

**THE DEPARTMENT OF JUSTICE OF
THE GOVERNMENT OF THE HONG KONG SPECIAL ADMINISTRATIVE
REGION OF THE PEOPLE'S REPUBLIC OF CHINA**

CONSULTATION PAPER

**ON THE PROPOSED APPLICATION OF THE UNITED NATIONS
CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF
GOODS TO THE HONG KONG SPECIAL ADMINISTRATIVE REGION**

EXECUTIVE SUMMARY

(This executive summary is an outline of the consultation paper issued to elicit public response and comment on the Department's questions and provisional recommendations. Those wishing to comment should refer to the full text of the consultation paper which can be obtained from the International Law Division, 7th Floor, Main Wing, Justice Place, 18 Lower Albert Road, Central, Hong Kong, or downloaded from the Department's website at: <https://www.doj.gov.hk/eng/public/CISG.html>.)

Comments should be submitted to the International Law Division by 31 May 2020.)

Preface

1. The United Nations Convention on Contracts for the International Sale of Goods ("CISG")¹ provides uniform rules to govern contracts for international sales of goods, with a view to removing legal barriers in, and promoting the development of, international trade². It was adopted at a Diplomatic Conference of the General Assembly of the United Nations on 11 April 1980 in Vienna, and entered into force on 1 January 1988³. As of 1 February 2020, 93 countries are parties to the CISG⁴, including more than half of the top 20 trading partners of the Hong Kong Special Administrative Region ("Hong Kong") by total volume of trade, namely, Mainland China, the USA, Japan, Singapore, South Korea, Vietnam, Germany, Switzerland, the Netherlands, France, Italy and Australia⁵.

1 Multilateral Treaties Deposited with the Secretary-General, United Nations, New York, available at https://treaties.un.org/doc/Treaties/1988/01/19880101%2003-03%20AM/Ch_X_10p.pdf.

2 CISG Preamble.

3 The entry into force date and the current status of the CISG are available at: https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtmsg_no=X-10&chapter=10&lang=en.

4 *Ibid.*

5 Information on Hong Kong's principal trading partners in 2018 is available at: https://www.tid.gov.hk/english/trade_relations/mainland/trade.html.

2. Whilst China is a Contracting Party to the CISG⁶, the CISG is currently not applicable to Hong Kong⁷.

3. With the number of Contracting Parties to the CISG growing, the Department of Justice considers that it is the appropriate time to consult the relevant stakeholders, in particular, the legal and business sectors, on the proposal to extend the CISG to Hong Kong.

4. The Department of Justice would like to seek the public's views and comments on **whether the CISG should be applied to Hong Kong, and if so, its implementation in Hong Kong**. This Consultation Paper sets out the salient features of the CISG, its interplay with Hong Kong law, and our initial economic and legal considerations and views about the proposed application and implementation of the CISG in Hong Kong.

Chapter 1

Introduction and Overview

Background of the CISG

5. The CISG provides uniform rules to govern contracts for international sales of goods, with a view to removing legal barriers in, and promoting the development of, international trade⁸.

6. In the 19th Century, efforts began for a unification of the substantive rules applicable to international trade, with the rise of industrialisation and the increasing importance of international trade. The existing conflict of laws approach was considered to be risky, uncertain and insufficient to deal with complex issues arising from international sale of goods contracts. Further, the domestic commercial law regimes at the time were fragmented, obsolete and generally inadequate to govern international transactions.

7. The first attempt at producing a uniform law for the international sale of goods was made by the International Institute for the Unification of Private Law ("UNIDROIT"), resulting in the adoption of two Uniform Laws on the subject at The Hague in 1964⁹. These Uniform Laws were not very successful. The main criticism was that their provisions primarily reflected the

6 The CISG entered into force for China on 1 January 1988. For details please refer to: http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html.

7 The CISG was not applied to Hong Kong prior to 1 July 1997. During and after the transition, China has not deposited notification with the Secretary General of the United Nations for applying the CISG to Hong Kong.

8 See fn 2.

9 Convention Relating to a Uniform Law on the International Sale of Goods (adopted 1 July 1964, entered into force 18 August 1972) 834 UNTS 107, and the Convention Relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods (adopted 1 July 1964, entered into force 23 August 1972) 834 UNTS 169.

legal traditions and economic realities of continental Western European countries, which had most actively contributed to their preparation.

8. Upon the establishment of the United Nations Commission on International Trade Law (“UNCITRAL”) in 1966, a new text on this subject was prepared in light of such criticism. Deliberate efforts were made to achieve a balance of representation from different regions of the world in the composition of UNCITRAL and its Working Groups. A Draft Convention was approved on 11 April 1980, and the CISG entered into force on 1 January 1988.

Status of the CISG

9. As of 1 February 2020, there are 93 parties to the CISG¹⁰, including six of the top 10 trading partners of Hong Kong by total volume of trade, namely Mainland China, the USA, Japan, Singapore, South Korea and Vietnam. 24 of the 27 member states of the European Union have adopted the CISG, the exceptions being Ireland, Malta and Portugal. Of the G20 nations, only the said three member states of the European Union above, India, Indonesia, Saudi Arabia, South Africa and the United Kingdom are not parties to the CISG. Of the 21 members of the Asia-Pacific Economic Cooperation (“APEC”)¹¹, 13 (e.g. Canada, Chile, New Zealand) have adopted the CISG.

Structure of the CISG

10. The CISG consists of 101 articles, divided into four Parts:
- (1) Part I (Articles 1-13) deals with the general rules of the CISG;
 - (2) Part II (Articles 14-24) deals with formation of contract. It contains provisions regarding offer, revocation, acceptance and withdrawal;
 - (3) Part III (Articles 25-88) contains provisions regarding the obligations of the buyer and seller in international sale of goods contracts, and remedies in case of breach; and
 - (4) Part IV (Articles 89-101) contains the final provisions, which include the rules of ratification and entry into force, as well as reservations.

Salient Features of the CISG

Scope of the CISG

11. In terms of territorial scope, the CISG only covers contracts between parties whose places of business are in different States: when (a) the

10 See fn 3.

11 The list of APEC members is available at: <https://www.apec.org/About-Us/About-APEC>.

States are Contracting States, or (b) the rules of private international law lead to the application of the law of a Contracting State¹².

12. As regards the subject matter scope of the CISG, there must be a contract for the sale of goods. It is irrelevant whether the contract is of a civil or commercial nature¹³. Further, the CISG does not apply to sales:

- (1) 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 bought for any such use;
- (2) by auction;
- (3) on execution or otherwise by authority of law;
- (4) of stocks, shares, investment securities, negotiable instruments or money;
- (5) of ships, vessels, hovercraft or aircraft;
- (6) of electricity¹⁴.

13. In relation to excluded matters, Article 4 provides that except as otherwise expressly provided in the CISG, it is not concerned with: (a) the validity of the contract or any of its provisions or of any usage; and (b) the effect which the contract may have on the property in the goods sold.

14. Other important matters that are not governed by the CISG include jurisdictional issues and limitation periods (except insofar as Article 39(2) requires the buyer to give notice of non-conformity within two years of delivery of the goods, in order to utilise the remedies in the CISG).

Interpretation of the CISG

15. Articles 7 to 9 are the main provisions on interpretation in the CISG:

- (1) Article 7 is the primary provision governing the interpretation of the CISG. It contains general interpretative principles (requiring regard to be had to the CISG's international character, the need to promote uniformity in application and the observance of good faith in international trade¹⁵) as well as a gap-filling provision¹⁶;

12 For completeness, Article 95 of the CISG allows a State to declare at the time of the deposit of its instrument of ratification, acceptance, approval or accession that it will not be bound by Article 1(1)(b).

