

**IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

CNA INTERNATIONAL, INC., an Illinois Corporation, d/b/a MC APPLIANCE CORPORATION,)

Plaintiff,)

v.)

GUANGDONG KELON ELECTRICAL HOLDINGS COMPANY, LIMITED, a Joint Stock Limited Company Incorporated in the People’s Republic of China with Limited Liability, and KELON INTERNATIONAL INCORPORATED, a British Virgin Islands Corporation,)

Defendants.)

Case No. 05-C-5734

District Judge Amy St. Eve

Magistrate Judge Nan Nolan

CNA INTERNATIONAL’S MEMORANDUM ON CHOICE OF LAW

NOW COMES the Plaintiff, CNA INTERNATIONAL, INC., an Illinois corporation, d/b/a MC APPLIANCE CORPORATION, and for its Memorandum on Choice of Law, states as follows:

I. INTRODUCTION

On June 17, 2008 this Court issued a Memorandum Opinion denying Defendants’ Motion for Summary Judgment. At the following status hearing, the Court ordered the parties to brief the Court on the applicable choice of law for this case to the extent that issue was not resolved during the summary judgment process. Plaintiff submits this Memorandum on Choice of Law and asserts that the United Nations Convention on Contracts for the International Sale of Goods (“CISG”), 15 U.S.C.A.App. (West. 1995), should be the law applied in this case. Barring the application of the CISG, Plaintiff asserts that the Uniform Contract Law of the People’s Republic of China (“UCL”) should be the applicable law.

II. ARGUMENT

A federal court sitting in diversity jurisdiction applies the choice of law rules of the forum state to determine the applicable substantive law. Klaxon Co. v. Stentor Elec. Mfg. Co., 313 U.S. 487, 496, 61 S. Ct. 1020, 85 L. Ed. 1477 (1941); Hinc v. Lime-O-Sol Company, 382 F.3d 716, 719 (7th Cir. 2004). Illinois, however, is bound by the Supremacy Clause of the United States Constitution to the treaties of the United States. U.S. Const., Art. VI, § 2, Usinor Industeel v. Leeco Steel Products, Inc., 209 F.Supp.2d 880, 884 (N.D. Ill. 2002). The CISG is a treaty of the United States so under general Illinois law, the CISG pre-empts inconsistent state law to the extent the CISG is determined to be applicable. See id.; see also, Chicago Prime Packers, Inc. v. Northam Food Trading Co., 2003 WL 21254261, *3 (N.D. Ill. May 29, 2003).

If the CISG is deemed to be *inapplicable*, then the Court must engage in a traditional choice-of-law analysis and look to Illinois' own choice-of-law rules. See generally Hinc v. Lime-O-Sol Co., 382 F.3d 716, 719 (7th Cir. 2004). Illinois has adopted the "most significant contacts" test of the Restatement (Second) of Conflicts (1971) in deciding choice-of-law disputes. See id.; see also Morris B. Chapman & Assoc., Ltd. v. Kitzman, 193 Ill.2d 560, 568, 739 N.E.2d 1263, 1269 (2000).

Section 188 of the Restatement (Second) of Conflicts provides the basic "most significant contacts" factors that the court must evaluate in determining which of the conflicting laws to apply. Section 188 states:

§ 188. Law Governing In Absence Of Effective Choice By The Parties

(1) The rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties under the principles stated in § 6.

(2) In the absence of an effective choice of law by the parties (see § 187), the contacts to be taken into account in applying the principles of § 6 to determine the law applicable to an issue include:

- (a) the place of contracting,
- (b) the place of negotiation of the contract,
- (c) the place of performance,
- (d) the location of the subject matter of the contract, and
- (e) the domicile, residence, nationality, place of incorporation and place of business of the parties.

These contacts are to be evaluated according to their relative importance with respect to the particular issue.

