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Legislative Council

LC Paper No. LS93/20-21

**Paper for the House Committee Meeting
on 16 July 2021**

**Legal Service Division Report on
Sale of Goods (United Nations Convention) Bill**

I. SUMMARY

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| 1. The Bill | The Bill seeks to implement the United Nations Convention on Contracts for the International Sale of Goods ("CISG") in Hong Kong. |
| 2. Public Consultation | According to the Legislative Council Brief, a public consultation was conducted in 2020 on the proposal to apply CISG to Hong Kong. There was general support among the respondents, including the Hong Kong Bar Association and the Law Society of Hong Kong. However, the Hong Kong General Chamber of Commerce expressed reservation. |
| 3. Consultation with LegCo Panel | The Panel on Administration of Justice and Legal Services was consulted on the policy related to the Bill at three meetings between 2019 and 2021. Whilst no objection was raised to CISG's application to Hong Kong, various concerns were expressed by Panel members. |
| 4. Conclusion | Subject to Members' views on the issues stated in paragraphs 10 and 11 of Part II of this Report, no difficulties have been identified in relation to the legal and drafting aspects of the Bill. Members may consider whether a Bills Committee should be formed to study the policy aspects of the Bill in detail. |

II. REPORT

The date of First Reading of the Bill is 14 July 2021. Members may refer to the Legislative Council ("LegCo") Brief (File Reference: IL/ITF/1/81) issued by the Department of Justice on 7 July 2021 for further details.

Object of the Bill

2. The Bill seeks to implement the United Nations Convention on Contracts for the International Sale of Goods ("CISG")¹ in Hong Kong.

Background

3. According to the LegCo Brief, CISG is an important and widely adopted commercial law treaty that provides a set of uniform rules governing contracts for the international sale of goods within its scope. It represents a modern and fair regime that introduces certainty in commercial exchanges and decreases transaction costs. According to the Administration, CISG's application to Hong Kong is expected to bring an array of benefits such as driving up the local Gross Domestic Product and reinforcing Hong Kong's role as a dispute resolution hub, etc.

4. The People's Republic of China is a Contracting State to CISG,² but CISG is currently not applicable to Hong Kong. The Administration has sought the support of the Central People's Government ("CPG") for CISG's application to Hong Kong. The Bill is introduced into LegCo with a view to implementing CISG in Hong Kong.³

Provisions of the Bill

5. The main provisions of the Bill are as follows:

- (a) clause 3 seeks to provide that the enacted Ordinance (if the Bill is passed) would apply to the Government;
- (b) clause 4 seeks to give CISG the force of law in Hong Kong;
- (c) clause 5 seeks to provide that if there is any inconsistency between the enacted Ordinance or CISG and any other law, the enacted Ordinance or CISG would prevail to the extent of the inconsistency; and
- (d) the Schedule to the Bill contains the text of CISG.

¹ CISG was adopted on 11 April 1980 in Vienna, and entered into force on 1 January 1988.

² The People's Republic of China has made a reservation under Article 95 of CISG. It means that it applies CISG rules only to international sale contracts between parties whose places of business are in different Contracting States; but not to international sale contracts where the rules of private international law lead to the application of the law of a Contracting State.

³ Whilst the People's Republic of China has made a reservation under Article 95 of CISG, in the light of certain responses from the consultation and after careful consideration, the Administration seeks to apply CISG without China's Article 95 reservation in Hong Kong.

Provisions of CISG

6. CISG, as set out in the Schedule to the Bill, contains 101 articles divided into four Parts: (i) general rules (Articles 1 to 13), (ii) provisions on formation of contract including on offer, revocation, acceptance and withdrawal (Articles 14 to 24); (iii) provisions on rights and obligations of the seller and the buyer in international sale of goods contracts, together with remedies in case of breach (Articles 25 to 88); and (iv) final provisions, including the rules of ratification and entry into force, as well as reservations (Articles 89 to 101). Members may refer to paragraph 7 of LC Paper No. CB(4)908/18-19(03) issued to the Panel on Administration of Justice and Legal Services ("AJLS Panel") in May 2019 for a summary of the key provisions of CISG.