13 CISG Article 1(3).

14 CISG Article 2.

15 CISG Article 7(1).

16 CISG Article 7(2).

- (2) Article 8 concerns the interpretation of the statements and other conduct of a party to the contract, including pre- and post-contractual statements and conduct. Such statements and conduct must be interpreted according to the party's intent where the other party knew or could not have been unaware what the intent was; if this is not applicable, the same must be interpreted according to the understanding that a reasonable person would have had, taking into account all relevant circumstances; and
- (3) Article 9 governs the role of usages and practices in interpreting the CISG, binding the parties to the contract to any usage to which they have agreed, and any practices which they have established between themselves¹⁷. The parties are also bound to usages of which the parties knew or ought to have known, and which are widely known in and regularly observed in international trade, subject to contrary agreement¹⁸.

16. Taken together, they establish the following hierarchy of rules (in descending order of primacy):

- (1) Article 12 of the CISG (discussed in paragraph 17 below), which is mandatory by virtue of Article 6;
- (2) Agreement of the parties, including established practices and agreed usages¹⁹, and agreed derogations or variations of the CISG provisions²⁰;
- (3) International trade usages²¹;
- (4) Rules of the CISG;
- (5) General principles on which the CISG is based²²; and
- (6) Applicable law by virtue of the rules of private international law²³.

Choices of opting out and opting in

17. The CISG applies automatically when the relevant conditions provided for in the CISG are satisfied. However, under Article 6, parties to a contract may exclude the application of the CISG, or derogate from or vary the

17 CISG Article 9(1).
 18 CISG Article 9(2).
 19 CISG Articles 8(3) and 9(1).
 20 CISG Article 6.
 21 CISG Article 9(2).
 22 CISG Article 7(2).
 23 *Ibid.*

effect of any its provisions. The exception is that the parties cannot derogate from or vary Article 12²⁴, which states that provisions allowing freedom of form for the creation, modification or termination of a contract of sale do not apply where the Contracting State in question has made a declaration under Article 96.

18. Parties to a contract may also opt in to the CISG if their contract does not otherwise satisfy the relevant conditions provided for in the CISG (for example, because one of the parties has its place of business in a non-Contracting State). Although the CISG does not explicitly address opting in, there is nothing that prohibits it in principle. Parties to a contract may do so by: (a) choosing the law of a Contracting State²⁵ as the applicable law so that Article 1(1)(b) applies, or (b) expressly agreeing that the CISG shall apply. This is further discussed in Chapter 2 below.

Chapter 2

Interplay between the CISG and the Relevant Law of Hong Kong

19. One major consideration for the proposed application of the CISG to Hong Kong is its impact on the pre-existing practice of international sales in Hong Kong.

20. This in turn requires consideration of several major issues concerning the interplay between the CISG and Hong Kong law. For this purpose, the Department of Justice has considered the following issues which are addressed in Chapter 2 of the Consultation Paper and its Annexes:

- (1) The extent to which the CISG differs from existing Hong Kong law, and the degree to which such differences would affect day-to-day sales by businesspeople;
- (2) A review of potential incompatibility issues between the CISG and Hong Kong law, i.e. issues which may be governed simultaneously by the CISG and Hong Kong law, and the proper approaches for resolving such incompatibility issues; and
- (3) A comparison of the relative merits of allowing parties to a contract to opt into the CISG (as under the status quo) versus opting-in by default and allowing opt-out (as would be the case if the CISG is applied to Hong Kong).

24 Parties to a contract can also exclude the entirety of the CISG including Article 12.

25 Except a Contracting State that has made an Article 95 reservation. However, even if the Contracting State has made such reservation, there is some uncertainty as to whether the forum court (if it is in another Contracting State), applying the law of that Contracting State, would nevertheless be bound by Article 1(1)(b): see para. 29 below.

21. It would appear that none of these issues weigh strongly against extending the application of the CISG to Hong Kong.

Comparison between the CISG and Hong Kong law

22. The CISG, which was created as “uniform law” to be applied uniformly across the world, is inherently a compromise between the different legal traditions of the world²⁶. As such, there will inevitably be concepts and practices embedded in the CISG which may be unfamiliar to Hong Kong lawyers (indeed to common law lawyers in general). The main text of Chapter 2 of the Consultation Paper provides a table summarising in short form differences between the CISG and the Hong Kong law on international sale.

23. The analysis in the said comparison table is derived from:

- (1) Annex 2.1 of the Consultation Paper, which reviews the Hong Kong statutory and common law of relevance to contracts for the international sale of goods; and
- (2) Annex 2.2 of the Consultation Paper, which briefly describes the CISG provisions and the CISG jurisprudence as to how they should be interpreted and applied, and further compares the CISG provisions to their Hong Kong law counterparts.

24. This Executive Summary highlights some important comparative issues across the two regimes.

Rules for Application

25. Under the *status quo*, the Hong Kong law on international sale applies when Hong Kong law governs the relevant sales contract. This is relatively straightforward when parties to the contract make an express choice of law; difficulties however arise when the contract is silent on this issue, in which case the governing law will have to be determined by using the choice of law rules of the forum court.

26. The applicability of the CISG could be a complex issue. Leaving aside the possibility of incorporating the CISG as contractual terms directly into a contract²⁷, the CISG is applied in two situations.

27. First, when the parties to a contract have their respective places of business in different CISG Contracting States²⁸. This is relatively straightforward.

26 Michael Bridge, 'A Law for International Sale of Goods' (2007) HKLJ 17, 17.

27 See para. 66(3) below.

28 CISG Article 1(1)(a).

28. Second, when the conflict of law rules of the forum court refers the contract to the law of a CISG Contracting State²⁹. This latter approach, however, may not be straight forward as the CISG (under Article 95) allows a Contracting State to reserve (in effect contract out of) this latter rule, such that it will not be bound by Article 1(1)(b) and may apply the CISG only between those parties to a contract whose places of business are in different CISG Contracting States³⁰.

29. In the second-mentioned cases, the analysis requires consideration of whether the forum State and/or the Chosen-law State (namely, the Contracting State whose law is referred to by the forum court) has made a declaration under Article 95. The prevailing view is outlined in the table below:

Forum State	Chosen-law State	Result
A Contracting State which is bound by Article 1(1)(b).	A Contracting State which is bound by Article 1(1)(b).	The CISG applies. Article 1(1)(b) applies directly.
A Contracting State which is bound by Article 1(1)(b).	A Contracting State which is <u>not</u> bound by Article 1(1)(b).	Prevailing view (with exceptions) is that CISG applies ³¹ .
A Contracting State which is <u>not</u> bound by Article 1(1)(b).	A Contracting State which is bound by Article 1(1)(b).	The forum State can, by policy, choose whether to apply the CISG ³² .
A Contracting State which is <u>not</u> bound by Article 1(1)(b).	A Contracting State which is <u>not</u> bound by Article 1(1)(b).	The CISG does not apply. Article 1(1)(b) has no application.

30. Finally, for completeness, the application of the CISG does not displace the traditional choice of law analysis. Domestic law often applies concurrently with the CISG (to issues not covered by the CISG); hence the forum court may need to ascertain which domestic law applies as a residual choice of law to a CISG contract.

