JUDGMENT : Mr Justice Field: Commercial Court. 14th September 2007

Introduction

1. This is an appeal by leave of Simon J from a partial final award dated 1st December 2006 made by a tribunal consisting of three arbitrators.

2. There are two issues. The first is whether the tribunal erred in law in deciding that two f.o.b. contracts for the sale of 27,000 metric tonnes of cement (plus/minus 10%) destined for Mexico from (respectively) Indonesia and Taiwan were frustrated by the intervention of Cemex, a company with a monopoly in the supply of cement in Mexico, with the result that no supplier of cement in Asia would provide the supply on which the fulfilment of the two contracts depended. The second issue is whether the tribunal erred in holding in the alternative that the contracts were subject to an implied term that if suppliers refused to supply cement because of the buyers' intended use of or dealings with it or because of its intended destination, both parties would be discharged from any liability or obligation under the contracts.

The factual background

3. The sellers under the two contracts were Transclear SA, a company incorporated in Switzerland which specialises in the worldwide marketing of cement. The buyers were CTI Group Inc, a company specialising in cement trading worldwide. The intermediate brokers were a Spanish company, Tradeland Commodities ("Tradeland").

4. In early 2004, the buyers embarked on a strategy designed to break the cartel operated in the Mexican cement market by Cemex. The plan was to acquire a large quantity of cement and ship it in a vessel that could be used as a floating silo that would be moored off the Mexico coast and from which cement could be supplied into the Mexican market. The cement was to be bagged onboard the vessel and then shipped to the mainland.

5. The vessel, the "*Mary Nour",* was owned by a company in the CTI group. In early 2004 she was completing a routine dry-docking in Guangzhou, China. She left the shipyard on 7th May 2004, the day on which the sellers and the buyers concluded the first of the f.o.b. contracts in question. The cement was to be shipped in one lot by the buyers, "*laycan Padang 15/18 May … price USD 28 pmt FOB Stowed/trimmed Padang, Sumatra, Indonesia.*"

6. Both parties knew that Cemex might try to disrupt the buyers' strategy and with this in mind agreed that the certificate of origin and the Sucofindo inspection certificate would state no destination and all the other documents would show the destination of the cargo to be Honduras, the Master being instructed to declare and sign accordingly.

7. The sellers' suppliers were PT Semen Padang ("PTS") who were to deliver the cement in accordance with the delivery terms of the contract between the sellers and the buyers. PTS had proved to be reliable suppliers of cement in the past.

8. The tribunal found that although the suppliers and the sellers (the latter acting by their Managing Director, Mr Paulovits) had an oral agreement as to quality, quantity, price, and the laycan for a spot cargo, *"it was unlikely …. that Mr Paulovits would have been able to prove that a legally binding contract under English law had been concluded with PT Semen Padang. On the other hand….arrangements had been made for the supply of the necessary parcel of cargo, which would have been effective but for [the intervention of Cemex]".*

9. On 13th May 2004, the sellers were informed that PTS would not provide the cargo. PTS's parent company was 25% owned by Cemex and would not allow the transaction to proceed. On 15th May 2004, having failed to find a substitute Indonesian supplier, the sellers informed the buyers that no cargo could be provided in Indonesia and gave the reasons why.

10. On 17th May 2004 the parties entered into the second f.o.b. contract on similar terms to the first, including the declared destination, save that the price was to be US$ 32.00 pmt and shipment was to be from a port in Taiwan during a different loading window. The second contract was in substitution for the first but was concluded without prejudice to the buyers' rights with respect to the sellers's failure to provide a cargo in Indonesia.

11. The sellers's intended suppliers for the second contract were China Rebar Ltd. However, on 19th May 2004, the sellers were informed by the local broker that China Rebar Ltd had been put under pressure by another Taiwanese company which had a major contract with Cemex for the supply of cement into the USA and as a consequence China Rebar Ltd would not be supplying the cargo. The agreement between China Rebar Ltd and the sellers was an informal arrangement of the same sort as that concluded with PTS.

12. The sellers had no other sources of cement in the Far East. None of the majors would supply cement destined for Mexico which they regarded as the province of Cemex and the sellers were sure that no other small factory was willing or able to provide the cargo. Accordingly, on 19th May 2004, the sellers gave the buyers formal notice that no cargo could be provided in Taiwan.