(3) If the place of negotiating the contract and the place of performance are in the same state, the local law of this state will usually be applied, except as otherwise provided in §§ 189-199 and 203. Restatement (Second) Conflicts, § 188¹

The first issue to resolve is whether the CISG applies, thereby obviating the need to engage in the “most significant contacts” test put forth under the Restatement (Second) of Conflicts.

A. THE CISG GOVERNS THE CONTRACTUAL DISPUTE AT ISSUE

In 1980 the General Assembly of the United Nations adopted the Convention on Contracts for the International Sale of Goods (“CISG”). See 15 U.S.C.A. App. (West 2005)(hereinafter referred cited as “CISG Art. ___”). The CISG became a treaty of the United States upon ratification by the Senate in 1986. See BP Oil Intern. Ltd. V. Empresa Estatal Petoleos, 332 F.3d 333, 336 (5th Cir. 2003). The CISG is applicable to contracts for the sale of goods between parties whose places of business are in different signatory nations or “Contracting States.” See CISG Art. 1(1)(a). Although the CISG also purports to be applicable “when the rules of private international law lead to the application of a Contracting State,” see CISG Art. 1(1)(b), both the People’s Republic of China and the United States made an Article 95 reservation indicating that it would not be bound by Article 1(1)(b), see CISG n.14. In light of this reservation, federal courts have concluded that “the *only* circumstance in which the CISG could apply [where a country has made an Article 95 reservation] is if all the parties to the contract were from Contracting States.” Prime Start Ltd. v. Maher Forest Products, Ltd., 442 F.

¹ A copy of Section 188 of the Restatement (Second) of Conflicts is attached as Exhibit A.

Supp.2d 1113, 1119 (W.D. Wash. 2006) quoting Impuls I.D. Internacional, L.S. v. Psion-Teklogix, Inc., 234 F. Supp.2d 1267, 1272 (S.D. Fla. 2002).

In the case before the Court, whether the CISG applies, depends on whether or not all parties to the contract are from Contracting States. There is no dispute that Plaintiff has its place of business in the United States and Defendant, Guangdong Kelon Electrical Holdings Company, Limited (“Guangdong Kelon”) has its place of business within the People’s Republic of China. The Court acknowledged the dispute over the place of business for Defendant Kelon International, Inc. (“Kelon International”) in its Memorandum Opinion and determined that, for purposes of a CISG analysis, that Kelon International’s place of business was in Hong Kong. See June 17, 2008 Mem. Op. p. 4.

The status of Hong Kong, a Special Administrative Region of the People’s Republic of China, remains unclear. See June 17, 2008 Mem. Op. p. 4; see also Ulrich Scroeter, The Status of Hong Kong and Macao Under the United Nations Convention on Contracts for the International Sale of Goods, Pace Int’l L. Rev. Vo. 16:307 (Fall 2004).² Plaintiff argues that the CISG applies for two reasons: 1) because the only parties to the contracts at issue in this case were plaintiff and Guangdong Kelon Electrical Holdings Co. Ltd. making Hong Kong’s status as a Contracting State irrelevant; and 2) even if the Court were to determine that Kelon International, Inc. were a party to the contract, the better reasoned approach in determining Hong Kong’s status under the CISG is to hold that based upon all the relevant circumstances, Hong Kong is a Contracting Party to the CISG.

1. The CISG Should Apply Because The Two Parties To The Contracts At Issue In This Case Were From Contracting States.

Plaintiff’s contention is that the contracts at issue were between Plaintiff and Defendant, Guangdong Kelon Electrical Holdings Co. Ltd. While Guangdong Kelon Electrical Holdings Co. may have decided on its own to utilize the services of its related company Kelon International Inc. to handle invoicing and payment with respect to the transactions at issue, the

² A copy of this article is attached hereto as Exhibit B.

contracts themselves were negotiated and agreed to among and between Plaintiff and Guangdong Kelon.