Contract Formation and Variation

31. Contract formation paradigmatically requires offer and acceptance. The CISG rules on offer are functionally similar to those under Hong Kong law. The major difference lies in how an offer may be revoked (i.e. rendered ineffective after receipt by the offeree):

29 CISG Article 1(1)(b).

30 CISG Article 95.

31 Ingeborg Schwenzer (ed), *Schlechtriem & Schwenzer: Commentary on the UN Convention on the International Sale of Goods (CISG)* (4th edn, OUP 2016) Article 1, para. 38.

32 CISG Advisory Council Opinion No. 15, para. 3.8, available at <http://www.cisg.law.pace.edu/cisg/CISG-AC-op15.html#60>.

- (1) Under the CISG, an offer can be revoked if the revocation reaches the offeree before the offeree dispatches an acceptance (as opposed to before the offeror receiving the acceptance)³³. This is similar to an application of the postal rule in Hong Kong law to the concept of revocation.
- (2) Further, under the CISG, an offer is irrevocable if it is expressed to be so³⁴. This is different under Hong Kong law, where an apparently irrevocable offer can be revoked if unsupported by consideration.

32. However, in terms of acceptance, the CISG does not apply the postal rule: acceptance is effective only when the offeror receives notice of the offeree's acceptance³⁵.

33. The above rule on acceptance is a rare exception to the trend of the CISG rules on contract formation being more pro-contract than Hong Kong law, for example:

- (1) The CISG allows for late acceptance in certain circumstances (i.e. where the acceptance reaches the offeror after a stipulated time for the offer's expiry), subject to the offeror's right to refuse³⁶. There is no direct equivalent in Hong Kong law.
- (2) In battle of the forms scenarios (i.e. where both parties consequentially put forward their own standard terms of business), the CISG provides, subject to a right to object, that a last shot which is not a mirror image of a previous offer is nonetheless effective to create a binding contract if the variations in the last shot are not "materially different"³⁷. This is a relaxation of the strict mirror image rule in battle of the form cases under Hong Kong law.
- (3) A CISG contract can be varied by mere oral agreement without any further requirement as to formalities³⁸, unless the contract includes a non-oral modification clause³⁹. Hong Kong law similarly respects non-oral modification clauses⁴⁰ but generally requires consideration before giving effect to an oral variation.

33 CISG Article 16(1).

34 CISG Article 16(2).

35 Barry Nicholas, 'The Vienna Convention on International Sales Law', (1989) LQR 201, 215.

36 CISG Articles 21, 22.

37 CISG Article 19(2).

38 CISG Article 29(1).

39 CISG Article 29(2).

40 *Rock Advertising Ltd v MWB Business Exchange Centres Ltd* [2019] AC 119.

Obligations of buyers and sellers

34. The fundamental obligation of buyers (to pay and take delivery) and sellers (to deliver proper goods at the right place and time) are largely similar across the CISG and Hong Kong law.

35. Perhaps worthy of special mention is the seller's obligation to ensure the fitness and quality of the goods delivered. Under both regimes, such fitness obligations are primarily defined by the terms of the contract, and secondarily by any request that the goods be used for specific purposes, and ultimately by a default standard of fitness. The only major difference lies at the third level: the CISG uses a single concept of "fitness" (i.e. that goods must be fit for the purposes for which goods of the same description would ordinarily be used)⁴¹; Hong Kong law adopts a patchwork of tests for "merchantability" and conformity to "description"⁴². Overall, it appears that the CISG scheme of fitness obligations is simpler and involves less technicalities whilst maintaining a similar scope of coverage as Hong Kong law.

Fundamental breach and remedies on breach

36. The starting point on breach and remedies under the CISG is the concept of "fundamental breach", as the availability of the important remedy of avoidance of the contract depends on whether such a breach is made out. A fundamental breach is one which causes such detriment to the other party as to substantially deprive him of the benefits under the contract⁴³. In practice, they are very rarely established, especially given the CISG pro-contract policy (which avoids the economic wastage of recovering and re-exporting rejected goods).

37. As such, it can be seen that the CISG regime of avoiding the contract is generally stricter than Hong Kong law. Importantly, there is no CISG equivalent to a contractual condition (which may be implied either by statute or by common law), minor breaches of which would give rise to a right of termination.

38. A fundamental breach under the CISG, if established, entitles the innocent party to avoid the contract⁴⁴ and seek restitution. There is some controversy as to whether the contract, if avoided, is *void ab initio* or transforms (by operation of law) into an alternative agreement to unwind the contract. In any event, once avoided, both parties must concurrently make restitution of all benefits received under the contract⁴⁵.

41 CISG Article 35(2).

42 The Sale of Goods Ordinance (Cap 26) ("SGO") sections 15-16.

43 CISG Article 25.

44 CISG Articles 49, 64.

45 CISG Article 81(2).

39. The clear difference here is that termination under Hong Kong law is prospective only whereas avoidance under the CISG has both prospective and retrospective effect – the entire contract is unwound.

40. Other CISG remedies for breach (and not necessarily fundamental breach) include compelling specific performance in various forms, including: (a) requiring the seller to deliver substitute goods, (b) requiring the seller to repair the defective goods, or (c) requiring the buyer to take delivery and pay the price⁴⁶. This, however, is subject to an overarching discretion of the forum court not to make such orders if specific performance would not be allowed under its domestic law⁴⁷.

41. Still further CISG remedies include the right of the buyer to accept defective goods and claim for a reduction of the price⁴⁸, the right of the innocent party to suspend performance in the event of a breach generally⁴⁹, and the right of the breaching party to cure defects⁵⁰ (which have no strict equivalent in Hong Kong law), or to claim damages for non-conformity (which is well-known to the Hong Kong lawyer, albeit the CISG rules for assessment appear to be less market-oriented than the Hong Kong law rules and focus more on the actual steps taken by the innocent party to mitigate his loss).

42. Finally, it should be noted that the CISG imposes somewhat broader duties than does Hong Kong law on the innocent party to preserve the goods and to engage with the breaching party:

- (1) The buyer must give reasonably prompt notice to the seller of any identified defect, or risk losing his remedies⁵¹;
- (2) He must preserve the goods in certain situations e.g. as opposed to simply refusing to accept delivery, in the case of the buyer⁵²;
- (3) He may sell the goods in the event of rapid deterioration, but only upon giving notice to the breaching party⁵³; and
- (4) He must notify the breaching party if he seeks to avoid the contract⁵⁴.

46 CISG Articles 46, 62.

47 CISG Article 28.

48 CISG Article 50.

49 Schwenzer (n 31) Article 71, para. 11.

50 CISG Articles 37, 48.

51 CISG Article 39.

52 CISG Articles 85, 86.

53 CISG Article 88.

54 CISG Article 26.

Conclusion: Effect of CISG/Hong Kong law differences in practice

43. From the summary of the comparative exercise above, it is noted that there are various differences between the CISG and existing Hong Kong law. However, in terms of the extent to which the differences would affect international sales in practice, the following observations can be made.

44. First, the CISG is relatively more pro-contract than existing Hong Kong law (in the sense that its policy is to keep the contract alive, even in the event of breach, rather than allow for easy termination⁵⁵). This suggests that the CISG is:

- (1) Economically more efficient, as it avoids the economic waste inherent in any rejection of goods in an international sales context (e.g. wasted costs of recovery and redelivery); and
- (2) Comparatively pro-seller, as it is usually the seller who has an interest in keeping a disputed contract alive.

