CHAPTER 5
The CISG in Action: Law and Practice in China

Dr Lijun (Liz) Zhao

1. Introduction

[5.1] The year 2018 has witnessed the 30th anniversary of the United Nations Convention on Contracts for the International Sale of Goods (CISG) coming into force. The Convention aims to achieve uniformity amongst the varied legal traditions on the law affecting international sale of goods. China is one of the founder State parties to the Convention and has followed it with an accession legislation in (mainland) China.[1]

[5.2] This research attempts to examine the application of the CISG and the principle of good faith with regard to international sales of goods contract in China. Clarification on the defining features of good faith being elusive, China, a civil law tradition adherent, has placed this concept into many PRC legislations, nevertheless did not define it. The CISG has, via Article 7(1), mandated the application of "good faith" but no attempt to define it there either.
The research explores the gaps in the law: first, the understanding of good faith; and secondly, the possible scope of this term to include, beyond the CISG, the relationship between the contractual parties. The author attempts to answer these questions, keeping the focus on China and its law and practice.

2. The Observation of Good Faith from Comparative Law Perspective

[5.3] Case law as well as the literature on the concept of good faith, noting the varied degree of acceptability of the principle of good faith and fair dealing in the civil law and the common law countries, has debated limiting the application of good faith only to the interpretation of the CISG while some preferred the extension of the concept to the rights and duties of the contractual parties.

[5.4] Article 7(1) calls for the interpretation of the CISG along the expression "the observance of good faith in international trade". The language of the Article is an attempt to present the concept within the Convention as a confluence between the common law and civil law traditions.

2.1 Common Law Countries

[5.5] Within the practice in common law countries, there is a varying degree of acceptance of the principle of good faith. The UK andAustralia, for example, have no legislative provisions on good faith obligations. In England and Wales, good faith has "played only a small part in

* The CISG in Action: Law and Practice in China, in Multi-Disciplinary Perspective on the UN Convention on Sales of Goods, P. Sooksipaisarnkit (Ed); (2019) Sweet & Maxwell: London and Hong Kong, Chapter 5. https://www.sweetandmaxwell.com.hk/BookStore/showProduct.asp?countrycode=HK&id=2778&ptab=1&bookstore=1&g=e06l&ec=QSNBGDKTJJVZRUJQFVYUWLETCEGLPOCFIZCQJNVZGOYLGYES

[1] China signed and ratified the CISG in 1988, <http://www.unis.unvienna.org/unis/pressrels/2013/unisl180.html> All website information stated in this paper was last accessed on 1 December 2018.

the case law, and has now shown in practice any meaningful content".[2] In Australia, good faith has had a tentative foothold. The concept's existence is derived from contractual terms.

> In Australia a coherent and predictable body of jurisprudence has developed around the simply expressed obligation in trade and commerce not to engage in conduct that is misleading or deceptive or likely to mislead or deceive. Likewise, in New South Wales a similarly coherent body of cases has developed around the [Austrlian] Contracts Review Act 1980, which authorises the court to vary or set aside non-business contracts that are 'unjust'. [3]

The USA, however, has included good faith in few of its statutes.

2.2 Civil Law Countries

[5.6] In civil law countries, good faith applies to the interpretation of the CISG and governs the rights and duties of the contractual parties as well. Notably in the French and German legal systems, good faith has been well established as an overriding principle in contract law. However, it should be noted here in spite of its long and chequered history - especially in Germany and France, the term lacks uniform understanding among countries. For instance, the French *'bonne foi'* and the German *'Treu und Glauben'* shared the same origin, but different interpretation and application do exist.

[5.7] This varied understanding among diverse legal systems, even amongst the civil law countries, could be because 'good faith' invokes 'fairness' and 'moralities' to some extent, and thus is impacted by the culture and legal system of each country.

[5.8] There is, however, a general universal point beyond any disagreement, a business does not continue to prosper if it behaves disreputably and in an unfair manner. It is also understood that businesses are driven by economic reasons and therefore act to protect their interest. Problems, therefore, arise from the intersection of these two modes of behaviour and whether good faith is the principle by which this intersection is found.

3. A Close Look at The CISG in China

3.1 Governing Laws

[5.9] China, owing to its German, Japanese and Russian law influences, is traditionally part of the civil law legal system. Article 4 of the The General Principle of Civil Law Act (GPCL), 1964, required that civil activities [including commercial contracts] follow the principles of voluntariness, fairness, equal pay, and good faith. In the PRC Contract Law Act of 1999,[4] good faith has been included as an overriding principle, extensively. For instance, Article 6 specified that "The parties shall observe the principle of good faith in exercising their rights and performing their obligations".

---

[2] Michael Bridge, 'Good Faith, the Common Law, and the CISG', (2017) 22(1) Uniform Law Review 98.
[3] Oxford University Obligations Group, Some Reflections on Good Faith in Contract Law, February 2012, <https://www.monash.edu/__data/assets/pdf_file/0019/141085/good-faith-as-in-contract-law-oxford.pdf>
[4] National Congress of PR China, Contract Law Act of 1999, came into effect on 1 October 1999, <http://www.gov.cn/banshi/2005-07/11/content_13695.htm>

[5.10] The 1964 Act has been updated and enriched with detail and reenacted as the General Provisions of Civil Law Act (GPCL), 2017.[5] Chapter 1 entitled "Basic Provisions" stipulates governing principles which could be characterised as "overriding principles".[6] Article 7 specifed,

> Civil subjects engaged in civil activities [including commercial contracts][7] shall abide by the principle of good faith, uphold honesty and fulfil their commitments.[8]

Another example of law reform on good faith is the PRC Choice of Law for Foreign-related Civil Relationships Act of 2010.[9]

3.2 Contract Validity: Written or Not?

[5.11] While depositing the instrument of ratification on 11 December 1986, China announced two reservations: first, disagreement with the expansion of the scope of application of the Convention, agreeing only to the Convention's application to contractual parties from State parties to the Convention; second, disagreement to the CISG provisions on conclusion, modification and termination of the contract, by requiring that contracts of international sales of goods should be written. Due to the lack of legislation governing electronic signature and communications until 2004, 'written' only meant being written in paper until the enactment of PRC Electronic Signature Act of 2004.[10]

[5.12] Two points should be noted in this context. First, the second reservation has been withdrawn in 2013. Second, PRC Electronic Signature Act of 2004 also governs electronic communications, particularly under its Chapter 2, Articles 4-12.[11]

[5.13] In January 2013, the Chinese government notified the Secretary-General of the United Nations its intention to withdraw the statement on the "Convention on Contracts for the International Sale of Goods of the United Nations" that China is not bound Article 11 of the Convention and the content of Article 11".[12] This withdrawal is effective since then.