7. Members may wish to note that pursuant to Article 6 of CISG, parties to an international sale contract can, by agreement, derogate from or vary the effect of any provisions of CISG (except Article 12⁴), or can exclude the application of CISG entirely.

8. As CISG is an international convention, it does not apply to transactions between businesses in the Mainland China and businesses in Hong Kong. According to paragraph 14 of the LegCo Brief, there is general support from the consultation for applying CISG to those transactions. The Administration would initiate discussion with CPG regarding negotiation of an arrangement between the Mainland and Hong Kong for mutual application of the CISG provisions.

Commencement

9. The Bill, if passed, would come into operation on a day to be appointed by the Secretary for Justice by notice published in the Gazette. According to paragraph 10 of the LegCo Brief, noting that relevant stakeholders may need time to adapt to CISG's implementation, the Administration plans to allow at least six to nine months after the Bill's passage before its commencement.

Legal Service Division's enquiries with the Administration

10. It is noted that the text of CISG is set out in the Schedule to the Bill, instead of its content being set out in the Bill as individual provisions after adaptation. Upon the Legal Service Division ("LSD")'s enquiry on this approach to implement CISG in Hong Kong, the Administration has replied that this approach is adopted because CISG provides a uniform text of law for international sales of goods and there is no need for adaptation. Moreover, the same approach for implementing CISG domestically has been adopted by other common law jurisdictions, such as Australia, Canada and Singapore.

11. As regards clause 5 of the Bill (paragraph 5(c) above), LSD has made enquiries with the Administration on whether any such inconsistencies have been identified. The Administration has replied that there are differences between CISG and

⁴ Article 12 states that CISG provisions allowing freedom of form for the creation, modification or termination of a contract of sale do not apply where any party has his place of business in a Contracting State which has made a declaration under Article 96 of CISG.

the local Hong Kong sales law at present, including rules governing (a) the formation of contract of sale and (b) the rights and obligations of the seller and the buyer arising from such a contract including remedies on breach. However, the Administration is of the view that such differences are not of a fundamental systemic nature, whilst there are significant similarities between the two regimes. Should a Hong Kong trader wish to adopt CISG (instead of Hong Kong law), the trader is likely required only to fine-tune, but not completely overhaul, his existing business practices. Members may refer to the Administration's reply in the Appendix.

Public Consultation

12. According to paragraphs 9 and 19 of the LegCo Brief, a public consultation was conducted from 2 March to 30 September 2020. A majority of the respondents, including the Hong Kong Bar Association ("HKBA") and the Law Society of Hong Kong ("LawSoc"), supported the proposal. However, the Hong Kong General Chamber of Commerce ("HKGCC") expressed reservation on whether Hong Kong businesses would be better off with the current "opt-in" position or, assuming CISG would be applied to Hong Kong, with the proposed "opt-out" position. The responses from HKBA and LawSoc were relayed by the Administration to HKGCC with a view to addressing its concerns. No other trade associations or chambers of commerce have written to the Administration to express reservation.

Consultation with LegCo Panel

13. As advised by the Clerk to the AJLS Panel, at the Panel meetings on 27 May 2019, 25 May 2020 and 22 March 2021, members were briefed by the Administration on the salient features of CISG, the proposed application of CISG to Hong Kong, and the public consultation in this regard and its outcome. Whilst no objection to the proposal was raised at the meetings, various concerns were expressed by members, including the benefits of CISG's application to Hong Kong and its legal profession, the differences and potential conflicts between CISG and the Hong Kong law, the effect on the freedom of contract, and the applicability of CISG to the Mainland-Hong Kong transactions.