45. Second, whilst the CISG is not totally free of issues concerning the interpretation of and interrelationships between its provisions, it seems on balance that the CISG is more comprehensive and accessible to the lay businessperson than the Sale of Goods Ordinance (Cap 26) (“SGO”). This is because:

- (1) The CISG is more comprehensive. The SGO must be supplemented substantially by common law or other statutory rules to produce a complete picture of the Hong Kong law on international sale⁵⁶; and
- (2) The CISG adopts somewhat simpler and “lay” language, and avoids historical or technical terms⁵⁷ used in the SGO.

46. Third, at least as regards two important areas, namely (a) obligations concerning the fitness and quality of goods sold, and (b) remedies, it appears that the CISG is more in line with modern commercial expectations and commercial practice:

- (1) Fitness obligations. The CISG utilises one main concept of “fitness for purpose”, as opposed to the patchwork of merchantability, fitness and description obligations under Hong Kong sales law. The simpler regime is more suited as a default rule, especially for small transactions (larger transactions will usually provide for express fitness obligations)⁵⁸.

55 Bridge (n 26) 22.

56 For example, the rules on all relevant aspects of contract law and private international law are not found within the SGO.

57 Such as “merchantable” quality.

58 Bridge (n 26) 22.

- (2) Remedies. The CISG provides remedies for breach of a sales contract which have no direct equivalent in Hong Kong law but which may make ample common sense to the businesspeople, such as the right to cure, the easy ability to vary the contract, and the remedy of price reduction⁵⁹. Further and importantly, the CISG subjects the awarding of remedies to innocent contracting parties to significant pre-conditions⁶⁰, such as the giving of notice or of prompt inspection. In this way, the CISG mandates that buyers and sellers maintain communication even in light of a breach and helps avoid breakdowns in communication that commonly precede repudiation of the contract and litigation.

47. Finally, the differences set out above are not of a fundamental, systemic nature, whilst there are significant similarities across the two regimes. It is arguable that the majority of the differences between the CISG and Hong Kong law may be of more interest to an academic lawyer than a modern businessperson: intricate differences as to quantification of damages or the proper approach to interpretation of terms raise interesting jurisprudential questions, but the similarities as to more practical issues such as buyer's and seller's obligations, rules as to early or partial delivery, and passing of risk are likely of more importance to the businesspeople. Should a Hong Kong businessperson wish to adopt the CISG (instead of Hong Kong law), he is likely required only to fine-tune, but not completely overhaul, his existing business practices.

Compatibility issues between the CISG and Hong Kong law

48. A second issue concerning the interplay between the two regimes is whether any issues of incompatibility arise, and if so whether well-defined mechanisms exist for addressing them.

49. "Incompatibility" in this context means the specific problem of the CISG providing one answer and domestic law providing a different answer in cases where both may apply at the same time. Incompatibility occurs because the CISG envisages a dual regime whereby the domestic law applies simultaneously with it, ostensibly to govern residual matters outside the scope of the CISG⁶¹. These "residual matters" however may sometimes impinge on matters within the CISG itself.

50. There are certain cases of potential incompatibility which are expressly catered for in the CISG itself. Two examples are:

59 *Ibid* 29 (right to cure); F.M.B. Reynolds, 'A Note of Caution' in Peter Birks (ed), *The Frontiers of Liability* (Vol.2) (OUP 1994) 18, 22 (variation); Schwenger (n 31) Article 48, paras. 18-21, Article 50, para. 1 fn 3 (price reduction).

60 See para. 42 above.

61 Schwenger (n 31) Article 6, para. 14.

(1) Undisclosed agency.

- (a) Agency is an area generally agreed to fall outside the scope of the CISG⁶² (hence domestic law will apply). The classic incompatibility problem occurs where a local agent does not disclose that he is acting for an overseas principal. Domestic law may then consider this an international sales contract. Under the CISG, however, the internationality of a sales contract must be disclosed before the contract is concluded⁶³. The CISG will therefore treat the problem scenario as one involving a domestic sales contract only.
- (b) This apparent incompatibility issue is resolved by the CISG elevating its disclosure requirement to a mandatory rule, i.e. carving out an exception to the general rule that agency issues are left to domestic law.

(2) Restitution after termination.

- (a) As with agency, issues of property are generally agreed to fall outside the scope of the CISG⁶⁴. As such, depending on whether CISG contracts are *void ab initio* after termination⁶⁵, parties to a contract may have substantive proprietary claims for restitution under domestic law. By contrast, the CISG itself does not provide for proprietary claims. This may give rise to incompatibility, especially in cases of insolvency, if remedies exist under domestic law but not under the CISG.
- (b) The CISG solution to this potential problem is to require mandatory concurrent restitution – in unwinding a contract after termination, restitution needs to be made by both parties. If one party to a contract cannot make restitution due to e.g. insolvency, then the other party is protected by the concurrency rule from having to make unilateral restitution⁶⁶.

51. Turning to incompatibility problems which require solutions outside of the CISG itself, the most well-known is that of misrepresentation. The typical problem scenario is that a pre-contractual representation concerning the quality of the goods has been incorporated as a term of the contract, and the representation turns out to be false.

62 Michael Bridge, *The International Sale of Goods* (4th Edn, OUP 2017) para.10.28.

63 CISG Article 1(2).

64 CISG Article 4.

65 See para. 38 above.

66 Michael Bridge, 'The Nature and Consequences of Avoidance of the Contract Under the United Nations Convention on the International Sale of Goods' (2008-2009) *International Law Review of Wuhan University* 118, 119-120.

52. In Hong Kong law, the representee would acquire a right to rescind for misrepresentation. As this may be a matter of “substantive validity” which the CISG expressly does not govern⁶⁷, the right to rescind may not be superseded by the CISG.

53. However, under the provisions of the CISG, avoiding the contract due to this misrepresentation requires showing that it is a “fundamental breach” of the contract which justifies wholesale termination⁶⁸. The CISG analysis presents a much higher hurdle for the representee. As such, potential incompatibility arises: for the same fact pattern, the contract may remain alive under the CISG, but rescinded under Hong Kong law.

54. CISG jurisprudence includes many solutions to this apparent issue of incompatibility due to misrepresentation. One leading solution⁶⁹ posits that it is improper to apply the Hong Kong law classification of rescission for misrepresentation as an issue of substantive validity; instead, an autonomous CISG classification should be used instead. This autonomous CISG analysis requires the court to exclude a domestic law rule if: (a) the rule is triggered by a factual situation to which the CISG also applies, and (b) the rule governs a specific risk addressed by the CISG already⁷⁰.

55. Applying this analysis, as regards innocent/negligent misrepresentation, the factual situation of pre-contractual negotiations over the quality of goods is covered by the CISG. The specific risk going to the buyer’s state of knowledge about the goods at the time of contract formation is also regulated by the CISG. As such, domestic law remedies should be excluded.

56. The analysis is different for fraudulent misrepresentation as to the state of the goods, as this involves the additional specific risk of dishonesty, which is not governed by the CISG. As such, domestic law remedies for fraud should not be excluded⁷¹.

57. This leading solution provides a well-reasoned framework free from domestic law categorisations with which to consider the substantive validity exception and resulting incompatibility issues.

58. A different kind of incompatibility problem arises from the commonly accepted approach that domestic law tests for substantive validity are to be read and interpreted in light of the underlying policies of the CISG⁷².