13. On 21st May 2004 the buyers concluded a further substitute contract, this time with Russian sellers and at a higher price. Delivery was made under this contract but the Mary Nour had to proceed to the Black Sea via the Suez Canal to receive the cargo and then on to Mexico instead of proceeding straight from Asia to Mexico via the Cape of Good Hope. By the time the vessel arrived off Mexico, Cemex was fully alive to the situation and prevented any of the cargo from being unloaded. The buyers kept the Mary Nour off Mexico for a year but then gave up their attempt to break the Cemex cartel and shipped the cement to Doha and Qatar where it was sold.

14. In the subsequent arbitration, the buyers claimed that the sellers were in breach of the first, alternatively the second contract, and sought as damages: (i) the difference in the contract sale price and the actual price paid: (ii) the additional expenses incurred in getting the cargo to Mexico compared with what it would have cost if delivery had been made under one of the two contracts; and (iii) the cost of bags which had become unusable because of the printing on them which stated that the contents originated from Indonesia.

15. The buyers' defences to the claim were that the contracts had become frustrated because performance had become commercially impossible and in any event the contracts contained an implied term discharging the parties in the events that had happened.

16. It was common ground that the contracts were governed by English law.

The tribunal's reasoning and findings on the frustration issue

17. The tribunal found (para.22) that by 19th May 2004 "*it had become impossible for the parties' contract to be performed in accordance with its terms, particularly those relating to the geographical source and loading of the vessel, in that there was simply no way in which cargo of the contractual description could be provided FOB for the "Mary Nour", whether in Indonesia or Taiwan.*"

18. In reaching the conclusion that the contracts were frustrated the tribunal applied Lord Radcliffe's well-known definition of frustration: "*…frustration occurs whenever the law recognises that without default of either party a contractual obligation has become incapable of performance because the circumstances in which performance is called for would render it a thing radically different from that which was promised by the contract.* [1]

19. The tribunal observed that the f.o.b. sale had the "highly unusual feature" of being inextricably linked to the "*project*" to break the Cemex cartel in Mexico by setting up an alternative source of supply moored off the Mexico coast and stated: "Again, it seems to us inconceivable that the parties should not implicitly have agreed that the contract should be terminated if provision of a cargo for this purpose turned out to be impossible, as was the case. (Para 38)

20. The tribunal went on to conclude that performance of the substance of the contract, which they defined as being the provision of a cargo of bulk cement to be shipped from Asia to Mexico on *The Mary Nour*, had become commercially impossible by 17th May 2004 as a result of commercial pressure placed by Cemex on potential suppliers and the only alternative performance (shipment from the Mediterranean or the Black Sea) was fundamentally different from that contemplated by the parties (para. 39).

21. They distinguished ***Atisa SA v Aztec AG*** [1983] 2 Lloyds Rep 579, ***In re Thornett & Fehr and Yuills*** [1921] 1 KB 219 and ***Intertradex SA v Lesieur Tourteraux SARL*** [1978] 2 Lloyds Rep 509 and held that there was no general principle that a contract of sale can never be frustrated where performance is rendered impossible by the failure of a supplier to supply the contractual material. In the tribunal's view, in each case the first step was to determine whether on a true construction of the contract it can be concluded that the seller had agreed to assume the risk of non-performance resulting from a failure by a third party supplier to supply the contract material (para 44).

22. The tribunal were of the view that although the parties contemplated that Cemex might interfere with the cartel-breaking project if they learned of it, this did not mean that the sellers took the risk of what had happened. *"In the present case we were not persuaded that the parties had foreseen – or must be taken to have foreseen – that any action which Cemex might take to interfere with the supply of the cargo would make it impossible to perform the contract on terms which bore any real commercial resemblance to those agreed between the parties. To hold the parties bound to their contract in these altogether different commercial circumstances would, in our view, be positively unjust and would therefore meet the test laid down by Lord Denning in* ***The Eugenia***." (Para 51)

23. Thus, in the "*altogether exceptional circumstances of this case*" they were persuaded that the sellers were entitled to rely upon the doctrine of frustration.

