

**For discussion on
27 May 2019**

**Legislative Council
Panel on Administration of Justice and Legal Services**

**Consultation on the Proposed Application of the
United Nations Convention on Contracts for the International Sale of
Goods to the Hong Kong Special Administrative Region**

Purpose

The Department of Justice intends to launch a three-month consultation exercise in July 2019 on the proposed application of the United Nations Convention on Contracts for the International Sale of Goods (CISG)¹ to the Hong Kong Special Administrative Region (Hong Kong). This paper seeks to brief Members on the consultation exercise by outlining the key issues and arrangements of the consultation.

Background

2. 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 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 30 April 2019, 91 countries are parties to the CISG⁴, including more than half of the top 20 trading partners of Hong Kong by total volume of trade, namely, China, the USA, Japan, Singapore, South Korea, Vietnam, Germany, France, the Netherlands, Switzerland, Italy and Australia⁵.

¹ The CISG is available at: <https://www.uncitral.org/pdf/english/texts/sales/cisg/V1056997-CISG-e-book.pdf>.

² CISG, Preamble.

³ The entry into force date and the current status of the CISG are available on this United Nations Treaty Collection webpage: https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=X-10&chapter=10&lang=en.

⁴ Ibid.

⁵ Information on Hong Kong's principal trading partners in 2017 is available at: https://www.tid.gov.hk/english/trade_relations/mainland/trade.html.

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

4. There are views in favour of extending the application of the CISG to Hong Kong for reasons that such application could potentially promote trade growth, prevent businesses from being subject to unfamiliar foreign laws when entering into cross-boundary transactions, improve Hong Kong's competence in resolving CISG disputes and hence enhance Hong Kong's status as an international trade and financial centre. These reasons are fleshed out in paragraph 10 below.

5. Further, with the number of Contracting States 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.

6. The background of the CISG, as well as our initial economic and legal considerations and views about the proposed application and implementation of the CISG in Hong Kong will be set out in detail in the consultation paper to be released in July 2019. The key issues are outlined below.

Salient features of the CISG

7. The key provisions of the CISG have been helpfully summarised by the United Nations Commission on International Trade Law and are listed below⁸:

- (a) The CISG applies to contracts for sale of goods between parties whose places of business are in different States:
 - (i) when the States are both Contracting States (Article 1(1)(a)), or
 - (ii) when the rules of private international law lead to the application of the law of a Contracting State

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: <http://legal.un.org/avl/ha/ccisg/ccisg.html>.

(Article 1(1)(b)).

In this regard, as permitted by the CISG (under Article 95), several Contracting States (e.g. China, Singapore and the USA) have declared that they are not bound by the latter ground⁹.

- (b) The CISG governs contracts for the international sales of goods between private businesses, excluding sales to consumers, sales of services, as well as sales of certain types of goods (e.g. shares, investment securities, ships, aircraft etc.).
- (c) Certain matters relating to the international sales of goods, e.g. the validity of the contract and the effect of the contract on the property in the goods sold, fall outside the scope of the CISG.
- (d) Part II of the CISG deals with the formation of the contract, which is concluded by the exchange of offer and acceptance.
- (e) Part III of the CISG deals with the obligations of the parties to the contract. Obligations of the sellers include delivering goods in conformity with the quantity and quality stipulated in the contract and transferring the property in the goods. On the other hand, obligations of the buyer include payment of the price and taking delivery of the goods.
- (f) In addition, Part III of the CISG provides common rules regarding remedies for breach of the contract. The aggrieved party may require performance, claim damages or, in case of fundamental breach, avoid the contract. This Part also includes rules regulating passing of risk, anticipatory breach of contract, damages, and exemption from performance of the contract.

⁹ See: <http://legal.un.org/avl/ha/ccisg/ccisg.html> and https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=X-10&chapter=10&lang=en.

Choices of opting-out and opting-in

8. The CISG applies **automatically** when the relevant conditions provided for in the CISG are satisfied. However, it should be noted that the autonomy of the parties to international sales contracts is a fundamental theme of the Convention: the parties can, by agreement, derogate from virtually any CISG rule (except Article 12¹⁰), or can exclude the applicability of the CISG entirely in favor of other law¹¹.

9. Parties to a contract may also **opt in** to the CISG if their contract does not otherwise satisfy the relevant conditions (e.g. because one of the parties has its place of business in a non-Contracting State). Although the CISG does not explicitly address opting-in, it appears that the CISG does not prohibit such opt-in in principle. Parties may do so by (i) choosing the law of a Contracting State¹² as the applicable law, or (ii) expressly agreeing that the CISG shall apply. However, there are limitations of an opt-in approach as outlined in paragraphs 17 and 18 below.