67 CISG Article 4.

68 See para. 36 above.

69 Ulrich G Schroeter, ‘Defining the Borders of Uniform International Contract Law: The CISG and Remedies for Innocent, Negligent, or Fraudulent Misrepresentation’ (2013) Villanova LR 553.

70 *Ibid* 563.

71 *Ibid* 585.

72 CISG Advisory Council Opinion No.10, paras. 4.2.1-4.2.2, available at <http://www.cisg.law.pace.edu/cisg/CISG-AC-op10.html>; Pascal Hachem, ‘Agreed Sums in CISG Contracts’ (2011) Belgrade Law Review, Year LIX, no. 3, 140 at para. 3.2.2; Bridge (n 62) para. 10.34.

59. This gives rise to particular difficulties with penalty clauses under Hong Kong law: whilst CISG jurisprudence accepts that the validity of such clauses is indeed a matter of substantive validity, the Hong Kong law test (i.e. that the clause is penal if it is a deterrence and not a genuine pre-estimate of loss) appears to run contrary to CISG jurisprudence and policy, which considers legitimate the right of parties to induce performance and deter breach by an agreed sum⁷³.

60. As such, there may be uncertainties in enforcing penalty clauses in CISG contracts governed by Hong Kong law. However, this difficulty may be addressed by reconsidering and modernising the penalty rule, which has recently occurred in the United Kingdom⁷⁴, where the Hong Kong law on penalties originated.

61. In short, if the CISG is extended to Hong Kong, although there could be potential incompatibility issues, international CISG jurisprudence appears to provide principled frameworks for resolving incompatibility problems, and any remaining difficulties may be addressed by domestic law reform.

Opting into or out of the CISG?

62. A third issue at the interface of the CISG and Hong Kong law is the relative merits and drawbacks of opting-in or opting-out as a default position.

63. In other words, given that one can opt-in or opt-out of the CISG expressly by contract⁷⁵, the question to be addressed is: “why not keep the *status quo* and opt into the CISG as needed; why should the default choice be opting in, leaving parties who wish to be governed by local Hong Kong law (rather than CISG) to opt out?”

64. This necessitates a comparison of the drawbacks of the two default choices.

65. Under the *status quo* (i.e. where opt-out is the default), the primary difficulty is that one cannot effectively create a contract which is governed primarily by the CISG to its full extent and which uses Hong Kong law as its residual law.

66. This is because, under the *status quo*, the CISG can only be applied under the following mechanisms, each with its difficulties:

- (1) One can choose to apply the law of a CISG Contracting State. However, this would mean that the residual law is not Hong Kong

73 CISG Advisory Council Opinion No.10 (n 72) paras. 4.3.2-4.3.7.

74 *Cavendish v Makdessi; Parking Eye v Beavis* [2016] AC 1172.

75 Benjamin Hayward, Bruno Zeller & Camilla Baasch Andersen, ‘The CISG and the United Kingdom - exploring coherency and private international law’ (2018) ICLQ 607 (opt-in); CISG Article 6 (opt-out).

law.

- (2) Alternatively, one can simply have a sales contract “governed by the CISG”. This however runs into issues of potential invalidity⁷⁶, and the residual law of such a contract will be determined by the choice of law rules of the forum court, which may result in unacceptable uncertainty.
- (3) Third, one can incorporate the CISG as contractual terms into a contract otherwise governed by Hong Kong law⁷⁷. This appears to be the best possible option for creating the desired CISG/Hong Kong law combination. However, this option is, on further inspection, subject to serious difficulties. Under this hybrid approach, the CISG rules on contract formation (which are themselves contractual terms only) may not be effective to displace local Hong Kong law. Further, mandatory rules of Hong Kong law take priority over the CISG terms. Third, the CISG rules on interpretation not only may not displace local Hong Kong law principles, but in fact may create internal inconsistency (as Article 7, governing the interpretation of the CISG generally, would need to be applied together with Article 8, governing the interpretation of contract terms)⁷⁸.

67. The short point is that opting-in under the status quo cannot fully apply the CISG as if the CISG had been extended and implemented in Hong Kong. There are hard limits to parties’ scope for contract imposed by the general law.

68. By comparison, if the CISG is extended to Hong Kong (such that opt-in is the default), there are no such limits on commercially useful combinations of choice of law. Parties to a contract would be free to utilise the CISG as designed, with Hong Kong law used as its residual law; alternatively, parties can choose to be governed solely by local Hong Kong law rather than the CISG.

69. The real drawbacks of extending the CISG to Hong Kong are likely to be transaction costs (e.g. negotiating choice of law for new contracts, or reviewing existing contracts governed by Hong Kong law to determine whether to opt-in or opt-out) and litigation costs (e.g. to work out the problems within the CISG and at the interface of the CISG and Hong Kong law). These, however, are likely to be short-term costs or costs which can be effectively controlled by a proper phase-in programme for the CISG.

70. As such, purely from a comparative legal perspective, it appears that extending the CISG to Hong Kong opens up useful and realistic contractual

76 Depending on the choice of law rules of the forum court.

77 Hayward, Zeller & Andersen (n 75) 616.

78 *Ibid.*

options whilst preserving the old ones. Freedom of contract, in principle, would support opting-in by default.

Chapter 3

Economic and Legal Considerations for Extension of the CISG to Hong Kong

71. In order to establish whether there is a need to extend the CISG to Hong Kong, we consider it relevant to consider not only the legal issues in relation to the comparison and compatibility of the CISG with Hong Kong law, but also the economic factors that may create a commercial need for the CISG to apply. We consider that relevant factors that should be taken into consideration include Hong Kong's external trade and position as a world trading partner, as well as Hong Kong's status as a leading international legal and dispute resolution services centre in the region.

72. Furthermore, we consider that the above factors should also account for the Belt and Road Initiative ("BRI") and in particular, Hong Kong's potential status as a dispute resolution services hub for the BRI and potential increased trading opportunities with BRI countries.

Whether there is a need for Hong Kong to apply the CISG?

General Economic Factors

73. The trade statistics of Hong Kong and Mainland China are recorded and published by the World Trade Organization ("WTO"). They include, among other things, data about total merchandise exports and imports, which we consider to be most relevant when considering application of the CISG.

74. In 2018, Hong Kong ranked eighth in world trade in both exports and imports of merchandise, and in relation to merchandise, accounting for 2.92% of the world's total exports and 3.16% of the world's total imports⁷⁹. Hong Kong has also seen significant trade growth over the past ten years, growing from total exports and imports of just over 763 billion USD in 2008 (13th in both exports and imports) to over 1.19 trillion USD in 2018⁸⁰. This places Hong Kong in the list of the top 10 merchandise importers and exporters in the world.

75. However, Hong Kong is also one of only two top 10 merchandise importers and exporters that has not applied the CISG (alongside the United Kingdom). Furthermore, of Hong Kong's top 20 largest trading partners, 12 are

79 World Trade Organization, "2018 WTO Trade Profile, Hong Kong, China", available at https://www.wto.org/english/res_e/statis_e/daily_update_e/trade_profiles/HK_e.pdf.

80 See Annex 3.1 to the Consultation Paper: Hong Kong's Rank in World Trade Since 2008.

Contracting Parties to the CISG, accounting for over HK\$ 6.8 trillion and approximately 77.3% of Hong Kong's total trade⁸¹.

Effect of the Belt and Road Initiative on the CISG implementation

76. The BRI consists of the development strategy launched by the Chinese government, designed to promote economic cooperation between various nations, most of whom exist along the old trade routes between China, Europe, and Africa⁸².