The distinguished authorities

24. In ***Atisa SA v Aztec AG***, the sellers sold to the buyers 13,000 –14,000 tonnes of Kenyan white crystal sugar f.o.b. stowed Mombasa. The contract was subject to the rules of the Refined Sugar Association which provided that the sellers were responsible for obtaining an export licence and that failure to obtain such a licence was not to be a ground of *force majeure*. It was the sellers' intention to fulfil the contract by delivering sugar purchased under a nearly matching contract with the Kenyan Government which was the only source of supply. However, the Kenyan Government failed to honour this contract claiming it was not binding for lack of authority and the buyers instituted arbitration proceedings for non-delivery. On appeal to the High Court, Parker J upheld the arbitrators' award that the contract had not been frustrated. He said: *"There was, here, no change in the law and nothing of the nature of a failure or destruction of the subject matter. At all times an export licence was required and the risk of being unable to obtain one was upon the sellers. No doubt they would certainly have been provided with one by the government had it decided to proceed with K G Ex 10. No doubt also the government would not have provided one having decided not to proceed but that circumstance does not affect the matter. In essence no more has happened than that (1) the sellers' supplier which was the sole supplier did not wish to supply partly for financial reasons and partly to preserve the build up of stocks and (2) that, having been advised that the contract was not binding, the supplier refused to perform. If the Attorney-General's advice was correct the sellers failed to make a proper supply contract. If it was incorrect then they will have an action on upon the supply contract.*

[1] ***Davis Contractors Limited v Fareham Urban District Council*** [1956] AC 696 at 729.

25. The tribunal distinguished this case on the ground that the refusal of the sellers to supply had nothing to do with the buyer's use of the intended cargo; rather, the immediate reason for the failure to supply was the seller's inability to obtain an export licence and under the contract this was not to be a *force majeure* event.

26. ***In re Thornett & Fehr and Yuills Ltd*** concerned a contract to sell a quantity of two brands of beef tallow, 1919 make. The manufacturers of the stipulated brands chose not to manufacture any tallow at one of their works and at the other they were prevented from manufacturing the required quantity by a strike. No delivery was made under the contract and the buyers were awarded damages in arbitration proceedings. On appeal to the High Court (Lord Reading CJ and Darling and Acton JJ) the umpire's finding that the contract had not been frustrated was upheld on the ground that the contract was not for specific goods but for unascertained goods; accordingly no term could be implied into the contract that the sellers undertook no liability if the manufacturer did not in fact manufacture the goods whatever the reason might be for that failure.

27. The tribunal held that in *Thornett & Fehr* it was significant that: (i) there was a *force majeure* clause; (ii) the decision was made when the prevailing view was that the doctrine of frustration did not apply to contracts for unascertained goods; and (iii) the failure to perform was due to a strike which was an obvious incident of commercial life, the risk of which one might expect any seller to have to bear.

28. In *Intertradex SA v Lesieur Tourteaux SARL* the contract was for the sale of a quantity of Mali groundnut expellers c.i.f. Rouen. The sellers intended to perform the contracts by appropriating a quantity of Mali groundnut expellers under a contract with suppliers who were the sole producers of the contract goods. Due to an electrical fault and to interruptions in the supply by rail of raw materials, the suppliers were unable to meet their commitments to the sellers who in turn were unable to supply the contract quantity to the buyers. The Court of Appeal upheld Donaldson J's finding that the contracts had not been frustrated. Lord Denning MR said: *"The events were not sufficient to warrant any finding of frustration. There was the breakdown of the machinery at the factory. There was the difficulty in getting raw material down by rail. Such events are commonplace in the world of affairs. If a party desires to avoid such consequences, he must insert a stipulation to excuse him. He cannot avoid them by a plea of frustration."*

29. In respect of this authority, the tribunal contented themselves with the observation that counsel for the sellers had submitted that the basis of the decision was that the seller had agreed to bear the risk and that it was of some assistance to the sellers because at first instance Donaldson J had recognised that even where there was a *force majeure* clause, frustration was a possibility.

The buyers' challenge to the frustration ruling

30. Mr Kenny for the buyers submitted that the tribunal had failed to apply a fundamental principle that governed this case, namely, that a party is not entitled to the benefit of the doctrine of frustration if the supervening event on which he relies results from his own fault. In his submission the inability of the sellers to perform the contract was due to the decision of their suppliers not to make the necessary supply when such supply was physically and legally possible. The suppliers, having originally agreed to deliver the cargo, were accordingly at fault and their fault was to be attributed to the sellers because they (the suppliers) had become the seller's delegate for the performance of the f.o.b. contract.