Initial economic and legal considerations for extension of the CISG to Hong Kong

10. An initial assessment of the benefits of extending the CISG to Hong Kong is set out below:

- (a) Potential to drive GDP and trade growth – Almost all major trading members of the World Trade Organization (including China, the USA, Japan, Singapore, South Korea, Vietnam, and Germany), and nearly half of the countries participating in the Belt and Road Initiative (BRI), are members of the CISG. Since the aim of the CISG is to reduce legal barriers that could diminish or hamper the free flow of trade between countries, increasing efficiency, and thereby driving economic growth, there exist logical and reasonable grounds to believe that the CISG will assist in driving Hong Kong's GDP and trade growth.

¹⁰ Broadly, Article 12 states that the CISG 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 of the CISG.

¹¹ See: <http://legal.un.org/avl/ha/ccisg/ccisg.html>.

¹² Generally, except a Contracting State that has made an Article 95 reservation.

- (b) Preventing Hong Kong businesses from being subject to unfamiliar foreign laws when entering into cross-boundary transactions – Given the economic strength of Hong Kong’s top trading partners, Hong Kong businesses may find themselves the weaker contractual parties and may have difficulties in ensuring that the contractual balance is kept¹³ or that a governing law familiar to them is chosen. Hong Kong businesses may therefore derive benefit from the default application of the “fair and uniform regime of the CISG”¹⁴ to contracts falling within its scope.
- (c) Improving Hong Kong’s competence in resolving CISG disputes – Extension of the CISG to Hong Kong and implementing it in local Hong Kong law may also bring indirect benefits by enhancing Hong Kong lawyers’ competence in handling and managing CISG-related disputes and thereby reinforcing Hong Kong’s position as a dispute resolution hub.
- (d) Freedom of contract – Extension of the CISG to Hong Kong could open up new useful and realistic contractual options whilst preserving pre-existing ones. This point is elaborated in the section below (“Interplay between the CISG and Hong Kong law”).

11. Notwithstanding the benefits listed above, care should be taken to consider if the business and legal sectors may have some concerns on the proposed application of the CISG to Hong Kong. Such concerns may be: changes to the status quo; the transaction costs involved in reviewing existing standard contracts; the CISG (as a legal hybrid between (a) the common law found in jurisdictions such as the United Kingdom, the USA and Australia, and (b) the civil law found in jurisdictions like France and Germany) presenting several concepts which may be unfamiliar to Hong Kong businesses and legal profession; and the CISG including several deliberate gaps in its application (e.g. the issue of validity of contract being explicitly excluded from its scope).

12. On the pros and cons of applying the CISG to Hong Kong as mentioned in paragraphs 10 and 11 above, the Department of Justice would welcome comments and views from the public during the

¹³ See: https://uncitral.un.org/en/texts/salegoods/conventions/sale_of_goods/cisg.

¹⁴ Ibid.

consultation exercise.

Interplay between the CISG and Hong Kong law

13. One key 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. 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:

- (a) 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 businesses; and
- (b) A comparison of the relative merits of allowing opting 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)¹⁵.

Differences between the two regimes

14. Firstly, it is noted that there are various differences between the CISG and the relevant existing Hong Kong law, covering rules of application, contract formation and variation, obligations of buyers and sellers, fundamental breach, and remedies on breach.

15. However, in terms of the extent to which such differences would affect international sales in practice, it is observed that:

- (a) 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 termination). This suggests that the CISG is economically more efficient and comparatively pro-seller;
- (b) Second, it seems that on balance the CISG is more accessible and comprehensive to the lay business

¹⁵ See paragraphs 8 and 9 above.

persons than the Sale of Goods Ordinance¹⁶ (“SGO”) (e.g. the CISG adopts somewhat simpler and “lay” language, and avoids historical or technical terms used in the SGO);

- (c) Third, at least as regards two important areas, namely, (a) obligations concerning the fitness and quality of goods sold (e.g. the concept of “fitness for purpose”) and (b) remedies (e.g. the right to cure, the easy ability to vary the contract, and the remedy of price reduction), it appears that the CISG is more in line with modern commercial expectations and commercial practice; and
- (d) Finally, the differences identified above are not of a fundamental, systemic nature, whilst there are significant similarities across the two regimes.

16. In considering the interplay between the CISG and Hong Kong law, there are questions as to whether any issues of compatibility¹⁷ arise, and if so whether well-defined mechanisms exist for addressing them. This issue will be addressed in the Consultation Paper. In gist, international CISG jurisprudence appears to provide principled frameworks for resolving incompatibility problems, and any remaining difficulties may be addressed by domestic law reform.

Merits and drawbacks of opting-in or opting-out

17. In addition, we have considered the relative merits and drawbacks of opting-in or opting-out as a default position¹⁸. The question in this case is “why not keep the *status quo* and opt into the CISG as needed; or why should the default choice be opting-in, leaving parties who wish to be governed by local Hong Kong law (rather than the CISG) to opt out?”