Conclusion

14. Subject to Members' views on the issues stated in paragraphs 10 and 11 above, no difficulties have been identified in relation to the legal and drafting aspects of the Bill. Members may consider whether a Bills Committee should be formed to study the policy aspects of the Bill in detail.

Encl.

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15 July 2021

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Urgent by email
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13 July 2021

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Dear Ms WAN,

Sale of Goods (United Nations Convention) Bill

We are pleased to set out below our responses to the questions regarding the Sale of Goods (United Nations Convention) Bill (“**Bill**”) raised in your letter of 9 July 2021.

Clause 4 of the Bill

2. Under the Bill, the United Nations Convention on Contracts for the International Sale of Goods (“**CISG**”) will be given the force of law in the Hong Kong Special Administrative Region through its incorporation into the enacted Ordinance – the text of the CISG is set out without any adaptation in the Schedule to the Ordinance. This incorporation approach is adopted because the CISG provides a uniform text of law for international sales of goods and there is no need for adaptation.

3. The above incorporation approach to implement the CISG domestically is in line with how other common law jurisdictions have implemented the CISG in their legal systems, for example:

a. for Australia, for instance:

- the Sale of Goods (Vienna Convention) Act 1986 (New South Wales) at <https://legislation.nsw.gov.au/view/whole/html/inforce/current/act-1986-119>;
- the Sale of Goods (Vienna Convention) Act 1986 (Queensland) at <https://www.legislation.qld.gov.au/view/whole/html/inforce/current/act-1986-041>;

b. for Canada: the International Sale of Goods Contracts Convention Act at <https://laws-lois.justice.gc.ca/eng/acts/I-20.4/FullText.html>; and

c. for Singapore: the Sale of Goods (United Nations Convention) Act at <https://sso.agc.gov.sg/Act/SGUNCA1995>.

Clause 5 of the Bill

4. Regarding the question in the third paragraph of your said letter on Clause 5 of the Bill, our reply is set out in the **Annex** to this letter. In brief, there are differences between the CISG and the local Hong Kong sales law at present, including rules governing (a) the formation of the contract of sale and (b) the rights and obligations of the seller and the buyer arising from such a contract including remedies on breach. Under the Bill, these differences will be subject to the overriding effect of the relevant provisions of the CISG. However, such differences are not of a fundamental systemic nature, whilst there are significant similarities across the two regimes. Should a Hong Kong trader wish to adopt the CISG (instead of Hong Kong law), the trader is likely required only to fine-tune, but not completely overhaul, his existing business practices.

5. Please let us know if we may be of further assistance.

Yours sincerely,



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Encl.

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Key differences between the CISG and Hong Kong law governing international sale of goods at present

1. The CISG, being a harmonization of sales laws around the world, bears some significant differences from local sales law of the Hong Kong Special Administrative Region (“**Hong Kong**”). Some of the key differences between the CISG and Hong Kong law governing international sale of goods at present are outlined below. For detailed discussions in this regard, reference may be made to Chapter 2 of the Consultation Paper¹ issued by the Department of Justice on 2 March 2020 and its Annex 2.2. The bulk of the information set out below has been set out in a note of “Frequently Asked Questions” available at the Department of Justice’s webpage on the CISG since August 2020².

Contract Formation

2. With some exceptions, the provisions of the CISG tend to be more pro-contract than local Hong Kong law. In this regard, there are some differences in formation of contract as compared to current Hong Kong law.

3. For example, in relation to revocation of offers, CISG Article 16(2) dictates certain criteria that make an offer irrevocable (such as when a fixed time for acceptance is stated or where it is reasonable to rely on the offer as irrevocable). This differs from common law, where an offer made that is unsupported by consideration is treated as revocable at will and stating a fixed time for acceptance is prima facie no more than an indication that after that time, the offer (unless revoked meanwhile) will lapse.

4. Another difference arises from late acceptance of an offer. CISG Article 21(2) provides that late acceptance may still be effective if it can be shown that, if the acceptance was transmitted normally, that it would have reached the offeror in time, unless the offeror informs the offeree without delay that the offer has lapsed. This departs from the Hong Kong “postal rule” which establishes acceptance being effective from the moment it is dispatched, and places additional burden on the offeror.