77. Consideration of the BRI is a relevant factor when examining whether there is a need to extend the CISG to Hong Kong in light of the fact that Hong Kong aims at being a leading international legal and dispute resolution services centre in the region.

78. As of 1 February 2020, 144 countries are participating in the BRI. Of those 144 countries, 66 (45.8 %) are Contracting Parties to the CISG. Of those 66 countries that are Contracting Parties to the CISG, the CISG has entered into force for 16 countries within the past 10 years, and entered into force for 27 BRI countries within the last 20 years. Since the BRI was first announced in 2013, 11 BRI countries have become members of the CISG⁸³. Given the current trends in CISG adoption, it is likely that the percentage of BRI members that will also be party to the CISG will rise above 50% and may drive greater adoption in the future.

79. The impact of BRI countries acceding to the CISG may impact Hong Kong both directly and indirectly. Firstly, as a participant in the BRI, extension of the CISG to Hong Kong would mean automatic application of the CISG between Hong Kong and other BRI members who are Contracting Parties to the CISG, allowing for a uniform law to govern the bulk of Hong Kong businesses' sales transactions, rather than having to potentially deal with the pitfalls of disparate legal systems, cultures, and backgrounds.

80. Secondly, Hong Kong's position as a dispute resolution hub for the BRI means that there will be a demand for lawyers prepared to advise on commercial transactions and who are qualified to handle disputes between different members of the BRI. Extension of the CISG to Hong Kong would enhance competence as a dispute resolution hub for CISG disputes among BRI countries.

81 See Annex 3.2 to the Consultation Paper: Hong Kong's Top 20 Trading Partners and their CISG Status.

82 Hong Kong Trade Development Council, "The Belt and Road Initiative", available at <http://china-trade-research.hktdc.com/business-news/article/The-Belt-and-Road-Initiative/The-Belt-and-Road-Initiative/obor/en/1/1X3CGF6L/1X0A36B7.htm>.

83 See Annex 3.4 to the Consultation Paper: Members of the Belt & Road Initiative and their CISG Status.

Confusion in foreign legal systems as to the position of Hong Kong under the CISG

81. While emphasis in this chapter has primarily been on economic factors that may support the extension of the CISG to Hong Kong, it is critical to understand that one of the most important factors in determining whether to apply the CISG is legal uncertainty in foreign courts and how application of an “incorrect” law could also create adverse impacts in the form of increased transaction and litigation costs.

82. The difficulty for many foreign courts in determining the applicable law regarding a transaction with a Hong Kong party arises primarily out of some confusion as to whether the notification sent by China to the Secretary-General of the United Nations shortly before the reunification of Hong Kong in 1997 that laid out the treaties that would apply to Hong Kong (and which did not mention the CISG) would be enough to constitute a declaration that the CISG would not apply to Hong Kong⁸⁴.

83. This legal uncertainty has been exhibited in several cases decided in foreign jurisdictions. Most foreign courts have correctly determined that the CISG is not applicable to Hong Kong⁸⁵. However, several foreign cases that have had to deal with a question of application of the CISG in relation to Hong Kong businesses, have determined that the CISG applied to Hong Kong⁸⁶.

84. Extension of the CISG to Hong Kong could remove such legal uncertainty. Such express extension would make it clear whether the CISG applies to Hong Kong. This in turn may result in lower transaction and litigation costs for businesspeople in Hong Kong as less time and money may be spent on research and legal advice for foreign jurisdictions.

Pros and Cons for Implementing the CISG in Hong Kong

85. Regarding the question of whether the CISG should be applied to Hong Kong, as discussed in paragraph 63 above, there is the question of “why not keep the status quo and opt into the CISG as needed”. On this question, we have assessed some of the most common and likely pros and cons that would arise from Hong Kong adopting the CISG, based primarily on economic issues in general, Hong Kong's position as a BRI disputes hub, and potential confusion in the governing law as applied by foreign courts. In what follows, we will look at some of these pros and cons in more detail.

84 CISG Article 93.

85 See Cour de Cassation, Case No. 04-117726 2 April 2008 (*Telecommunications Products Case*), tr. Nathalie Hoffman, available at <http://cisgw3.law.pace.edu/cases/080402f1.html>; *Innotex Precision Ltd v Horei Image Products* 679 F. Supp. 2d 1356 (2009); *Wuhan Yinfeng Data Network Co. Ltd. v Xu Ming* (19 March 2003), Hubei High People's Court, tr. Jing Li, available at <http://cisgw3.law.pace.edu/cases/030319c1.html>.

86 See *CNA Int'l Inc. v Guangdong Kelon Electrical Holdings et al* (Case No. 05 C 5734 (2008)) contracts for the sale of goods between parties with their places of business respectively in Mainland China and Hong Kong; *Electrocraft Arkansas, Inc. v Super Electric Motors Ltd.* (2009) 4:09 CV 00318 SWW.

Pros of Implementing the CISG in Hong Kong

Implementation of the CISG will potentially drive GDP and trade growth

86. Almost all major trading economies, including Mainland China, the USA, Japan, Singapore, South Korea and Germany are also Contracting Parties to the CISG.

87. There exist examples of economies that have grown and developed significantly following adoption of the CISG and while these examples may be correlative rather than causative, there do not appear to be contrary examples where GDP or trade growth has stalled following adoption of the CISG.

88. Further, given that the aim of the CISG is to reduce legal barriers that could diminish or hamper the free flow of trade between economies, thereby increasing efficiency and driving economic growth⁸⁷, there exist logical and reasonable grounds to believe that the CISG will assist in driving Hong Kong's GDP and trade growth.

Implementation of the CISG will prevent Hong Kong businesses from being subject to unfamiliar foreign laws when entering into cross-boundary transactions

89. Hong Kong's top trading partners include economic powerhouses such as Mainland China, the USA, Japan, and South Korea. In particular, Mainland China and the USA constituted 57% of Hong Kong's total trade in 2018.

90. Given the economic strength of these major players, it is arguable that when concluding contracts with businesses from these countries, Hong Kong businesses may find themselves with limited negotiation or bargaining power in shifting entrenched positions in relation to governing law and jurisdiction clauses.

91. Extension of the CISG to Hong Kong would allow for the application of a strictly neutral set of rules to govern these transactions⁸⁸. It is arguable that the application of neutral rules may be beneficial for Hong Kong businesses, allowing for reduced transaction costs of negotiation and research of governing law clauses and possible reduced litigation costs in the event that a dispute arises by avoiding having to obtain legal advice on foreign law and retain foreign litigators. This may also mean that the CISG may provide a solution to Hong Kong businesses in situations where their counterparts have much stronger bargaining power and therefore insist on using their own domestic law as the governing law of the contract.

87 Lisa Spagnolo, *CISG Exclusion and Legal Efficiency* (Kluwer Law International 2014) 29.

88 Schwenzer (n 31) Preamble, para. 8.

92. Finally, even if a Hong Kong business can contract on the basis of Hong Kong law, there is no guarantee that the foreign court of forum will apply Hong Kong local law correctly, if at all. Even if Hong Kong law is decided by the foreign court of forum to be the applicable law, parties may subsequently face increased litigation costs in obtaining expert evidence to establish the provisions of any applicable foreign law, a matter that can be avoided if the CISG applies, since the CISG calls for a uniform interpretation and is authoritatively available in multiple languages.