18. It is observed that opting-in under the *status quo* cannot fully apply the CISG as if the CISG had been extended and implemented in Hong Kong because there are hard limits to parties’ scope for contract imposed by the general law (e.g. the CISG is not capable of regulating

¹⁶ Chapter 26 of the Laws of Hong Kong.

¹⁷ “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*.

¹⁸ See paragraphs 8 and 9 above.

contract formation if it is incorporated only as contract terms). By comparison, if the CISG is extended to Hong Kong (such that opting-in is the default), there are no such limits on commercially useful combinations of choice of law. Parties would be free to utilise the CISG as designed; alternatively, parties can choose to be governed solely by Hong Kong local law rather than the CISG. As such, purely from a comparative legal perspective, it appears that applying the CISG to Hong Kong opens up useful and realistic contractual options whilst preserving the old ones. Freedom of contract in principle would support opting-in by default.

19. In short, it appears that **none** of the issues raised above weigh strongly against extending the application of the CISG to Hong Kong.

Proposed application of the CISG to Hong Kong and its implementation into Hong Kong law

20. As mentioned in paragraph 3 above, China is a Contracting State to the CISG. If it is decided that the application of the CISG should be extended to Hong Kong, the Government of the Hong Kong Special Administrative Region would seek such application under Article 153 of the Basic Law¹⁹.

21. To give effect to the CISG in Hong Kong under the common law system, the CISG will need to be implemented by way of local Hong Kong law. Having made reference to how other common law jurisdictions have implemented the CISG in their domestic legal systems (e.g. Australia, Canada and Singapore), it is proposed that similar implementation methods should take place in Hong Kong as follows:

- (a) the CISG be implemented in Hong Kong law by way of enacting a new stand-alone Ordinance (New Ordinance);
- (b) the New Ordinance would reflect any declaration/reservation made under the CISG which is applicable to Hong Kong; and

¹⁹ 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...”

- (c) 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).

Hong Kong/Mainland transactions

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

23. However, even if the CISG would not automatically apply to such transactions, in view of the close economic ties between the Mainland and Hong Kong, to facilitate sale of goods between businesses in the two places, it is proposed that, on a unilateral basis, the New Ordinance would contain provisions which would in effect apply the CISG rules also to Hong Kong/Mainland transactions.

Reservation under Article 95 of the CISG

24. 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 (as mentioned in paragraph 7(a) above).

25. Article 95 allows a Contracting State to the CISG to declare that it will not be bound by Article 1(1)(b) of the CISG²⁰. In this regard, it is noted that there appears to be confusion which sometimes surrounds the application of Article 1(1)(b).

26. As mentioned above, 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.”²¹ 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

²⁰ See paragraph 7(a) above.

²¹ See: https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=X-10&chapter=10&lang=en#EndDec.

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.

Separate issue: Possible arrangements between Mainland China and Hong Kong

27. For the reason of further facilitating trade between businesses in Hong Kong and businesses in Mainland China, the Department of Justice considers that it may also be an opportune time to consider the possibility of having a reciprocal arrangement in place between Hong Kong and Mainland China such that a sale of goods contract between businesses in the two places would be treated by both jurisdictions as if it were a contract between businesses in different Contracting Parties to the CISG. Any proposal of such arrangement would be subject to careful studies and further exploration and discussions with the relevant Mainland authorities, without prejudice to the proposed application (and implementation) of the CISG to Hong Kong as outlined in paragraphs 20 to 26 above.

Consultation arrangements and issues

28. The three-month consultation exercise will start in July 2019, and the consultation paper will be made available online on the Department of Justice website²² as well as in hard copy.

29. In summary, the Department of Justice aims to seek the public's views on **whether the CISG should be applied to Hong Kong, and if so, its implementation in Hong Kong**. Regarding the latter aspect, the public's views are sought on the following questions:

- (a) should the declaration made by China under Article 95 of the CISG in respect of Article 1(1)(b) apply to Hong Kong so that the Convention would apply only between those parties whose places of business are in different Contracting States to the CISG;
- (b) in respect of sale of goods between Mainland China and Hong Kong, should our local legislation, which

²² See: www.doj.gov.hk.

seeks to implement the CISG, also apply where the parties involved have their respective places of business in Mainland China and Hong Kong; and

- (c) as a separate issue, whether the public is in favour of having a reciprocal arrangement in place between Hong Kong and Mainland China, under which a contract of sale of goods between businesses of the two places will be treated by both jurisdictions as if it were a sale between different Contracting Parties to the CISG.

30. We welcome views from the public, including in particular traders, business chambers and the legal profession. We shall consider the views received during the consultation period carefully and then brief the Panel on the proposed way forward in due course.

Advice sought

31. Members are invited to take note of the intended public consultation exercise and give their views on the proposed application of the CISG to Hong Kong in the light of the issues outlined in paragraph 29 above.

Department of Justice
May 2019