[5.14] This withdrawal also unified different forms required for domestic and international sales of goods contracts. Before this withdrawal, China treated domestic and international sales of goods contract differently under Chinese law: the former is a 'simple contract' with no legal requirements as to the form; the latter is a 'special contract' requiring a written form according to the PRC Economic Contract Law Involving Foreign Interests Act of 1985[13] and its

---

[5] National Congress of PR China, General Provisions of Civil Law Act of 2017, came into effect on 1 October 2017, <https://www.chinacourt.org/law/detail/2017/03/id/149272.shtml>
[6] General Provisions of Civil Law Act of 2017, Articles 1-12.
[7] (Emphasis added).
[8] General Provisions of Civil Law Act of 2017, Article 7.
[9] National Congress of PR China, PRC Choice of Law for Foreign-related Civil Relationships Act of 2010, Effective since 4 January 2010, <http://www.gov.cn/flfg/2010-10/28/content_1732970.htm>
[10] National Congress of PR China, <http://www.npc.gov.cn/wxzl/wxzl/2004-10/20/content_334609.htm>
[11] *Ibid*.
[12] China Withdraws "Written Form" Declaration Under the United Nations Convention on Contracts for the International Sale of Goods (CISG), January 2013. <http://www.unis.unvienna.org/unis/pressrels/2013/unisl180.html>
[13] PRC, Foreign Economic Contract Law Act of 1985.

accompanying Judicial Interpretation issued by the PRC Supreme Court,[14] and particularly in paper-based form and signed by the contracting parties.

[5.15] In terms of the use of electronic communications, CISG is also supplemented by the 2005 United Nations Convention on the Application of Electronic Communications in International Contracts.[15] "Communication" or "written" under CISG should be interpreted to include electronic communication. China has signed it on 6 July 2006 but it has not yet been ratified by China.[16] Thus, it is worth noting that the governing law in China on electronic signature and communications is still the above stated domestic Act of 2004, instead of the 2005 UN Convention.

4. Empirical Study of Cases invoking the CISG heard by Courts in China

[5.16] The CISG is guided by the purpose of promoting uniformity in international sales law. Article 7 CISG sets out a guideline to the interpretation under which regard is to be had to the CISG's international character, the need to promote uniformity in its application, and the observance of good faith in international trade. Uniform application primarily means that arbitral tribunals and courts should apply the Convention to cases in which the CISG is the proper law to be observed. Therefore, the author conducted an empirical study on judgments in China which invoked the CISG.

[5.17] More specifically, the author employed a database – "China Judgements Online" (hereafter 'Judgments Database')[17] – which is administered by the Supreme Court of PR China and publishes judgments online. It was launched in 2013 and contains judgments delivered by all courts in China and some previous judgments as well. Thus, this database seems to be the most comprehensive database. All figures and calculations in this empirical research below considered judgments were last accessed by the author on 30 November 2018.

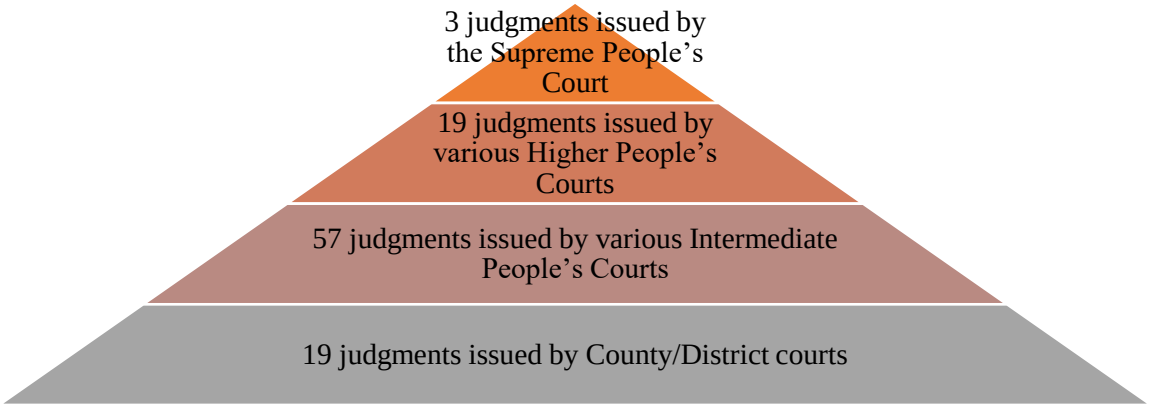
[5.18] The search keywords "the CISG" on the Judgments Database[18] returned a total of 202 cases, which referred to or mentioned the CISG. Among these cases, 98 directly invoked the CISG as the authority of law the judgments relied on. The author analysed these 98 judgments by grouping them on criteria as showed in the figures shortly.

[5.19] The 98 cases have been grouped four categories according to the hierarchy of the courts which deliver the judgment (Figure 1). At the apex, the Supreme People's Court (the highest court in China) handled 3 cases, the 32 Higher People's Courts (at provincial level) handled 19 cases,[19] various Intermediate People's Courts (at municipal level, inferior to the Higher

[14] Response of the Supreme People's Court to Certain Questions Concerning the Application of the Foreign Economic Contract Law of 1987, effective from 19 October 1987, repealed by the Contract Law Act of 1999.
[15] UNCITRAL, <http://www.uncitral.org/uncitral/zh/uncitral_texts/electronic_commerce.html>
[16] UNCITRAL,
<http://www.uncitral.org/uncitral/zh/uncitral_texts/electronic_commerce/2005Convention_status.html>
[17] China Judgements Online, <https://wenshu.court.gov.cn/>
[18] China Judgements Online, Online Database, <https://wenshu.court.gov.cn/>
[19] In China, regarding the province or province equivalent, including 23 provinces (namely, Hebei, Shanxi, Jilin, Liaoning, Heilongjiang, Shaanxi, Gansu, Qinghai, Shandong, Fujian, Zhejiang, Taiwan, Henan, Hubei, Hunan, Jiangxi Province, Jiangsu Province, Anhui Province, Guangdong Province, Hainan Province, Sichuan Province, Guizhou Province, Yunnan Province), 4 equivalent-to-Province municipalities (Beijing, Shanghai, Tianjin, and Chongqing), and 5 autonomous regions (namely, Inner Mongolia Autonomous Region, Xinjiang Uygur Autonomous Region, Ningxia Hui Autonomous Region, Guangxi Zhuang Autonomous Region, Tibet

People's Court) handled 57 cases, and County/District courts (at county or below levels) handled 19 cases. As shown in Figure 1, the majority of cases relied on the CISG were handled by the Intermediate People's Courts, rather than the County/District courts; neither by the Higher People's Courts. The reason for this phenomenon might be two: first, Articles 17-20 of PRC Civil Procedural Law Act of 2017 provide that the Intermediate People's Courts and the Higher Court act as the trial court if the case has a significant impact in the administrative region where the court is based, and cases involving in 'international' trade and sales of goods usually related to goods worthing a huge amount of value; second, the involvement of foreign-related elements and foreign law, including the CISG, makes the law more complex, and judges serving at these levels of courts are more experienced in this type of cases.