Plaintiff only named Guangdong Kelon Electrical Holdings Co. as a defendant in each of the breach of contract counts. (See First Am. Compl. Cts. I, III, and V). Kelon International is only named in alternative quasi-contractual counts under a theory of unjust enrichment. See First Am. Compl. Cts. II, IV, and VI. Defendants themselves concede as much in their pleadings because in their related complaint (that was consolidated with this case), it is Guangdong Kelon Electircal Holdings Company, Ltd. and not Kelon International Inc. that is attempting to collect payment based on an alleged breach of the very same or substantially similar contracts that are at issue in Plaintiff's claim. See Guangdong Kelon's Complaint that was consolidated in to this Case.

This Court has determined that there is a genuine issue of material fact precluding summary judgment in this case and one of the disputed facts cited by the Court was whether or not Kelon International, Inc. was a party to the contract at issue. See June 17, 2008 Mem. Op. p. 5. If at trial, the fact finder determines that the contract was between only Plaintiff and Guangdong Kelon, then the CISG is applicable because the parties to the contract were both from Contracting States. Since Kelon International would not be a contracting party under these circumstances, it would be irrelevant to the choice-of-law determination whether or not Hong Kong was considered a Contracting State under the CISG.

2. Even If Kelon International Were Considered A Contracting Party, The Better Reasoned Approach Would Be To Hold Hong Kong As A Contracting Party To The CISG

Even if the finder of fact ultimately determined that Kelon International, Inc. were a party to the contract, the better reasoned approach to deciding the choice-of-law issue would be to identify Hong Kong as a part of Contracting State under the CISG. As the Court pointed out in its decision on summary judgment, the status of Hong Kong as a Contracting Party is far from clear. See June 17, 2008 Mem. Op. p. 4.

The People's Republic of China ratified the CISG in 1986 and the Convention went into force on January 1, 1988. See United Nations Commission on International Trade Law website³; see also Schroeter supra at 312. On June 30, 1997, the United Kingdom transferred sovereignty over Hong Kong to China. See id. at 313. Thereafter, beginning on July 1, 1997, Hong Kong became a Special Administrative Region of the People's Republic of China. See id. at 314. According to Hong Kong's Basic Law, the Hong Kong Special Administrative Region is characterized as "an inalienable part of the People's Republic of China." See Chapter I, Art. 1, The Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China.⁴

a. Hong Kong Is Within The Territorial Limits Of China – A Contracting Party To The CISG

The CISG instructs that it applies to contracts of sale of goods between parties whose places of business are in different States when the States are Contracting States. CISG Art. 1(1)(a). As stated above, the People's Republic of China, of which the Hong Kong Special Administrative Region is an "inalienable part" is a Contracting State. On this basis, Hong Kong should be considered as part of China as a Contracting State.

b. Upon Resumption Of Sovereignty Over Hong Kong, China Did Not File An Article 93 Declaration And The CISG Is Therefore Automatically Applicable To Hong Kong

Dr. Schroeter in the article referenced by the Court in its Memorandum Opinion, further explored other means of determining whether Hong Kong should be considered a part of China as a Contracting Party under the CISG. Dr. Schroeter looked to the text of the CISG itself to determine whether China had complied with those provisions that allow a Contracting Party to except territorial units within that Contractual State from applicability under the CISG. Schroeter supra at 320-325.

³ Available at: <http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html>

⁴ An excerpt is attached hereto as Exhibit C and is also available at <http://www.info.gov.hk/basic_law/fulltext>

Article 93, provides that if a Contracting State has two or more territorial units that have separate systems of law dealing with matters governed by the CISG, that Contracting State may declare that the CISG applies to all territorial units or to only one or more of those units – and may amend that declaration at any time. CISG Art. 93(1). If a Contracting State does not make a declaration under Article 93(1), the CISG expressly applies to all territorial units of the State. CISG Art. 93(4).