Obligations of Buyers and Sellers

5. Whereas the Sale of Goods Ordinance (Cap. 26) includes a patchwork of criteria such as conformity with description, sample, and implied terms as to

¹ Available at https://www.doj.gov.hk/en/featured/consultation_paper.html.

² See https://www.doj.gov.hk/en/featured/pdf/CISG_FAQ_en.pdf.

merchantability, 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). Overall, the CISG uses a simpler and more streamlined way of defining merchantability while maintaining a similar scope of coverage as local Hong Kong law.

6. Generally, buyers have rights under CISG Article 35 to goods that are fit for their ordinary purpose, and any particular purpose that it has specified to the seller (or which the seller should have reasonably known). The goods must also possess the qualities of any samples or models provided to the buyer, and be properly packaged. Any deviation from these requirements renders the goods non-conforming and any non-conformity establishes a breach.

7. Further, under CISG Articles 37 and 48, when there is non-conformity, the seller may cure any defects before and after delivery is due, so long as this can be done without undue delay, expense, or inconvenience to the buyer. This may conflict with the buyer's right to reject goods under local Hong Kong law.

8. For buyers, some obligations may differ from local Hong Kong law. In relation to inspection, for example, CISG Article 38 requires buyers to examine the goods as soon as possible once obtaining possession. CISG Article 39 also requires the buyer to provide notice to the seller of any defects within a reasonable time, or in any event within two years after the goods were handed over, or else the buyer loses the right to rely on lack of conformity. This is more stringent than what local Hong Kong law provides, which only bars the buyer from rejecting the goods if inspection is not carried out in a reasonable period of time.

Fundamental breach and avoidance of contract

9. The concept of fundamental breach is defined under CISG Article 25 as a breach that causes such detriment to the other party as to substantially deprive them of the benefits under the contract. While this test appears somewhat (linguistically) similar to the test for a repudiatory breach of an innominate term in existing Hong Kong law, it is a much stricter requirement than what traders may be used to under Hong Kong common law. If fundamental breach is established, the innocent party is entitled to "avoid" the contract under either CISG Article 49 or 64 and seek restitution. This means that both parties must be put into their pre-contractual positions as far as possible.

10. In practice, the specific concept of fundamental breach is very rarely established, especially given the CISG's pro-contract policy, and should not be considered similar to breaches of contractual conditions which under local Hong Kong law, would give rise to rights of termination.

Termination of the contract

11. Local Hong Kong law generally allows for greater rights of termination as compared to the CISG. Under Hong Kong law, breaches of condition generally give rise to termination rights. However, under the CISG, avoidance and termination are viewed in the context of fundamental breach, which is a much higher bar than what is normally seen in local Hong Kong sales law. Further, avoidance under the CISG has retrospective effect, meaning that both parties are required to make restitution of the benefits received, in an attempt to put the parties in the same situation that they would have been in prior to entering into the contract.

Choice of remedies on breach

12. One major difference between remedies under the CISG and under Hong Kong law is that the CISG allows the buyer to claim for a reduction in price for non-conforming goods: under CISG Article 50, buyers have the choice to keep any non-conforming goods, and to subsequently claim for a reduction of the price to reflect the value of the goods actually delivered. While there is a rough equivalent remedy under existing Hong Kong law by way of damages for “abatement against the price” if the price has not been paid, this specific remedy allows a buyer under the CISG to essentially choose whether to reduce the price or seek damages.

13. Further, the CISG provides for some greater latitude in compelling performance of the contract (“specific performance”), but this remedy is typically subject to domestic courts’ discretion (see CISG Article 28).