Figure 1: Overview of the existing cases on the CISG

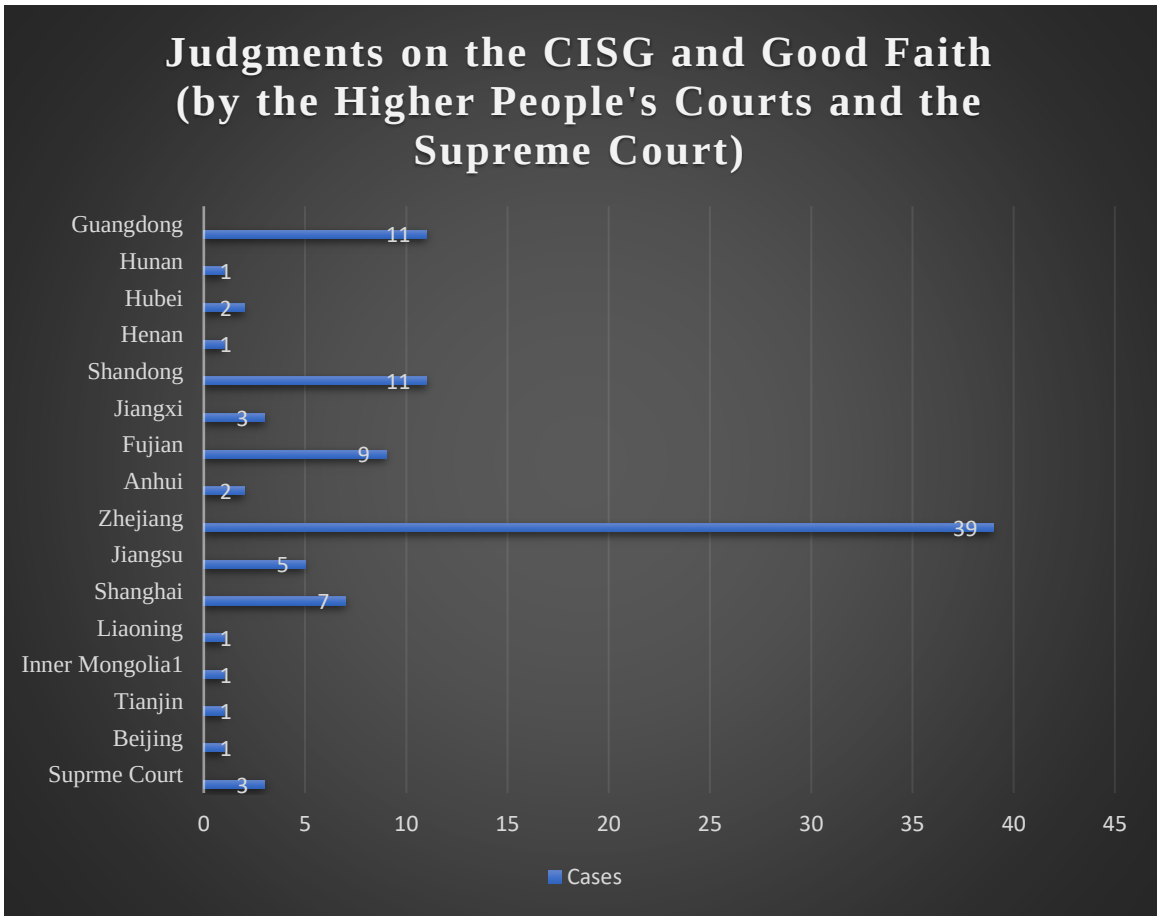


Source of data: Chinese Judgements Online; Figure compiled by the author

[5.20] Travelling through the judgments invoking the CISG and good faith issued by the Supreme Court and by Higher People's Courts, they were further subgrouped through tracing which court issued such judgment (Figure 2). As mentioned, there are 32 Higher People's Courts, one each in a province (or province equivalent). Figure 2 shows the province in which a judgment was issued by the Higher People's Court of that province. As seen, the Supreme Court issued 3 judgments; it is noting that the Zhejiang Provincial Higher People's Court had issued 39 judgments, and the Shangdong Provincial Higher People's Court issued 11 judgments, the Guangdong Provincial Higher People's Court also issued 11 judgments, and the else Higher People's Courts issued a much less number of judgments; the reason for a large number of judgments invoking the CISG in the three provinces – Zhejiang, Shangdong, and Guangdong – is probably because these regions have been playing an active role in China's import and export trade of goods.

Autonomous Region). Apart from all mentioned above 32 province/its equivalent, there are another 2 special administrative regions are also province equivalent: Hong Kong Special Administrative Region, Macao Special Administrative Region; however, because they do not apply Chinese law, so Hong Kong and Macao SARs are not analysed in this paper.

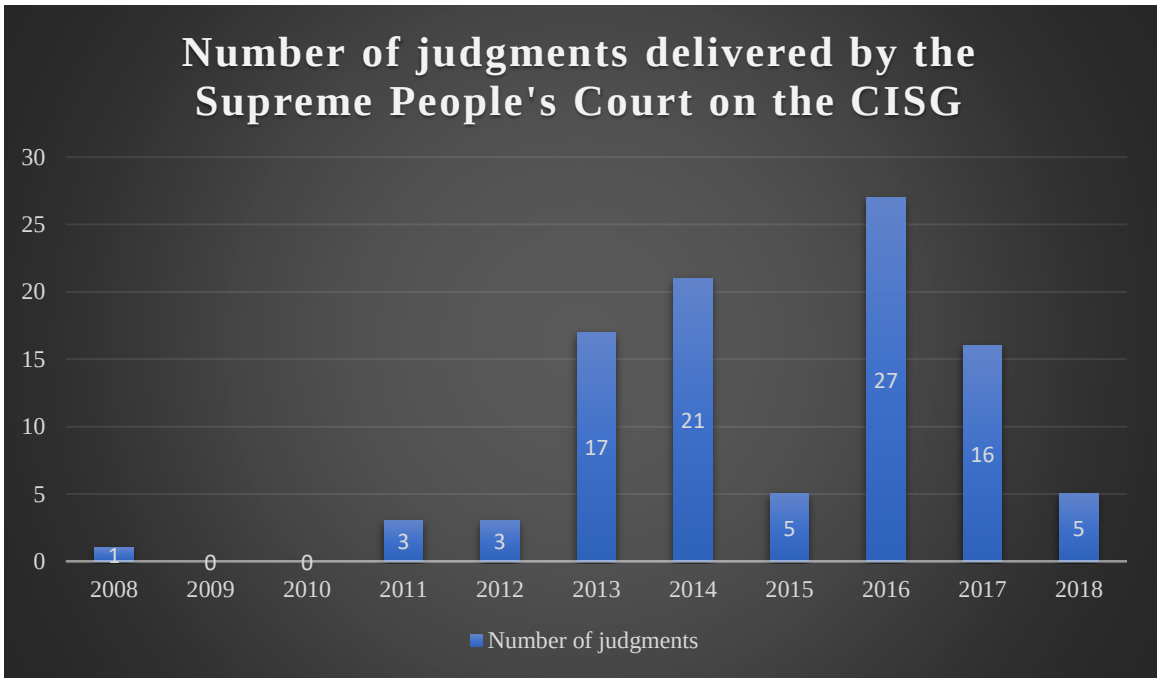
Figure 2: Breakdown of Judgments considering the Geographical Factor