When China resumed control over Hong Kong, it did not file an amended declaration under Article 93(1) of the CISG and, therefore, pursuant to the CISG's own text, the CISG is applicable to all territorial units of the People's Republic of China, including Hong Kong. See Schroeter supra at 324.

c. The One French Decision Addressing The Issue Made An Incorrect Inference In Determining That China Did Not Intend The CISG To Apply To Hong Kong

One case has been decided by the Supreme Court of the Republic of France addressing Hong Kong's status under the CISG. See Cour de Cassation, 1st Civil Chamber, No. 04-17726 (April 2, 2008)⁵ (hereinafter "French Decision"). In the French Decision, the buyer was from France and the seller was from Hong Kong. See id. A dispute arose over the applicable law governing the transaction. See id. The court ruled that the CISG did not apply. See id. In reaching this conclusion, the Court acknowledged the provisions of Article 93 of the Convention, but stated that because China had previously filed a declaration with the Secretary General of the United Nations, a list of the conventions to which China was a party that would apply to Hong Kong but the CISG was not on that list. See id. The court concluded that this was sufficiently tantamount to an Article 93 declaration and the CISG was not, therefore applicable to Hong Kong. See id.

Although it is unclear from the text of the translation of the French Decision what specific list of conventions was deposited with the Secretary General of the United Nations, the

⁵ Attached as Exhibit D and also available at <<http://cisgw3.law.pace.edu/cases/080402f1.html>>.

one referenced by commentators such as Dr. Schroeter is a Letter of Notification dated June 20, 1997. See Schroeter supra at 315. Yet this Letter of Notification expressly provides that “[f]or the avoidance of doubt, no separate formalities will need to be carried out by the Government of the People’s Republic of China with respect to treaties which fall within the category of foreign affairs or defence or which, owing to their nature and provisions, must apply to the entire territory of a State.” See Schroeter supra at 316 quoting June 20, 1997 Letter of Notification of treaties applicable to Hong Kong after July 1, 1997. This was China’s expressed intention to honor, without special formality, any treaty obligations that must apply to all territories of a State. See Schroeter supra at 325. Since Article 93(4) makes the CISG applicable to the entire territory of a State in the absence of a specific declaration under Article 93(1), the absence of the CISG from the list of the treaties in the Letter of Notification did *not* give rise to an inference that China intended to exclude Hong Kong from the applicability of the CISG. See Schroeter supra at 325. Therefore, the French Supreme Court in rendering the French Decision, was incorrect when it made this inference and concluded that China intended to exclude Hong Kong from the CISG.

d. China’s Own International Economic & Trade Arbitration Commission Considered Territories Belonging To A Contracting State As Subject To The CISG

No United States decisions were uncovered on the specific issue of the CISG’s applicability to Hong Kong. There have, however, been some decisions where China’s International Economic & Trade Arbitration Commission applied the CISG to Hong Kong parties – though the reasoning for the application of the CISG was not always clear. For instance, in a decision issued by the China International Economic & Trade Arbitration Commission, the “Cold Rolled Steel Plates Case” dated July 30, 1998, the Chinese arbitration commission rendered a decision on a contract dispute between a Chinese buyer and a Hong Kong Seller and applied Article 50 of the CISG in making its decision. See Cold Rolled Steel Plates Case (July 30, 1998).⁶ The same Chinese trade arbitration commission also treated Macao

⁶ Translation attached as Exhibit E. Also available at <<http://cisgw3.law.pace.edu/cases/980730c1.html>>

(now a Special Administrative Region of the People's Republic of China just like Hong Kong) as a territory of Portugal and ruled that the CISG applied because it believed (though incorrectly) that Portugal was a Contracting State and Macao was part of Portugal. See e.g. Wool Case (February 27, 1996)⁷; Natural Rubber Case (September 4, 1996).⁸ Thus even the judicial bodies within the People's Republic of China viewed the CISG applicable to territories when those territories were under the control of countries that they believed were Contracting States to the CISG. The People's Republic of China and Hong Kong should not now be permitted to declare that same principal inapplicable simply because the territories now belong to China.

e. Policy Considerations Underlying the CISG Favor Application of the CISG to Hong Kong