93. These considerations become more important when considering the effect of the BRI and the fact that Hong Kong businesses participating in the BRI may find themselves dealing not only with foreign legal systems but also legal systems that may not be as developed as the major trading partners that Hong Kong businesses have traditionally dealt with.

Consultation Question 1:

We would welcome views and comments, in particular from the Hong Kong business and legal sectors, on:

- (a) What proportion of their sale of goods contracts with a non-Hong Kong business are governed by Hong Kong law (as compared with non-Hong Kong law)?
- (b) Where such contracts are governed by non-Hong Kong law, which non-Hong Kong law is the most commonly chosen?
- (c) What proportion of such contracts include the express choice of the CISG in their governing law clauses?
- (d) Whether there is any experience of being advised to exclude the application of the CISG in their governing law clauses?

Implementation of the CISG will enhance Hong Kong's competence in resolving CISG disputes

94. Extension of the CISG to Hong Kong and implementing it in Hong Kong law may bring indirect benefits by enhancing Hong Kong lawyers' competence in handling and managing CISG-related disputes and thereby preparing Hong Kong to serve as a dispute resolution hub for BRI members.

95. Similar competence has been established for arbitration services. Specifically, Hong Kong has built up a pro-arbitration regime and the reputation as a high-profile, high-volume arbitration jurisdiction⁸⁹. Extending this to the CISG, the conclusion should be that jurisdictions that have extensive and

89 Spagnolo (n 87) 125.

frequent contact with CISG matters should enjoy a comparative advantage when compared against jurisdictions with no such expertise or experience.

96. In this regard, Hong Kong is behind the curve in relation to CISG expertise when compared with other key dispute resolution jurisdictions which have joined the CISG⁹⁰. Application of the CISG would allow for Hong Kong to catch up with the competence and experience developed by such key dispute resolution jurisdictions, and would prove useful for advising clients dealing with BRI matters as well as provide a stable of competent and experienced CISG lawyers to handle what appears to be a growing number of CISG-applicable disputes. This competence will also provide increased benefits as time goes on, due to the fact that the CISG exhibits network effects – the value of the CISG tends to increase proportionally to the increasing number of its users.

Access to relevant information and resources will make CISG provisions easier to understand for businesses

97. Extension of the CISG to Hong Kong potentially presents new questions and complexities that will need to be dealt with. Businesses that may either be planning on incorporating the CISG expressly into their contracts, or whom will be covered by the automatic sphere of application provided for under Article 1 of the CISG will need to understand the differences between the CISG and the laws that they had operated under before.

98. To promote uniform application and autonomous interpretation of the CISG, there exist concerted efforts to provide as much transparency and visibility in relation to cases, commentaries, and scholarly articles as possible, and include projects such as the Case Law on UNCITRAL Texts (“CLOUT”) initiative⁹¹, the CISG Advisory Council⁹², and the Institute of International Commercial Law (“IICL”)’s database of CISG case law from around the world⁹³. All of these materials are publicly available to lawyers and businesspeople, easing the learning curve for both lawyers and laymen if and when the CISG is adopted.

The ability to derogate from the CISG increases party autonomy and flexibility

99. One of the greatest strengths of the CISG is its ability to be flexible and respect for party autonomy. In particular, Article 6 of the CISG expressly provides for the derogation or variation of any of its provisions subject to only Article 12 as mentioned in Chapter 1 above. The flexibility of the CISG therefore makes it suitable for businesses that consider certain provisions of the CISG not having done enough to protect their interests or for those consider that

90 Charles Lim Aeng Cheng and Soh Kee Bun, 'Singapore and the CISG' (UNCITRAL-Singapore Seminar on 35 years of the CISG: Achievements and Perspective, Singapore, 23-24 April 2015).

91 United Nations Commission on International Trade Law, 'Case Law on UNCITRAL Texts (CLOUT)', available at http://www.uncitral.org/uncitral/en/case_law.html.

92 CISG Advisory Council, available at <https://www.cisgac.com>.

93 Institute of International Commercial Law, Pace Law School, “CISG Database”, available at <http://iicl.law.pace.edu/cisg/cisg>.

application of Hong Kong local law would be more favorable to them. Extension of the CISG to Hong Kong therefore provides a safety net of sorts, where parties to a contract are free to opt out of its provisions, but to protect those who have not considered or included specific provisions to govern their contractual relationship.

Cons of implementing the CISG in Hong Kong

The implementation of the CISG in Hong Kong may disturb the status quo

100. Hong Kong has managed to make itself the seventh largest merchandise trader in the world and has managed to show steady improvement in trade growth, all without reliance on the CISG. Accordingly, there may be some arguments or criticism against extending the CISG to Hong Kong on the basis that there is no need at the moment to disturb or disrupt the status quo.

101. In particular, Hong Kong's relative strength as a world trader may mean that businesspeople enjoy economic strength when determining the governing law of their disputes and consequentially, are able to utilize the local sales laws of Hong Kong to their advantage. Application of the CISG as a neutral set of rules may negate this advantage and disturb the status quo.

102. However, the existence of the CISG should be seen as an option for flexibility and not as an impediment to economic or trading strength. Almost all of the top trading countries in the world are also Contracting Parties to the CISG and normalisation of the rules governing transactions through removing legal barriers such as disparate governing laws for contracts for the international sale of goods is, in our initial view, more likely to benefit local businesspeople than their overseas counterparties.

Implementation of the CISG would detract from the common law

103. As examined under Chapter 2 above, the CISG presents several concepts foreign to the current Hong Kong legal system. As a hybrid between the common law found in jurisdictions such as the United Kingdom, the USA, and Australia and the civil law found in jurisdictions like France or Germany, some concepts in the CISG have no corresponding equivalent in Hong Kong law.

104. However, it should be noted that several major Contracting Parties to the CISG such as Australia and the USA, are also common law jurisdictions. It is therefore not unworkable for the CISG to form part of or even influence aspects of the common law system.

Consultation Question 2:

We would welcome views and comments on whether the CISG should be applied to Hong Kong.

The practice of exclusion of the CISG

105. The flexibility of the CISG allows for the parties to derogate from certain provisions of the CISG or exclude it entirely. However, the effect of this is that parties may automatically decide to exclude the CISG in the first place, whether that is due to the nature of their industry, concerns about gaps in the CISG, or simply due to comfort with their pre-existing practice.

106. Recent data has shown that several of the largest Contracting Parties to the CISG, such as the USA, Germany, Austria, and Mainland China, also exhibit high rates of exclusion of the CISG from individual contracts⁹⁴. While there could be several reasons for this high rate of exclusion, the end result is that the alleged benefits of the CISG may be reduced or diminished by potentially high rates of exclusion.

Consultation Question 3:

In respect of sale of goods contracts between Hong Kong businesses and non-Hong Kong businesses, we would welcome views and comments (in particular from the Hong Kong business and legal sectors) on:

- (a) Why would one choose to opt out of the CISG in such contracts?
- (b) The likelihood of opting out of the CISG in such contracts if given the opportunity?

Chapter 4

Application and Implementation of the CISG in Hong Kong

107. This chapter considers how the CISG is to be applied and implemented locally in Hong Kong, if it is decided that the CISG will be extended to Hong Kong as a matter of treaty law. It will also consider whether and how Hong Kong local law, which seeks to implement the CISG in Hong Kong (if it is so extended), should apply to sale of goods transactions between Mainland China and Hong Kong where the parties to the transactions have their respective places of business in Mainland China and Hong Kong. Finally, a set of draft legislative provisions for implementation of the CISG, are attached as Annex 4.1 to this Consultation Paper.