Source of data: Chinese Judgements Online; Figure compiled by the author

[5.21] The decisions on the Judgments Database belonged to the time period 2008 - 2018 (Figure 2). Fewer judgments between 2008-2010 invoking the CISG have been found (Figure 2), the author suggests the reason could be estimates it is because that fewer judgments from that period were populated into the Judgments Database. Further, it could be that in 2009 and 2010, there were no judgments mentioning the CISG could be, according to,the author, that the disputes were resolved at lower court level and therefore did not reach the Supreme People's Court.

Figure 3: Breakdown of Judgments by the year of the decision



Source of data: Chinese Judgements Online; Figure compiled by the author

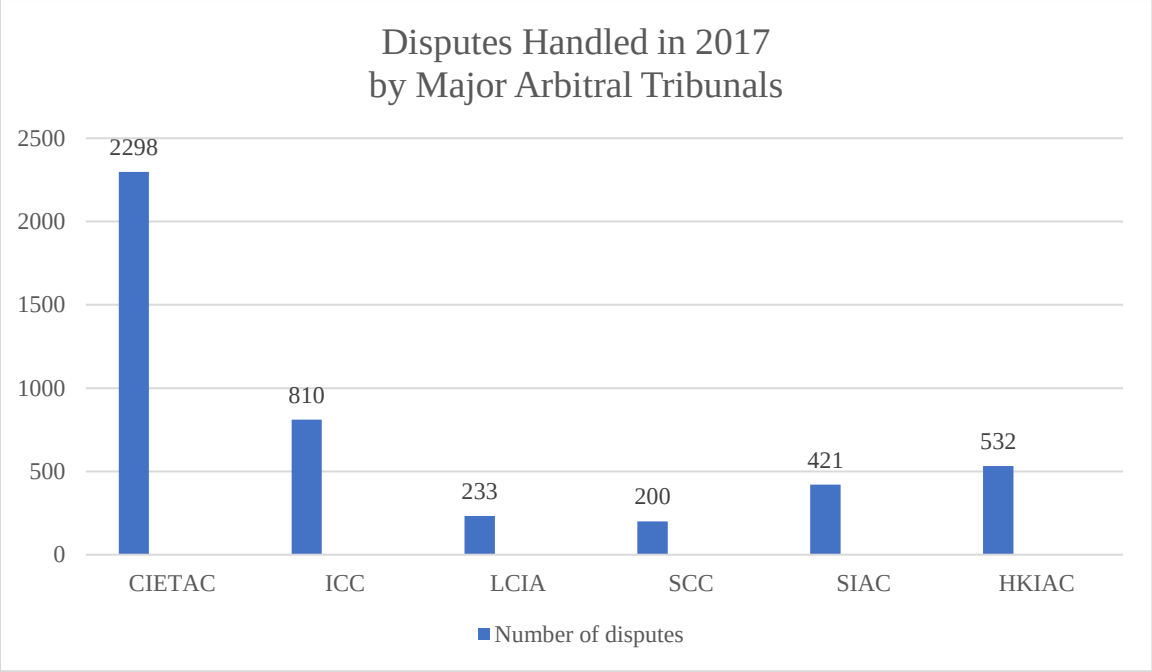
[5.22] Sixty six judgments were issued by trial courts at the first instance, and twenty nine cases reached appeal court levels (direct superior court of the trial court at the first instance); one judgment was issued by retrial and trial supervision proceeding, and another two judgments were issued through other proceedings.

5. Empirical Study of Arbitral Awards invoking the CISG heard by CIETAC

[5.23] The author perceives that the volume of disputes related to international sale of goods contracts dealt through arbitration involving Chinese party(s) is much higher than through litigation in China. Thus, it is of great use to consult the typical arbitral awards published in order to examine the application of the CISG in China.

[5.24] Two reasons have been identified by the author for studying the arbitral awards published by China International Economic and Trade Arbitration Commission (CIETAC), for two reasons. First, CIETAC is an important arbitration services provider with high case docket. According to the "2017 China International Commercial Arbitration Annual Report", CIETAC handled 2298 disputes, outnumbering all other major counterparts.[20] The other reason is that CIETAC's awards are accessible to the public and made available through their online portal.

[20] CIETAC, China International Commercial Arbitration Annual Report of 2017, [17].



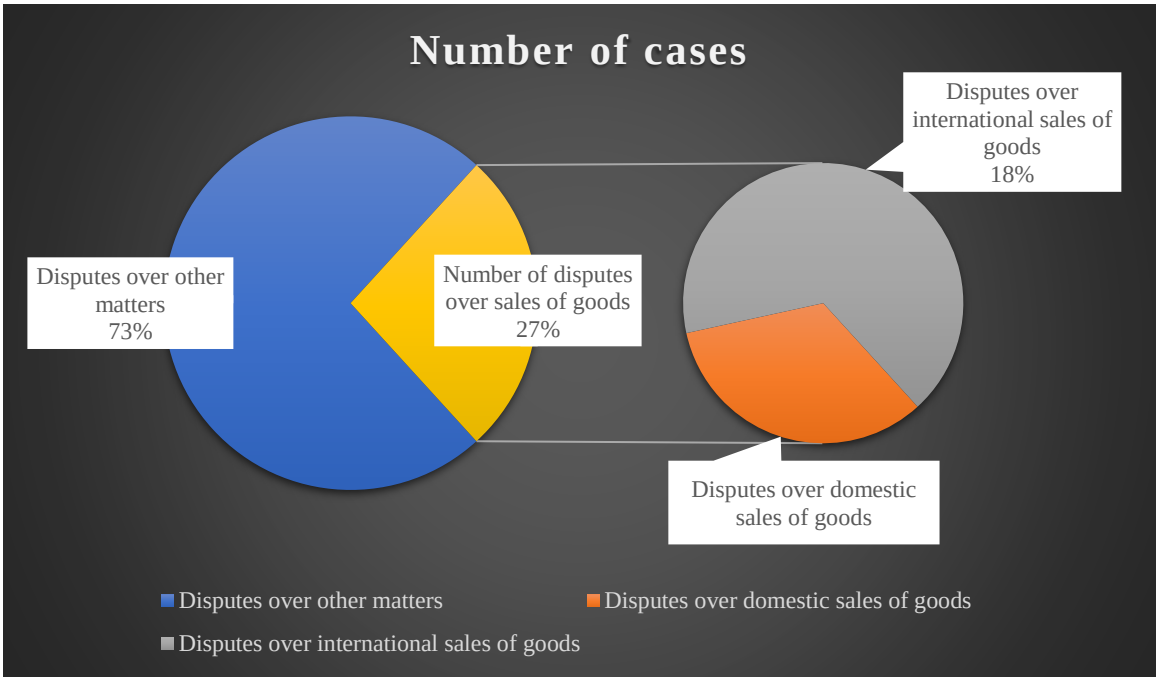
Source: CIETAC, China International Commercial Arbitration Annual Report of 2017
Figure compiled by the current author.