Damages

14. Claims for damages in the CISG and under local Hong Kong law are largely the same with some minor differences such as when damages are ascertained and how they may be calculated. Under the CISG, damages are assessed at the time of trial, whereas Hong Kong law dictates that damages should be determined at time of breach. Further, damages are primarily assessed with reference to the market under Hong Kong law, whereas the CISG first looks at any actual substitute transactions before resorting to the market. Finally, the CISG limits recovery by examining whether damages are foreseeable, whereas under Hong Kong law, there is a more complex system of causation and remoteness.

15. In summary, the following key observations from the above comparison are noted in particular: (a) 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 a breach, rather than allow for easy termination); and (b) the CISG provides remedies for breach of a sales contract which have no direct equivalent

in Hong Kong law but may make ample common sense to traders, such as the right to cure and the remedy of price reduction.

16. On the other hand, the differences set out above are not of a fundamental systemic nature, whilst there are significant similarities across the two regimes. Should a Hong Kong trader wish to adopt the CISG (instead of Hong Kong law), the trader is likely required only to fine-tune, but not completely overhaul, his existing business practices.

How would the CISG (as implemented in Hong Kong) work alongside existing Hong Kong law which governs international sale of goods?

17. The CISG does not provide a complete code on international sale of goods, and only covers particular areas of such sale³. For areas that are specifically excluded from the CISG as well as questions concerning matters covered by the CISG but are not adequately answered by its own principles, Hong Kong law may be relied upon.

18. For example, the CISG does not cover issues of validity of contract. Therefore if a claim arose in a Hong Kong court where the CISG applied, and one party were to allege that the contract is not valid as it was procured by fraud, the issue of whether there was fraud and its effect on the contract would be governed by Hong Kong law.

19. As mentioned above, there may be differences between the CISG and local Hong Kong sales law, and in some cases these differences may be significant. For example, concepts of fundamental breach and avoidance, which are concepts which arose from civil law jurisdictions, find their way into the CISG by way of the CISG's very nature as a compromise between civil and common law systems.

20. However, notwithstanding such differences, there does not appear at this moment to be any provisions of the CISG that are fundamentally incompatible with provisions of local Hong Kong law. Furthermore, in situations where the CISG may contemplate remedies that may affect domestic court's discretion such as specific performance, provisions such as CISG Article 28 preserve the domestic court's inherent discretion under domestic law.

21. In its submission in response to the public consultation, the Hong Kong Bar Association commented that it acknowledges there are bound to be differences between the CISG and existing Hong Kong law, as in any case of adoption of any uniform international law. However, Hong Kong's judiciary and legal sector have

³ CISG Article 4 provides that the CISG governs only the formation of the contract of sale and the rights and obligations of the seller and the buyer arising from such a contract.

rich experience in adopting international rules into the HKSAR's legal system in a sensible and harmonious manner, and in any event, CISG Article 6 allows parties to contracts to opt out of the CISG or, subject to a limited caveat, derogate from or vary the effect of any of the provisions of the CISG⁴. Similarly, the Law Society of Hong Kong in its submission noted that the CISG and Hong Kong domestic laws do not have grave differences that lead to incompatibility. Overall, most of the principles and provisions in the CISG are not irreconcilable with the provisions in the Sale of Goods Ordinance (Cap. 26) or the common law legal concepts⁵.

22. Furthermore, under the current implementation proposal, the CISG rules will be given prevailing effect under the implementing legislation. Thus, in situations where the CISG would apply and the CISG provisions govern that issue, the CISG rules would prevail to the extent there is any inconsistency between the implementing legislation/CISG and any other Hong Kong laws.

⁴ See paragraph 15 of the submission of the Hong Kong Bar Association dated 3 August 2020, at Annex 4 to the AJLS Panel paper available at <https://www.legco.gov.hk/yr20-21/english/panels/ajls/papers/ajls20210322cb4-648-3-e.pdf>.

⁵ See paragraph 7 of the submission of the Law Society of Hong Kong dated 27 October 2020, at Annex 4 to the AJLS Panel paper mentioned in footnote 4 above.