There are also a host of policy reasons for concluding that Hong Kong is subject to the CISG. In the Preamble to the CISG, the Convention declares that drafters sought to establish a New International Economic Order. CISG, Preamble. In so doing, the drafters further sought to develop international trade on the basis of equality and mutual benefit as promoting friendly relations among States. Id. The drafters sought the adoption of the convention as the way to implement a uniform set of rules taking into account the differences among social, economic, and legal systems around the world in an effort to remove legal barriers in international trade. Id. The CISG was intended to achieve predictability in international trade. See Schroeter supra at 311. Article 7 further provides that in the interpretation of the CISG, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade. CISG, Art. 7(1). To the extent questions concerning matters governed by the Convention are not expressly settled, those questions are to be resolved in conformity with the general principles on which the convention is based. CISG, Art. 7(2).

⁷ Translation attached as Exhibit F. Also available at <<http://cisgw3.law.pace.edu/cases/960227c1.html>>

⁸ Translation attached as Exhibit G. Also available at <<http://cisgw3.law.pace.edu/cases/96904c1.html>>

The CISG's acceptance as a uniform and predictable law governing international sales transactions continually grows. It is believed that at least two-thirds of all international sales of goods are subject to the CISG. See Schroeter supra at 309. Importantly, Hong Kong is a leading entity in international trade and will figure prominently in the future of international commerce. In fact, as of 2001, Hong Kong's total merchandise trade amounted to \$409 *billion* making it the world's 10th largest trading entity. See Schroeter supra at 309. As stated above, the CISG has as one of its goals, uniformity in application and predictability. Such a policy can only be furthered if territories that have major stakes in world commerce are brought within the sphere of the CISG so that critical ambiguities such as the applicable law governing a transaction (in the absence of an agreement on choice of law) are no longer left to chance. This is particularly the case where the country to which a territory belongs has a method for unambiguously declaring that the CISG should not apply to the territory – Article 93 – yet refuses to take the appropriate action.

The language of the CISG in the context of Hong Kong transfer to the People's Republic of China, together with the public policy justifications for bringing Hong Kong within the CISG strongly favor the application of the CISG to businesses located in Hong Kong, a lone French court decision notwithstanding.

B. IF THE CISG IS DETERMINED INAPPLICABLE THEN UNDER THE “MOST SIGNIFICANT CONTACTS” TEST, LAW WOULD APPLY

As stated above, in the event the CISG is determined inapplicable, the Court would need to employ the traditional choice-of-law rules applicable to the forum, Illinois, state. Illinois follows the “most significant contacts” test from the Restatement (Second) of Conflicts. Under this test, set out in section 188 of the Restatement, the court should look at factors such as i) the place of contracting; ii) the place of negotiation of the contract; iii) the place of performance; iv) the location of the subject matter of the contract; and v) the domicil, residence, nationality, place of incorporation and place of business of the parties. See Rest. (Second) Conflicts, § 188; See Hinc, 382 F.3d. at 719.

In this case, aside from the CISG, there are only two realistic alternative choices of law to apply – the Illinois Commercial Code (“ICC”) or the Uniform Contract Law of the People’s Republic of China (“UCL”).⁹ While some provisions of ICC are similar to provisions of China’s UCL, there are certainly differences. For example, the UCL does not utilize the nomenclature of “rejection,” “acceptance,” and “revocation of acceptance” – three issues asserted by the Defendants as important in this case in their summary judgment memorandum. (See Defs.’ Br. In Support of MSJ, pp. 5-9). Instead, the UCL speaks to notification of “quality or quantity non-compliance” terms more aligned with the CISG. See Uniform Contract Law, Arts. 157 and 158. Therefore a true conflict exists between the two bodies of law.

In evaluating the factors under the “most significant contacts” test, it appears that the appropriate choice of law in this case would be the application of China’s Uniform Contract Law.