[5.25] CIETAC has compiled four volumes[21] of arbitral awards regarding disputes on the sales of goods and foreign investments. These volumes encompass a great number of arbitral awards issued in the period ranging from 1960 to 2006; 160 cases on the international sales of goods decided after 1988, i.e. when the CISG had come into effect. However, it seems that CIETAC has stopped publishing any volume of books since 2006 and afterwards. Even so, the sample awards after 2007 can be found through CIETAC's official website.[22]

[5.26] Empirical analysis of CIETAC awards issued between 1996-2003 has been previously reported,[23] this research would focus on the CIETAC awards issued after 2007.[24] Owing tto the confidential nature of the proceedings and publication, not all awards have been published online; only 34 awards are available.[25] The empirical analysis in this work examines them. Among the 34 awards, 9 cases related to sales of goods issues, including 3 cases on domestic sales of goods,[26] and the other 7 cases involving international sales and thus the CISG was invoked.

---

[21] CIETAC, The Compilation of Arbitral Awards on China International Economy and Trade (1963-1988), Beijing 1993; CIETAC, The Compilation of Arbitral Awards on China International Economy and Trade (1989-1995), Beijing 1997; CIETAC, The Compilation of Arbitral Awards on China International Economy and Trade (volume on sale of goods 1995-2002), Beijing 2002; CIETAC, The Compilation of Arbitral Awards on China International Economy and Trade (volume on sale of goods 2003-2006), Beijing 2007.
[22] CIETAC, Case Review, <http://www.cietac.org/index.php?m=Article&a=index&id=93>
[23] Wei Li, 'The Interpretation of the CISG in China', in Andrew Janssen and Olaf Meyer (ed), *CISG Methodology*, (2009, Sellier) 343.
[24] CIETAC, Case Review, <http://www.cietac.org/index.php?m=Article&a=index&id=93>
[25] CIETAC, Case Review, <http://www.cietac.org/index.php?m=Article&a=index&id=93>
[26] Sales contract dispute arbitration case decision (27 June 2007),
<http://www.cietac.org/index.php?m=Article&a=show&id=246>.
IBM Software Sales Contract Dispute (14 April 2006)
<http://www.cietac.org/index.php?m=Article&a=show&id=235>.
Calcium chloride sale contract arbitration award (26 September 2006)
<http://www.cietac.org/index.php?m=Article&a=show&id=232>.



Source: CIETAC; Figure compiled by the current author

[5.27] The author studied these seven CIETAC arbitral award - international sale of Electrolytic copper contract dispute and arbitral award (18 August 2006), [27] Jacket Sales Contract Dispute Arbitration Award regarding the statutory time bar of litigation and arbitration (15 December 2006),[28] International Sale of Diethanolamine (DEA) contract (21 September 2008), [29] and three interesting disputes will be discussed shortly.

5.1 CIETAC Cases and Application of the CISG in China

5.1.1 Case on Interpretation of Payment Clause: Wool Purchase Contract Dispute from Australia to China[30]

[5.28] On 5 March 2003, the buyer (Hong Kong-based company/Respondent) signed the three "order confirmation forms" that formed the contracts of sales of wool. The buyer stated that it acted as the agent of the seller (Applicant of this case, from Australia). The contract's payments-related clause states: An irrevocable documentary credit is to be issued by fax one month before shipment. The signature section of the contracts clearly states that A. DF Hong Kong Ltd. acts as the seller's agent, and the contracts were signed by the representative of the agent. The buyer's representative, Chen X, is the "buyer (we have accepted)" Buyer)" also signed. Later, when the seller made the goods ready for shipment, the buyer did not arrange payment. The seller had not resold the goods but sent a letter to the buyer on 12 November 2003, announcing the termination of the contract.

[5.29] There are two issues in this dispute:

1) Applicable law;
2) The validity of the contract

[27] CIETAC, <http://www.cietac.org/index.php?m=Article&a=show&id=233>
[28] CIETAC, <http://www.cietac.org/index.php?m=Article&a=show&id=231>
[29] CIETAC, <http://www.cietac.org/index.php?m=Article&a=show&id=244>. Result: settled by parties.
[30] CIETAC, <http://www.cietac.org/index.php?m=Article&a=show&id=238>, (16 September 2005)

[5.30] Regarding the first issue, the arbitral tribunal found that the applicant is the seller from Australia, the respondent is the buyer from China, and noted that Australia and China are Convention States. Therefore, the tribunal held that, in accordance with the obligations of the CISG under the two countries, in cases where the parties did not rule out the application of the Convention, the Convention should be applicable law in the disputes arising from the contract in this case. In the absence of an agreement on applicable law, it is to be identified according to conflicts of laws rules. In accordance with the principle "the closest connection", the country of the buyer and the seat of arbitration are both China, and thus China bears the closest connection; accordingly, the law of the People's Republic of China shall apply. Although the Tribunal did not explicitly state the authority of law, the current author estimates that the authority of the principle of the 'closest connection' applied here is Article 145.2 of GPCL of 1964.

[5.31] While the contract obligated the buyer to issue a letter of credit within the stipulated time, the buyer had not fulfilled its contractual obligation of payment. The tribunal held that that the buyer failed to comply with the contract terms on payment, and this constituted a fundamental breach of contract. Accordingly, the applicant can claim damages.

