COMMENTARY ON EFFECT OF CHANGED CIRCUMSTANCES ON MINERAL AND PETROLEUM SALES CONTRACTS

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This topic invites us to consider the effect of changed circumstances on mineral and petroleum sales contracts and the legal consequences arising from a change in circumstances occurring after the formation of the contract and without default by either party. Our attention focuses on a contract for the sale of generic goods; we are concerned with one party's right to performance of the other party's obligations notwithstanding the changed circumstances and the other party's right to terminate, suspend or adjust the contract on account of the changed circumstances. Underlying our enquiry are concerns for, and notions of, 'sanctity of contract', 'absolute obligations', 'certainty', 'excuse', 'fairness' and 'utility'.

Background

In the Australian context, in a majority of the contracts of the type under discussion but obviously not in all cases, the seller will be the producer or a company closely associated with the producer and the buyer will be the end user or a party closely associated with the end user. Where the seller is not the actual producer and the buyer is not the end user, the seller will be aware nevertheless of the contemplated end use of his product and the buyer will be aware of the mine or basin from which the product is to be derived. There will be 'spot sales' but invariably the contract will be for a term and provide for multiple deliveries over that term.

Buyer and seller could well be substantial business organizations or at least supported by such organizations in a commercial if not a legal sense. They will have entered into the contract 'with their eyes open'; they will have been represented by experienced and competent negotiators; and the wise will have engaged the services of their lawyers.

No limit has been placed on the nature of the supervening events or circumstances we should consider. However, our present interest lies not so much with situations where contractual performance has been prevented on account of physical impossibility (for example, where the subject matter of the contract has been destroyed or becomes unavailable) or with situations where contractual performance is prevented on account of legal impossibility (for example, where performance is prohibited by law).

In the light of the dramatic economic upheavals of inflation, a world energy crisis and a world recession during the course of the last fifteen years, we might be excused for being more interested in the contractual position of

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the parties where the seller might be inclined to allege that performance by reason of the changed circumstances has become so burdensome that he should be excused or where the buyer might be inclined to allege that the changed circumstances have so greatly reduced the value of the contract product to him that he should be no longer bound to accept and pay for it as originally agreed.

Contracts for the sale of generic goods ('trade contracts') should and in most instances will contain a code of provisions to regulate and overcome the adverse consequences that may arise not only from changed circumstances which render performance physically or legally impossible but also from changed circumstances which render performance more costly or disadvantageous. This code is of course to be found in the *force majeure*, price review, hardship and other adjustment provisions contained in the contract. The need for such a code arises from a confluence of concerns.

Firstly, protection against hardship arising from changed circumstances does not lie in assuming relief will be found in an Australian court. Protection lies in ensuring appropriate adjustment clauses are contained in the contract itself. As discussed below, the two common law remedies, frustration and the implication of a term, are very restricted in their application. It will be a rare and special case where either of these two remedies are successfully invoked in an Australian court by a party to a trade contract to overcome hardship arising from changed circumstances. In any event, frustration results in termination of the contract which in itself may be inadequate where all that a party requires is an adjustment of the contract terms.

Secondly, parties to trade contracts accept the inevitability of change: they accept that a sellers' market today may become a buyers' market tomorrow; they are fully aware that obstacles to performance may arise. The same parties also appreciate that acceptance of a contractual obligation is a decision as to risk: whether to accept a risk by assuming an absolute obligation in return for some advantage or concession from the other party or whether to hedge that risk by qualifying or seeking a right to adjust the contractual obligation. An absolute obligation may become tremendously profitable; it may also become a financial disaster. A contracting party is also aware of the time and cost incurred in securing a contract and he is aware of the time and cost and potential harm to his trading position should he and the other party become involved in litigation or arbitration. Cognisant of all these concerns and variables, each contracting party generally accepts the need to incorporate in the contract a code of adjustment provisions not only to protect his own position but also to protect the equilibrium of his contractual relationship with the other party.

Against this background, it is proposed to comment on the scope and limitations of the two common law remedies—frustration and the implication of a term—and then to consider some aspects of the effectiveness and enforceability (or lack thereof) of adjustment provisions where one party seeks to rely on such a provision to terminate, suspend or adjust his contractual obligations and the other party might be inclined to argue that the changed circumstances do not justify any such termination, suspension or adjustment.