31. Mr Kenny relied on the following passage in the judgement of Bingham LJ in ***The Super Servant Two*** [1990] 1 Lloyds Rep 1:

"The essence of frustration is that it is caused by some unforeseen supervening event over which the parties to the contract have no control and for which they are therefore not responsible. To say that the supervening event occurs without the default or blame or responsibility of the parties is, in the context of the doctrine of frustration, but another way of saying it is a supervening event over which they have no control; still less can it apply in a situation in which the parties owed a contractual duty to one another to prevent the frustrating event from occurring… When, in Bank Line Ltd … Lord Sumner made his famous observation that "Reliance cannot be placed on a self-induced frustration" he was contrasting a self-induced frustration with one arising "without blame or fault on either side". As the judge observed (at p. 156)--

…in some respects the doctrine of frustration and the concept of "self-inducement" are simply opposite sides of the same coin. ….

Lauritzen have pleaded in some detail the grounds on which they say that Super Servant Two was lost as a result of the carelessness of Wijsmuller, their servants or agents. If those allegations are made good to any significant extent Wijsmuller would…. be precluded from relying on their plea of frustration.

32. Mr Kenny drew my attention to Article 79 of the Vienna Convention on Contracts for the International Sale of Goods, which has now become law in the USA, Australia, Canada, New Zealand, Singapore, Germany, France, Italy, seven other EU countries, China and Russia, amongst others. Article 79 stipulates:

(1) A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.

(2) If the party's failure is due to the failure by a third person whom he has engaged to perform the whole or a part of the contract, that party is exempt from liability only if:

(a) he is exempt under the preceding paragraph; and

(b) the person whom he has so engaged would be so exempt if the provisions of that paragraph were applied to him.

33. In support of his submission that PTS's "default" was attributable to the sellers Mr Kenny cited *Lebeaupin* ***v Richard Crispin and Company*** [1920] 2 KB 714. Here there were two contracts each of which was for the sale of 2500 cases of "*British Columbia Fraser river salmon*". The first contained the words: "*The salmon to be the first 2500 cases of ½ lb flat pinks packed by the St Mungo Cannery … during the season of 1917*". The second provided: "*The salmon to be the first 2500 cases of ½ lb flat pinks packed by the Acme Cannery.*" To cover themselves on the contracts the sellers made contracts with a third party who in turn made contracts with the St Mungo and the Acme Canneries. The St Mungo Cannery found that a quantity of their tins was defective and by the time they had replaced them the run of salmon in 1917 had ceased. The Acme Cannery filled their 1 lb tins first and when they came to use their ½ lb tins the run of fish had ceased. By reason of these events the sellers were unable to fulfil the two contracts, and when faced with a claim for non-delivery pleaded, inter alia, that both contracts had been frustrated. On appeal from an umpire's award in favour of the buyers, McCardie J upheld the umpire's decision. He said (at p.718): *"In my opinion the decision in* ***Howell v Coupland*** *does not cover the present case. The vendors here must, I think, be treated, for the purposes of the present contracts, as occupying the position of the St Mungo Cannery Co. and the Acme Cannery Co. They cannot rely on any defence or failure of subject-matter which those companies (if they were defendants in the present proceedings) would be disabled from relying upon. This being so, I point out that it is clear that there was no failure of the fish crop at all. It was indeed larger than usual. The reason for the default was in the one case the omission of St Mungo Co to provide good tins, and was in the other case the deliberate choice of Acme Co to pack 1 lb tins in priority to ½ lb tins…. There is no scope here for an application of the* ***Howell v Coupland*** *principle. If it were to be applied to such a case as the present, the result would be greatly to impair the obligation of vendors."*

34. Mr Kenny submitted that it did not matter that the tribunal had found that there was no binding contract between the sellers and PTS because it was clear from the award that these parties had concluded an agreement which was *tantamount* to a contract. Further, and in any event, what mattered was whether the sellers had *engaged* or *arranged* to use a particular supplier, not whether they had concluded a binding supply contract, and it was plain from the award that the sellers had indeed engaged PTS to deliver the cargo, thereby securing performance of their contract with the buyers.

35. In ***Lebeaupin v Richard Crispin & Co*** McCardie J resorted to the notion of attributed fault in order to distinguish *Howell v Coupland*. Another perhaps more modern approach would be to say that where a seller has covered his contract of sale by concluding a contract with a supplier the seller is to be taken to have assumed the risk that his supplier will fail to supply the necessary goods unless the supplier is entitled to claim that the supply contract has been frustrated. This is essentially the approach taken by Parker J in ***Atisa SA v Aztec AG*** in the passage cited above. It produces a sensible and just outcome. The seller's unqualified promise is enforced at the ultimate expense of the defaulting supplier unless the supplier is excused by reason of a frustration.