[5.32] Therefore, according to Article 76 of the CISG, the applicant's claim for the difference between the price agreed in the contract and the market price at the time of the fundamental breach of contract, namely when failing 'to issue an irrevocable documentary credit by fax one month before shipment' was allowed.

5.1.2 Case on Imported Cattle Contract from the USA to China (dispute dated on 18 January 2006)[31]

[5.33] The breeding company in China (the buyer and the applicant) and the seller in the USA (the respondent) contracted for the sale of breeding cattle at a price of CFR. The parties agreed in a 'veterinary quarantine clause' in accordance with that the PRC government signed with the American government regarding importing cattle from the USA. After the contract is signed, the breeding company arranges the actual delivery and transportation of the cattle and signs an insurance policy for the buyer for the live cattle from the PRC Insurance Company's live poultry policy which has been used from 1 January 1976. The insurance policies cover air transportation from the US airport to Tianjin airport, Tianjin Airport to Beijing isolation field, Beijing isolation field quarantine period, and from Beijing isolation field to the Changji Yushugou Delong breeding base in Xinjiang, as well as all the disability, death and epidemic disease of the cattle.

[5.34] Thereafter, the batch of cattle was transported by air from the USA to Tianjin, China, and arrived at the Beijing quarantine site. After the Beijing Quality Inspection Bureau quarantined the cattle, nineteen cattle were detected 'positive' and issued an animal quarantine certificate. According to the 'PRC Law of on Entry and Exit Animal and Plant Quarantine', the nineteen positive cattle were killed. The Breeding Company transferred all the interests of the insurance as damages to the Applicant and authorised the Applicant to recover or sue the responsible party. Accordingly, the Applicant filed an arbitration accordingly.

[5.35] The first issue is what factor caused the change in the quality of goods. The arbitral tribunal found that the cattle had been quarantined, according to the Agreement between the

[31] CIETAC, Selected Published Award, <http://www.cietac.org/index.php?m=Article&a=show&id=236>

Chinese and the American governments and the contract, before the shipment at the US airport, and both parties approved the quarantine at that time, though the quarantine result was positive after the cattle arrived in Tianjin, China. The Applicant failed to provide evidence to prove the reason causing the change of the quarantine results. Neither did the Respondent. Therefore, the Tribunal rejected the Applicant's arbitral request on the faulted quality.

[5.36] Moreover, the parties disputed about the quality of the goods (nineteen breeding cattle), and seek to rely on the PRC Contract Law Act of 1999 (Articles 62, 125, 140, 149, 153, 154 and 155) providing that contracts with unclear quality requirements shall refer to national standards and industry standards to fulfil.

[5.37] The second issue is over the validity of the contract of sale of goods (live breeding cattle). The Tribunal held that the contract signed in October 2002, and the additional clause signed on 24 February 2003, between the Applicant and the Respondent, on an equal and voluntary basis. The contents of the contract had not violated Chinese laws and regulations, and conform to the general legal requirements – representing the true meaning of both parties – for the contract to take effect. Therefore, the contract is legal and valid. Furthermore, during the performance of the contract, neither party had raised any doubts about the validity of the contract. Therefore, the Tribunal held that the contract can be used as a basis for determining the rights and obligations of both parties.

[5.38] While there has been no disagreement between the contractual parties regarding the process and the results of the pre-transit inspection of the cattle under the contract in this case (conducted in the USA) and those of the post-transit inspections conducted in China, the disputes between the two parties is the changed quarantine results of the nineteen cattle and the responsibility for the resultant loss.

[5.39] The Applicant argued that the only reason for the loss was the Respondent's failure at supplying goods complying the quarantine requirements of the contract at the place of according to the contract, and the Respondent should be liable for the compensation for breach of contract.

[5.40] The Respondent argued against any connection with the risk associated with the shipment. The Respondent subjectively did not, intentionally and negligently, implement any behaviour that led to the accident. Therefore, the Respondent did not have a fault and had no direct causal relationship with the occurrence. The Applicant has not submitted evidence to prove the fault of the Respondent.

[5.41] The Tribunal reviewed the evidence submitted by the parties and noted that they emphatically stated that the pre-transit quarantine and the post-transit quarantine were unqualified, but neither party had arbitrated. The Tribunal opined that the arbitral tribunal could not confirm the reasons for the change between the two quarantine results and the responsibility of the two quarantine results based on the available evidence. Therefore, the Tribunal considered that the above two quarantine results were caused by reasons and responsibilities that could not be attributed to both parties.

5.1.3 Case regarding The Consequence of Performance in International Sales of Goods: International Sales Bicycles and Motorcycles Contract Dispute[32]

[5.42] The Applicant (buyer in China) and the Respondent (Agency of the Seller in the USA) signed three sales contracts for the goods, stipulating that the Applicant would purchase bicycles and motorcycles from the Respondent, and tender the price in two instalments. The applicant paid 30% of the total price of the three contracts. Later, the respondent did not fulfil the delivery obligation under the contract.

[5.43] Because the Respondent acted as an agency of the seller from another country that is a signatory to the CISG, the same applied to the dispute. It needs to be noted here that the Convention did not apply to every aspect of the international sale of goods contract, and thus national law applied to contractual terms, in the instant case, the Contract Law Act of 1999 applied to interpret a disputed contractual clause.

5.1.4 International Sales of Goods (walnuts) (1994)[33]

[5.44] This dispute invoked Article 77 of the CISG

> "a party claiming that the other party has breached the contract must take reasonable measures to mitigate the losses caused by the other party's breach of contract, including loss of profits. If he does not take such measures, the party that violates the contract may request that the amount of damage that could have been mitigated be deducted from the damages."

[5.45] The contract specified that in the case of the apparent breach by the Respondent, the Applicant should take reasonable measures to resell the goods at the current market price to mitigate the whole loss. This obligation originates from good faith principle under the GPCL within Chinese law. Moreover, the difference between the price stipulated in the contract and the current price shall be the reasonable and direct loss of the Applicant. The Respondent shall be responsible for compensating this loss of the Applicant.

6. Differences between the CISG and Chinese Domestic Law

[5.46] The Chinese legislation, namely the Chinese Civil Law Acts of 1964 and of 2017, and Contract Law Act of 1999 are consistent with the CISG to a large extent, though the differences merely occurred in a limited number of circumstances. This Section examines such differences, by examining the CIETAC published awards; two reported disputes have been identified to illustrate the difference between the CISG and the Chinese Contract Law Act of 1999.