FRUSTRATION

An Overview

A short treatment of the frustration principle would be to quote Lord Radcliffe's 'now classic' formulation of the principle in *Davis Contractors*[1] and to emphasize, using Lord Radcliffe's words, 'it is not hardship or inconvenience or material loss itself which calls the principle of frustration into play. There must as well be such a change in the significance of the obligation that the thing undertaken would, if performed, be a different thing from that contracted for.' A short treatment would also mention some of the factors which have limited the scope of the principle: the reluctance of the courts to allow a party to rely on the principle to escape a bad bargain; the tendency of commercial contracts to 'draft out' possible causes of frustration by making express provisions for obstacles to performance (in *Bremer v. Vanden*[2], Salmon L.J. considered the prohibition on export clause in that case had superseded the common law principle of frustration in relation to the governmental embargo which was the subject of the case); and thirdly, the principle grants no judicial power to adjust a contract in the light of supervening events, simply a power to terminate the contract.

Given, however, the economic upheavals of the last fifteen years, the developments in English and Australian contract law over the same period and the extensive recent treatment of the frustration principle by the House of Lords in *National Carriers*[3] and later in *Pioneer Shipping*[4] and by the High *Court in Brisbane City Council*[5] and *Codelfa*[6], an attempt to delve deeper into some of the issues raised by the frustration principle is justified. That attempt is further encouraged when divergencies in principle appear between the common law courts of England and Australia on the one hand and the United States on the other, and when divergencies although perhaps only to the extent of a different emphasis appear between the House of Lords and the High Court.

The Tests

For Australia and England the three important formulations of the frustration principle are those of Lord Reid and Lord Radcliffe in *Davis Contractors* and Lord Simon of Glaisdale in *National Carriers.*

According to Lord Radcliffe, 'frustration occurs whenever the law recognizes that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract. Non haec in foedera veni. It was not this that I promised to do.'[7]

1 *Davis Contractors Ltd. v. Fareham U.D.C.* [1956] A.C. 696.
2 *Bremer Handelsgesellschaft v. Vanden* (1978) 2 Lloyds Rep. 109.
3 *National Carriers Ltd. v. Panalpina (Northern) Ltd.* [1981] 1 All E.R. 161.
4 *Pioneer Shipping Ltd. v. BTP Tioxide Ltd.* [1981] 2 All E.R. 1030.
5 *Brisbane City Council v. Group Projects Pty. Ltd.* 145 C.L.R. 143.
6 *Codelfa Construction Pty. Ltd. v. State Rail Authority of N.S.W.* 56 A.L.J.R. 459.
7 *Supra* n.1, 729.

Lord Reid described frustration as 'the termination of the contract by operation of law on the emergence of a fundamentally different situation.'[8] In his view, the task of the court is to determine 'on the true construction of the terms which are in the contract read in the light of the nature of the contract and of the relevant surrounding circumstances', 'whether the contract which they did make is . . . wide enough to apply to the new situation: if it is not, then it is at an end.'[9] Later in his judgment, he said the question is whether the supervening events alleged to frustrate the contract were 'fundamental enough to transmute the job the contractor has undertaken into a job of a different kind, which the contract did not contemplate and to which it could not apply.'[10]

Under Lord Simon of Glaisdale's formulation:

> Frustration of a contract takes place when there supervenes an event (without default of either party and for which the contract makes no sufficient provision) which so significantly changes the nature (not merely the expense or onerousness) of the outstanding contractual rights and/or obligations from what the parties could reasonably have contemplated at the time of its execution that it would be unjust to hold them to the literal sense of its stipulations in the new circumstances; in such case the law declares both parties to be discharged from further performance.[11]

In *National Carriers* and *Pioneer Shipping*, Lord Radcliffe's formulation was firmly adopted by the House of Lords and following *Codelfa* may now be said to be the High Court's preferred formula.

Taken together the abovementioned three formulations represent the construction theory or approach to frustration. As will be discussed later, Lord Reid's formulation has, according to Stephen J. in *Brisbane City Council*, an emphasis on the emergence of a fundamentally different situation; Lord Radcliffe's test has an emphasis, according to Stephen J. in *Brisbane City Council*, on 'a change in the obligation' and, according to Aikin J. in *Codelfa*, on 'a change in the significance of the obligation'; and Lord Simon of Glaisdale's formulation has an emphasis on 'justice'.