36. Whichever be the preferred approach, attributed fault or risk allocation, is it necessary under ***Lebeaupin*** that the seller have a binding contract with the supplier? Plainly, the risk allocation approach set out above is predicated on the seller being in a position to obtain recourse against the supplier and this will only be so where there is a binding contract of supply. What of the attributed fault approach? In my judgement, before the default of a supplier can be attributed to a seller the supplier must have been legally obligated to the seller or to another supplier in the chain to make the supply. If a supplier who fails to make the contemplated supply was not legally bound to make the supply, he cannot in my view be said to have been at fault and thus there is no relevant fault to be attributed to the seller. It follows, in my judgement, that Mr Kenny's first submission fails.

37. This does not mean, however, that the tribunal's decision is beyond legal challenge. Having found that the f.o.b. contracts were impossible to perform, the tribunal were correct to say that the key question was whether the risk of the failure of supply was on the sellers or on the buyers. This question was a question of law. The situation was different from those cases like the Suez cases or ***Davis Contractors*** or ***The Nema***[2] where performance of the contract was not impossible but its achievement involved actions and/or expense (including opportunity costs) that were radically different from what had been originally contemplated. In these cases, Lord Radcliffe's definition of frustration is very much in point. In the instant case, however, performance of f.o.b. contracts with narrow loading windows had become impossible through supplier failure and that being the situation, as I have said, the question was whether the risk of such an occurrence was on the buyer or the seller.

38. Did the tribunal err in answering the question as they did? I am of the view that they did. In my opinion, where a seller makes an unqualified promise to sell he bears the risk of a failure of his contemplated source of supply where that source is not the specified source or the goods are not specific goods and the supplier is not excused by frustration, e.g. it is physically and legally possible for the supplier to make delivery but he chooses not to. This is because there is always a risk of supplier failure and as between the buyer and the seller, it is the seller who is in a position to guard against the risk either by making a binding and enforceable contract with the supplier with an appropriate jurisdiction or arbitration clause, or, as Lord Denning said in ***Intertrade***x, by protecting himself by making his promise conditional on the goods being available for delivery. This is no more than good sense and common justice. In a commercial age in which wealth is made up largely of promises,[3] it is of the greatest

[2] [1982] AC 724

[3] Roscoe Pound, *Introduction to the Philosophy of Law*

importance that contractual obligations are enforced in accordance with their terms save only in a most limited range of circumstances.

39. It follows that the tribunal's finding that the f.o.b. contracts were frustrated cannot stand.

The implied term issue

40. The tribunal expressed the view that there was considerable force in the submission made by the sellers that if they were to bear the risk of Cemex being able to undermine the sale because of the buyers' intended use of the cargo, one would have expected a term of the contract making this clear and a significant profit margin to reflect the risk assumed. They went on to say *"Having heard all the evidence from, and cross-examination of, each of the three gentlemen principally concerned in this transaction, we could not avoid the conclusion that had they been asked at the time of contracting what they intended should be the consequence if Cemex intervened so as to prevent the contractual cargo even becoming available in Asia, they would have been bound to acknowledge that "all bets are off" and that the contract would have to be cancelled by mutual agreement. That being so, had it been necessary for us to do so, we would have concluded that the presumed intention of the parties justified the implication of the …implied term*….(Para 58)

41. In my judgement, if, as I have held, the risk of the suppliers choosing not to supply was on the sellers and not the buyers there can be no basis for any implied term discharging the sellers from the contract because of a refusal by the suppliers to supply because of the intervention of Cemex. In short, the postulated term is so fundamentally inconsistent with the effect of the contract's express terms, that it cannot be said that the term is necessary to give the contract business efficacy, or that it is so obvious that it goes without saying, or that the term will be implied as a matter of law. Accordingly, I hold that the tribunal erred in law in finding that the f.o.b. contracts contained an implied term discharging the parties from the contracts in the event that the suppliers refused to supply the necessary cement because of the destination of the cargo. Neither contract contained any such implied term.

Conclusion

42. The buyers' appeal succeeds. The tribunal's findings that the f.o.b. contracts were frustrated, alternatively, were discharged pursuant to an implied term, must be set aside.

43. As agreed at the hearing, I will hear submissions on what consequential orders ought to be made, including, in particular, whether any issues relating to the damages recoverable by the buyers should be referred back to the tribunal.

Julian Kenny (instructed by Hill Dickinson LLP) for the Claimant/Buyers
Michael Nolan (instructed by Salans) for the Defendant/Sellers