6.1 Scenario 1 (extracted from a real case)[34]

[5.47] A buyer from Country A (CISG signatory) sent a purchase order to a seller from China ordering 1000 pairs of shoes. The seller did not respond to the order but delivered 800 pairs of

[32] CIETAC, Guidance Case, Award dated 28 July 2006 <http://www.cietac.org/index.php?m=Article&a=show&id=234>

[33] CIETAC, Guidance Case 6: <http://www.cietac.org/index.php?m=Article&a=show&id=19>

[34] Extract from a real case – Oberlandesgericht Frankfurt am Main, 23 May 1995, available at <http://cisgw3.law.pace.edu/cases/950523g1.html>

shoes to the buyer within a period of delivery fixed in the order. The buyer accepted the goods but refused to pay the purchase price of 800 pairs of shoes.

[5.48] The buyer argued that it had ordered 1000 pairs of shoes instead of the 800 pairs that were delivered.

[5.49] Per Article 14(1) of the CISG, the buyer's purchase order for 1000 pairs of shoes was an 'offer'. The seller's performance of the contract, as in delivery of 800 pairs, amounted to 'an acceptance by performance' according to Article 18(1) of the CISG. The delivery of a different quantity of goods (800 pairs of shoes) materially alters the terms of the offer (see Article 19(3) of the CISG). Thus, the seller's delivery has to be interpreted as a 'rejection' of the offer and thereby constituted a 'counter-offer' under Article 19(1) of the CISG. The buyer's acceptance of the 800 pairs of shoes is an 'acceptance' of the counter-offer. The contract with regard to 800 pairs of shoes was concluded.

[5.50] The application of the Chinese Contract Law to the same facts is problematic though. There is no provision in Chinese Contract Law that is similar to Article 18(1) of the CISG.[35] Article 22 of the Chinese Contract Law Act of 1999 provides:

> "An acceptance should be made in form of notice, in light of trade practices or as indicated by the offer, the offeree may indicate the assent by performing an act."

[5.51] If the specific situation referred to within the last alternative of Article 22 of the Chinese Contract Law Act did not exist, the seller's delivery of 800 pairs of shoes could neither be construed as an 'acceptance' nor as a 'counter-offer' – there is no rule in the Chinese Contract Law like Article 8(1), CISG that governs the interpretation of parties' conducts. Article 125 of the Chinese Contract Law Act is a rule which only regards the interpretation of a contract.

[5.52] Article 36 of the Chinese Contract Law Act states: "Where the parties fail to make a contract in written form as provided for by laws or administrative regulations or as agreed by the parties, but a party has already performed the major obligations and the other party has accepted the performance the contract shall be considered as executed." Hence, the decision depends on whether the seller's delivery of 800 pairs of shoes can be construed as "performed the major obligations".

6.2 Scenario 2 (extracted from a real case)[36]

[5.53] Party A entered into a contract to purchase cotton clothes from Party B, and A and B both belonging to jurisdictions signatory to CISG. The parties admitted that a contract existed but they disagreed on how arbitration is to be treated. A's form provided for arbitration of disputes in New York by the American Arbitration Association. B's form provided for arbitration in Hong Kong. The problem is that the CISG contains no special rules governing standard business terms.

[5.54] The issue of "battle of forms" is – following the predominant opinion – governed by the general rules on formation of the contract in the second part of the CISG.[37] So one can assume that A's form is the offer, and B's form is the purported acceptance. B's arbitration provisions

[35] Wei Li, (n 23).
[36] Extract from a real case – *Leatai Textil Co. v Manning Fabrics*, Inc. 411F, Supp.1404 (S.D.N.Y, 1975).
[37] See generally, Wei Li, (n 23) on the problem of the "battle of forms".

constitute a material modification to A's offer. The parties have already performed the contract. If one were to apply the traditional "last-shot rule"[38] then A would be bound by B's arbitration provision; however, the "last-shot" rule is not undisputed under the CISG.

[5.55] Under the Chinese Contract Law the situation is much different - Article 40 of the Chinese Contract Law Act specified,

> "a standard clause shall become invalid … if the party that provides the standard clause exempts itself from the liability, imposes heavier liability on the other party, or precludes the other party from its main rights."

[5.56] It seems that this rule concerns the validity – pursuant to Article 4 of the CISG – and is outside the scope of the CISG. B's arbitration provision in its form "exempts itself from the liability, imposes heavier liability on the other party, or precludes the other party from its main rights." It becomes invalid.[39] As the parties have performed the major obligations the contract has been concluded by virtue of Article 36 of Chinese Contract Law Act.

[5.57] Note here that not all arbitration clauses in standard contract terms are automatically invalid. Per Articles 39 and 41 of the Chinese Contract Law Act 1999, if the party that provided the standard arbitration clause calls in a reasonable manner the other party's attention to it, or the arbitration clause in the standard contract was written in a non-standard manner, the arbitration clause is valid.

7. The Connectivity between Good Faith and Public Policy under Chinese Law

[5.58] A new judicial interpretation on enforcement is issued by the Supreme Court of China in China; it is called "The People's Court Provisions on Several Issues Concerning Enforcement of Arbitral Awards" (2018), [40] and introduced critical changes to the implementation of arbitral awards. This 2018 judicial interpretation aims to respect party autonomy and promote integrity during arbitration, and reflects the requirements of party autonomy and good faith.

[5.59] Under this judicial interpretation, the court shall examine the case regarding not to execute the arbitral award based on the requests of the application of the executor and the application of third party; the court shall not examine other requests beyond the requests of the executor, unless that the arbitral award may be contrary to the public interest.[41] Moreover, the executor requests not to support the arbitral award or such an arbitral award made according to the settlement agreement or the mediation agreement between the parties, the people's court shall not support the request, unless the arbitral mediation or arbitral award is contrary to the public interest.[42] Although the judicial interpretation refers to the term 'public interest' only without stating 'good faith', CIETAC opined that claims that 'observance of good faith' is part

[38] However, the "last-shot" rule is not undisputed under the CISG, and here are cases where courts apply the so-called "knock-out" rule (see e.g. Bundesgerichtshof, 9 January 2002, CISG-online no. 651).
[39] Wei Li, (n 23)
[40] Supreme Court of China, The People's Court Provisions on Several Issues Concerning Enforcement of Arbitral Awards, 23 February 2018, <http://www.court.gov.cn/zixun-xiangqing-81932.html>
[41] The People's Court Provisions on Several Issues Concerning Enforcement of Arbitral Awards, Article 11.
[42] The People's Court Provisions on Several Issues Concerning Enforcement of Arbitral Awards, Article 17.

of 'public interest'.[43] thus a breach of good faith constitutes the breach of public interest and therefore the arbitral award can be prevented from being implementing on that ground.

8. The Application of the CISG and Impact of Free Trade Zone in China

[5.60] The Supreme Court of China has introduced a 'Guiding Case' system, in which typical cases are published and recommended to be followed by in future judgments. One of the Guiding Cases – Belt and Road Typical Case 12[44] – illustrates the application of the CISG when the disputant parties are located in a free trade zone in China.