94 Spagnolo (n 87) 150.

Application and Implementation of the CISG in Hong Kong

Application of the CISG to Hong Kong

108. Article 91 of the CISG states that the CISG is only open for accession by States. As a result, Hong Kong would not be able to independently accede to the Convention.

109. As mentioned in paragraph 2 above, China is a Contracting Party to the CISG. Accordingly, if it is decided that the CISG should be applied to Hong Kong, the Government of the Hong Kong Special Administrative Region would seek such application under Article 153 of the Basic Law⁹⁵.

How should the CISG be implemented locally?

110. In order to give effect to the CISG in Hong Kong, the Convention would need to be incorporated into Hong Kong local law.

111. We consider that it is useful to refer to how other common law jurisdictions have approached the incorporation of the CISG into their domestic legal systems. Australia and Singapore, for example, incorporate the CISG into their domestic law via separate Acts, which allows for the CISG to co-exist with their domestic sales laws both in statute and common law⁹⁶. Both jurisdictions also specifically provide for the superiority of Convention law to the extent that there may be any inconsistency between itself and domestic law, allowing for CISG principles and provisions to supersede common law principles.

112. Having made reference to the above implementation approach, it is proposed that similar implementation methods should take place in Hong Kong as follows:

- (1) the CISG be implemented in Hong Kong law by way of enacting a new stand-alone Ordinance ("New Ordinance");
- (2) the New Ordinance would reflect any declaration/reservation made under the CISG which is applicable to Hong Kong;
- (3) the New Ordinance would contain provisions with the effect that the CISG rules would prevail to the extent there is any inconsistency between the New Ordinance or the CISG and any other Hong Kong laws (e.g. SGO and the relevant common law principles).

95 Article 153 of the Basic Law provides that: "The application to the Hong Kong Special Administrative Region of international agreements to which the People's Republic of China is or becomes a party shall be decided by the Central People's Government, in accordance with the circumstances and needs of the Region, and after seeking the views of the government of the Region..."

96 See footnote 90 in the case of Singapore. In the case of Australia, see, for example, "Sale of Goods (Vienna Convention) Act 1986 Western Australia", available at http://www8.austlii.edu.au/cgi-bin/viewdb/au/legis/wa/consol_act/sogca1986308/.

113. Incorporating the CISG via an entirely separate Ordinance will draw a clear distinction between the application of the CISG as opposed to the application of local law such as the SGO. Secondly, this would better allow for incorporation of specific provisions of the CISG (such as any reservation under the Convention which is applicable to Hong Kong) into local law. Thirdly, this may reduce the potential usage of local law to fill gaps in the CISG at first instance, rather than as a last resort. Finally, this makes clear that where the CISG does apply, its provisions would prevail to the extent there is any inconsistency between the New Ordinance or the CISG and any other Hong Kong laws (e.g. SGO and the relevant common law principles).

Reservation under Article 95 of the CISG

114. The CISG allows a Contracting State to make certain declaration/reservation under the Convention. Of particular relevance to Hong Kong is Article 95 of the CISG.

115. Article 95 allows a Contracting State to the CISG to declare that it will not be bound by Article 1(1)(b) of the CISG⁹⁷. In this regard, it is noted that there appears to be confusion which sometimes surrounds the application of Article 1(1)(b)⁹⁸.

116. China has made a declaration pursuant to Article 95 of the CISG that, “The People’s Republic of China does not consider itself to be bound by subparagraph (b) of paragraph 1 of Article 1”⁹⁹. In order to prevent potential confusion in applying the CISG to Hong Kong-related disputes, the Department of Justice’s initial view is that, if the CISG is extended to Hong Kong, China’s declaration under Article 95 should also apply in respect of Hong Kong. This means that Hong Kong will apply CISG rules to the contracts of sale of goods only between those parties whose places of business are in different Contracting States to the CISG. The New Ordinance is proposed to reflect this accordingly.

Mainland China/Hong Kong transactions

117. As regards transactions between businesses in Mainland China and businesses in Hong Kong, since such transactions are within the same country, the CISG (being an international convention governing international sale of goods) would not apply.

118. However, even if the CISG would not automatically apply to such transactions, in view of the close economic ties between Mainland China and Hong Kong, to facilitate sale of goods between businesses in the two places, it

⁹⁷ See para. 28 above.

⁹⁸ See para. 29 above.

⁹⁹ See: https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=X-10&chapter=10&lang=en#EndDec.

is proposed that, on a unilateral basis, the New Ordinance would contain provisions which would in effect apply the CISG rules also to contracts for the sale of goods between parties with their places of business respectively in Mainland China and Hong Kong.

Consultation Question 4:

In respect of sale of goods transactions between Mainland China and Hong Kong, should our local legislation, which seeks to implement the CISG, also apply where the parties to those transactions have their respective places of business in Mainland China and Hong Kong?

Provisions of the Draft Bill

119. A set of draft legislative provisions to implement the CISG in Hong Kong local law can be found in Annex 4.1 to the Consultation Paper. Among the key provisions are sections incorporating the CISG into local law and providing for an Article 95 reservation (Section 4(1)), the superiority of Convention law over local sales law when applicable (Section 3), and, on a unilateral basis, the applicability of the provisions of the CISG to Mainland China/Hong Kong transactions (Section 4(2)).

Consultation Question 5:

We welcome the public's comments on the draft legislative provisions to implement the CISG in Hong Kong law (as attached to Annex 4.1 to the Consultation Paper).

Chapter 5

Final Comments and Summary of Recommendations

120. In this final chapter, we shall take stock of the issues covered and summarise the recommended way forward for consultation.

121. On the proposal to extend the CISG to Hong Kong, we have considered the following:

- (1) the salient features of the CISG;
- (2) the interplay between the CISG and Hong Kong law and in particular, the comparison and overall compatibility of the CISG and Hong Kong law regimes;

- (3) whether it will be for Hong Kong's overall benefit to apply the CISG, taking into account relevant factors such as Hong Kong's external trade, its role in the BRI and Hong Kong's status as a leading international legal and dispute resolution services centre in the region, and after balancing the pros and cons for applying the CISG to Hong Kong;
- (4) how the CISG will be implemented in Hong Kong, including whether the proposed Hong Kong's legislation, which aims to implement the CISG, should apply to cross-boundary sales of goods where the parties involved have their respective places of business in Mainland China and Hong Kong.

122. In view of the above, we have the following recommendations:-

- (1) as it appears that the proposed application of the CISG could bring significant and relevant benefits to Hong Kong which outweigh its potential disadvantages, that the CISG should be extended to Hong Kong;
- (2) in order to prevent potential confusion in applying the CISG to Hong Kong-related disputes, if the CISG is extended to Hong Kong, China's declaration under Article 95 of the CISG should also apply in respect of Hong Kong such that Hong Kong will apply CISG rules to the contracts of sale of goods only between those parties whose places of business are in different Contracting States to the CISG;
- (3) if the CISG is applied to Hong Kong, since the CISG would not govern sales within the same country such as those between businesses in Mainland China and businesses in Hong Kong, and in order to facilitate sale of goods between business in the two places, that the Hong Kong legislation (which seeks to implement the CISG in Hong Kong) should apply the CISG rules also to Mainland China/Hong Kong transactions;
- (4) for the purposes of implementing the recommendations in subparagraphs (1) to (3) above, that local legislation be enacted along the lines of the draft provisions as attached to Annex 4.1 to this Consultation Paper.

- End -