle of “*caveat emptor*”, which is one, the hallmark principle under the Common Law is not acceptable. Dr.Mohd Ali Baharum in his book entitled ‘Misrepresentation: A study of English and Islamic Contract Law’,¹⁵ elucidates that non-disclosure, which is known in Islamic law as “*katmān*”, in a situation where disclosure is required by law, is one of the ways in which misrepresentation can operate. Non-disclosure or reticence concerning a matter in such a case may have the same effect as representation of its non-existence. The Islamic law also requires the disclosure of known defects.

1.6 SCOPES AND LIMITATION OF STUDY

This research concentrates on the elements of good faith and fair dealing in the hire purchase contracts with references to the Malaysian and Islamic law perspectives. It is also important to state that the laws stated in this dissertation are as at April 2005.

¹⁴ Sect. 8(2).

¹⁵ Mohd. Ali Baharum, *Misrepresentation: a study of English and Islamic contract*, Al-Rahmaniah, 1988 at 118.

1.7 RESEARCH METHODOLOGY

The research methodology applied in this dissertation is mainly library research. However, it also includes some field work in the form of interviews with respective officers of selected banks in Malaysia which offer Islamic and Conventional hire purchase financing.

CHAPTER 2

HIRE PURCHASE CONTRACT UNDER THE MALAYSIAN LAW AND THE ISLAMIC LAW

2.1 INTRODUCTION

Hire purchase contracts were developed in England and Wales towards the end of the nineteenth century, and strikingly develop in the twentieth century.¹⁶ It is impossible to understand the reason for their existence without appreciating the legal context, which already existed.¹⁷ Obviously, at that time there was a need for a form of contract for the sale of goods on credit.¹⁸ Situations occurred when customers wanted to buy on credit and financiers who were willing to supply the credit wanted a security. Meanwhile, the seller also would like to reserve some security on the goods.

It always happens; there is a possibility that a seller sells the goods to a third party without notice to the owner. Even though the seller has reserved the property in the goods, the Sale of Goods Act 1895,¹⁹ enables a person who has 'bought or agreed to buy goods' to pass a good title to a third party. Thus, it defeats the purpose of the transaction. Another obvious reason is that the method of achieving the desired result, which was not for the seller to sell and deliver the goods outright to the buyer, but to require the buyer to grant him a mortgage, or charge, or a right to repossess the goods in the event the buyer, fails to pay the installments. Under the Common Law, it was

¹⁶ Audrey L.Diamond, *Introduction to hire purchase law*, Butterworths: London, 1971 at 9.

¹⁷ Hector L.,Mac Queen,J.N,Adam& P.S, Atiyah, *The sale of goods*, 10th Edition, Pearson Education : England, 2001 at 15.

¹⁸ See Diamond, n.16, at 10. Since World War II, hire purchase has expanded greatly and today the outstanding hire purchase (and credit-sale) debt in Britain is estimated as more than one thousand million pound. It is used not only for consumer goods but also for commercial and industrial financing.

¹⁹ Sect. 25 (1).

possible to create a charge of this nature of goods, which would be binding even on third parties. Most probably, a legal arrangement of this nature would still have been covered the Sale of Goods Act 1895.

The whole essence of this scheme is that one person, the buyer, should have the possession of the goods and be entitled to the use of them as though he were the owner, while another person, the financier, should actually have a charge or mortgage on the goods. Now, this kind of transaction is one, which is frowned upon by the law because third parties may be induced to do business with, or give credit to the buyer in the belief that he is the unencumbered owner of the goods in question. And if the buyer becomes insolvent, they will then find the financier has a prior claim to the goods. It is generally thought to be that the financier should be able to do this unless he has in some way publicized his transaction with the buyer.

The contract of hire purchase was the answer to this problem and the House of Lords in two watershed cases upheld its efficacy in 1895. The first case, *Helby v Matthews*²⁰ gave birth to the modern hire purchase agreement. The facts of the case is the owner of a piano agreed to let it on hire, the hirer to pay a rent by monthly installments on a terms that the hirer might terminate the hiring by delivering up the piano to the owner, he remaining liable for all arrears of hire also that if the hirer should punctually pay all the monthly installments, the piano should belong to the hirer until such full payment, the piano should continue the sole property of the owner. The hirer received the piano, paid a few installments, and pledged it with a pawnbroker as security for an advance. It was held that the buyer or the hirer could not dispose the goods to a third party (pawnbroker) without contravening the

²⁰ [1895] AC 471.

agreement. Thus, the seller's or owner's security was fully protected until the full payment had been made.

Of greater significance perhaps was the second case, *McEntire v Crossley*,²¹ by an agreement in writing the 'owners or lessors' of a gas-engine agreed to let to the lessee, the engine at a rent to be paid by installments. It was agreed that, upon payment in full the agreement to be end become the property of the lessee, but until payment in full to remain the sole and absolute property of the lessors. It was also agreed that in case of failure to pay of the installments or if the lessee should become bankrupt, the lessors might elect either to recover the full balance or to resume possession of the engine and sell it. In this case, the lessee paid the first installment and the engine was placed on his premises. While it was still there he became bankrupt, some installments being overdue. The House of Lords ruled that upon the true construction of the agreement of the property in the engine never passed to the lessee but remained in the lessors.

The outcome of these difficulties was a search for a legal form of sale, which enable the seller to retain security in the goods and which also give protection against bona fide purchasers from the buyer.

From the decision of the two cases, it is a clear that the owner maintains the title with him and could safely hire the goods or equipments to the hirer without bearing the risk of losing the title to a third party in the case of wrongful or innocent sale of the goods to an innocent third party.²² Thus, this fundamental principle of hire purchase had been adopted in our local Hire-Purchase Act up till now. Hire Purchase

²¹ [1895] AC 457.

²² Wu Min Aun & Beatrix Vohrah, *The commercial law of Malaysia*, 2nd Edition, Longman: Selangor, 2003 at 258.