8.1 Fact of Belt and Road Typical Case 12

[5.61] On 23 September 2005, Golden Landmark Company and Siemens Company signed a contract for the supply of goods, stipulating that Siemens Company should transport certain equipment to a work site before 15 February 2006. The contract also stated that, if[any dispute occurred, the parties were required to submit it to the Singapore International Arbitration Centre (SIAC) for resolution by arbitration.

[5.62] Later, a dispute arose between the parties. Golden Landmark Company initiated arbitration proceedings at the SIAC, demanding an order rescinding the contract and stopping payment for the goods. Siemens Company raised a counterclaim, demanding payment for all of the goods, for interest, and for compensation for other losses. In November 2011, the SIAC delivered an arbitral award, rejecting Golden Landmark Company's arbitration claim and supporting Siemens Company's arbitration counterclaim.

[5.63] Golden Landmark Company paid a portion of the sum of money, but still owed a total of 5,133,872.30 RMB as an outstanding payment plus interest under the arbitral award. Based on 'the Convention on the Recognition and Enforcement of Foreign Arbitral Awards' (the New York Convention), Siemens Company made a request to the No. 1 Intermediate People's Court of Shanghai Municipality, urging it to recognise and enforce the arbitral award rendered by the SIAC.

[5.65] In the court proceeding, Golden Landmark Company defended its position, arguing the arbitral award should not recognised and enforced, on the grounds that the arbitration clause is invalid: both parties were legal persons of China and the place for the performance of the contract was within China; thus, the civil relationship involved in the case did not have foreign-related elements; therefore, the parties' agreement stipulating that disputes were to be submitted to a foreign arbitration institution for arbitration was invalid. Recognising and enforcing the arbitral award involved in the case would violate China's public policy.

[5.66] After reporting the case level by level within the court system to reach the Supreme People's Court and receiving the highest court's reply, the No. 1 Intermediate People's Court of Shanghai Municipality held that it should rule to recognize and enforce the arbitral award involved in the case, based on the provisions of the New York Convention.

8.2 Issue of the validity of arbitration clause

[43] CIETAC, Chinese Commercial Awards Annual Report, (2017), 158-159.
[44] Supreme Court of China, Belt and Road Typical Case 12, translated by Stanford CGCP Classroom.

[5.67] On the issue of whether the arbitration clause stipulating that the dispute, in this case, would be submitted to a foreign arbitration institution for arbitration was valid, the key was to determine whether the contractual relationship at issue had foreign-related elements. If there were foreign-related elements, the arbitrational clause was valid; otherwise, it was invalid.

[5.68] According to the "Interpretation (I) of the Supreme People's Court on Several Issues Concerning the Application of the 'Law of the People's Republic of China on the Laws Applicable to Foreign-Related Civil Relationships'" and its Article 1.5,[45] the court found that the contractual relationship at issue was a *foreign-related* civil law relationship, due to the following reasons:

[5.69] Firstly, though Siemens Company and Golden Landmark Company are both legal persons of China, their places of registration fell within the area of the Shanghai Pilot Free Trade Zone. They are both wholly foreign-owned enterprises by nature, and have close relationships with their investors from the territory beyond China.

[5.70] Secondly, the characteristics of the performance of the contract, in this case, had foreign-related elements. The equipment involved in the sales of goods case was first transported from outside China's territory to the Shanghai Pilot Free Trade Zone for the authorities to carry out supervision of these bonded goods. Then, in accordance with the needs for the performance of the contract, procedures for customs clearance were handled at appropriate times. Subsequently, it should be noted that the goods were transferred from the Zone to outside the Zone, and only at this point were the procedures for the importation of the goods considered to be complete. Therefore, the course of circulation of the subject-matter of the contract also had certain characteristics of an international sale and purchase of goods.

[5.71] Therefore, the arbitration clause was valid owing to its involved foreign elements, thus the two Chinese legal persons choose a foreign arbitral tribunal did not conflict with China's public policy. Pilot free trade zones are foundational platforms, important nodes, and strategic footholds for China's promotion of the Belt and Road construction. Aligning China's practices with common international practices, supporting the development of pilot free trade zones will help strengthen the international credibility and influence of China's rule of law.

8.3 The Supreme People's Court Opinions on the Provision of Judicial Safeguards for the Construction of Pilot Free Trade Zones, 2017

[5.72] Pilot free trade zones, for instance, Shanghai FTZ and Hainan FTZ, work as arenas increasing the convenience of investment and trade, the ruling of 'Belt and Road Typical Case 12' which has been articulated above gave necessary attention to the determination of whether there were foreign-related elements with respect to a contractual dispute between wholly foreign-owned enterprises within a pilot free trade zone, confirmed that the arbitration clause is valid when both disputant parties are Chinese legal persons but they run business within free trade zones.[46] This guiding case is ground-breaking which allows Chinese enterprises within pilot free trade zones to choose arbitration tribunal outside the territory of China.

[45] Supreme Court of China, Interpretation (I) of the Supreme People's Court on Several Issues Concerning the Application of the Law of the People's Republic of China on Foreign-Related Civil Relations.
[46] See details in the previous section on 'foreign-related elements'.

[5.73] Subsequently, The Supreme People's Court Opinions on the Provision of Judicial Safeguards for the Construction of Pilot Free Trade Zones was issued in January 2017. This new law embraces the approach taken in the typical case 12 and to cover other related provisions. This new law has impacted the application of the CISG in China when the free trade zone is involved that there is a possibility that foreign-related element is involved so as to trigger the application of the CISG instead of purely domestic Chinese laws.

9. Conclusion

[5.74] As a member-Party to the CISG, China, growing up as a civil legal system has laws related to international sales of goods – the GPCL (General Provisions of Civil Law Act) of 1964 and 2017, and Chinese Contract Law Act of 1999. Due to its legal tradition, good faith plays a major role in all the stated legislation and sales of goods. There seems to exist a close connection between 'good faith' and 'public policy' under these relevant laws, and reaffirmed in cases and judicial interpretation called 'The People's Court Provisions on Several Issues Concerning Enforcement of Arbitral Awards' in 2018. Furthermore, the Supreme People's Court of China has introduced the guiding case system which learns from the common law tradition of the doctrine of precedents, though this system does not grant strictly binding effects to the guiding cases. Belt and Road Typical Case 12 is discussed in detail in this research and shows Chinese enterprises within pilot free trade zones can be regarded as 'foreign-related element' which enables that the CISG applies to a contract of sales signed between two 'domestic' enterprises but relating to 'foreign-related element'. The Supreme People's Court Opinions on the Provision of Judicial Safeguards for the Construction of Pilot Free Trade Zones, issued in January 2017, is the governing law relevant to the application of the CISG in China.