1. Place of Contracting

The place of contracting is the place where the last event necessary to render a contract valid took place. See Hinc, 382 F.3d at 719. In this case, Plaintiff would issue purchase orders to Defendant that were accepted by Defendants in China and acknowledged via email and shipping updates. See Aff. Heesoo Han, ¶¶ 20 and 21 – previously filed in opposition to summary judgment.

2. Place of Negotiations

Where negotiations do not take place in person, but conduct negotiations via email or telephone, the place of negotiation factor is accorded less significance. See Usinor Industeel v. Leeco Steel Products, Inc. 209 F. Supp. 2d 880, 886 (N.D. Ill. 2002). In this case, employees of Plaintiff visited China to inspect the Guangdong Kelon manufacturing plant in advance of reaching agreement. See Dep. Of Mr. Oh, p. 19, attached as Exhibit 4 to the previously filed Defendant’s Rule 56.1 Statement of Facts. Other discussions were by telephone or email. See

⁹ An excerpt of a translation of relevant provisions of the Uniform Contract Law of the People’s Republic of China is attached as Exhibit H.

id. 18; see Han Aff. ¶¶ 13-14. Therefore, while negotiations took place via phone and email in both countries, the pre-contract in person visits took place in China. Therefore this factor again favors application of the Uniform Contract Law.

3. Place of Performance

The parties agree that Guangdong Kelon manufactured the refrigerators in China and shipped the refrigerators from China. See Pltf.'s Response to Deft.'s Rule 56.1 Statement of Facts, ¶ 5. The alleged defect occurred as a result of improper welding that took place in the manufacture process in China. See Pltf.'s Response to Deft.'s Rule 56.1 Statement of Facts, ¶¶ 84-86. The products were distributed throughout the United States. Pltf.'s Response to Deft.'s Rule 56.1 Statement of Facts, ¶ 70. Payment was usually made by letter of credit from the Korea Exchange Bank in Korea, Pltf.'s Response to Deft.'s Rule 56.1 Statement of Facts, ¶ 67, and wired to HSBC in Hong Kong, see id. and SOF Ex. 5. No one country's contacts stand out with respect to performance, though the fact that the goods were manufactured in China and the breach occurred there, suggests a slight bias again favoring application of the Uniform Contract Law.

4. Location of the Subject Matter

This factor favors the United States generally as the refrigerators were again distributed throughout the United States. It has not been determined, however, how many of those units were sold into the State of Illinois.

5. Domicil[e], Residen[ce], Place of Incorporation, and Place of Business of the Parties

This factor does not appear to favor any one party. Plaintiff is an Illinois corporation with its place of business in Illinois (and is therefore domiciled in and a resident of Illinois). The Court has previously determined that Kelon International while organized under the laws of the British Virgin Islands, has its place of business in Hong Kong. Guangdong Kelon is a company organized under the laws of the People's Republic of China and maintains its place of business

within China as well. No one factor stands out as supporting the application of one country's law over that of another.

In balancing all of these factors, the place of contract, the place of negotiation, and the place of performance all favor application of the Uniform Contract Law from the People's Republic of China. The location of subject matter factor favors Illinois, and the last factor has no impact on the analysis. Under all of the circumstances, to the extent the CISG is deemed inapplicable, the Uniform Contract Law of the People's Republic of China is the substantive law that should be applied under the Illinois choice-of-law analysis.

III. CONCLUSION

The CISG is the law that should be applied to this dispute. The two parties to the contract, CNA International and Guangdong Kelon are both from Contracting States and so the CISG should apply pursuant to Article 1(1)(a). If the court determines that Kelon International is a party to the contracts at issue here, the CISG should still be applied because China never executed a reservation under Article 93 declaring Hong Kong exempt from the CISG when China resumed control over Hong Kong as a Special Administrative Province. To the extent the Court determines that the CISG is inapplicable, then utilizing the traditional choice-of-law analysis under Illinois choice-of-law rules, the Uniform Contract Law of the People's Republic of China should govern this disputed because China has the "most significant contacts" to the dispute.

Respectfully submitted,

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