A Perspective

It will be appreciated from the outset that the three formulations do not present us with a value-free test. They necessarily involve 'questions of degree' and it has been said that what in fact constitutes a 'radically different' obligation is often a matter of 'judicial speculation'.[12] The main aim of this commentary is to highlight both the inherent flexibility of the formulations and the call that the frustration principle be applied 'rarely and with reluctance'.

Whilst it will be (and many will contend that it should be) a rare and special case where a trade contract is held to have been frustrated, it is misunderstanding of the frustration principle to assume that the principle is incapable of applying in the case of a trade contract. There is no class of contracts in relation to which the principle cannot apply.[13] Circumstances

8 *Ibid.* 723.
9 *Ibid.* 720-721.
10 *Ibid.* 723.
11 *Supra* n.3, 175.
12 Trakman L.E.; 'Frustrated Contracts' (1983) 56 *Modern Law Review* 39, 48.
13 *Supra* n.3.

can vary infinitely and the principle remains 'flexible, to be applied whenever the inherent justice of the particular case requires its application.'[14]

An understanding of the various formulations of the frustration principle is incomplete without an appreciation of some of the current concerns and trends in contract law. Thus, before considering the various formulations of the construction theory or approach to frustration, an attempt to identify some of those concerns and trends is more than useful in the interests of obtaining some perspective.

Given that frustration is 'not a physical fact but an intellectual conception'[15], there is no limit in the scope for lawyers to adopt different views and approaches to the question when a contract is and should be dissolved by reason of supervening circumstances.

Two years after *Davis Contractors* and, as Stephen J. in the *Brisbane City Council* case observed, despite or perhaps in the light of the decision of their Lordships in that case, Diplock J. said:

> It would appear to be the fate of frustration cases when they reach the highest tribunals that either there should be agreement as to the principle but differences as to its application, or differences as to the principle but agreement as to its application.[16]

Frustration both in terms of formulating a test setting out the conditions when a contract is frustrated and in terms of applying that test presents many complex issues. At the root of the problem lies the tension and interaction in contract law between the values of certainty and fairness.

In support of certainty as an ideal, legal writers have expressed the view that certainty is more important than justice in trade contracts. Further, judicial recognition of the need for certainty finds expression in the insistence of English and Australian courts that termination of the contract by reason of frustration should be a 'rare and reluctant conclusion'. On the other hand, concerns for fairness find recognition in the judicial desire and instinct to do justice whenever the particular facts and circumstances of the case so demand and the adoption of legal technique which has an 'inbuilt flexibility' to achieve that end when the case so demands.

The Concern for Certainty

(a) A loud cry in the interests of certainty comes from Berman[17] and Trakman[18] whose respective arguments are essentially that there is little or no scope for the application of the frustration principle and that the principle that contractual obligations are absolute should apply in the case of those commercial contracts such as international trade contracts where it is usual to make provision for unseen contingencies or where the party seeking excuse from performance on account of that contingency could reasonably have been expected to make such a provision. The principle of absolute

14 *Supra* n.3, 184.
15 McNair A.D., 'Frustration of Contracts by War', (1940) 56 *Law Quarterly Review* 176, 200.
16 *Port Line Ltd. v. Ben Line Steamers Ltd.* [1958] 2.Q.B. 146, 162.
17 Berman H.J., 'Excuse for non-performance in the light of contract practices in international trade' (1963) 63 *Columbia Law Review* 1413.
18 *Supra* n.12.

obligations remains a fundamental principle of contract law and continues to be applied. Thus in *Lewis Emanuel & Sons Ltd. v. Sammut*[19] a seller under a c.i.f. contract who was prevented from delivering his goods due to an unavailability of shipping was held liable for his failure to deliver on the grounds he could reasonably have been expected to contract 'subject to shipment' but did not do so.

Considerations of fairness according to Berman have no place in the law governing international trade contracts. The parties to such contracts are aware of the many types of risk involved in international trade that may make performance impossible or excessively costly and take it for granted that the risk of events not specifically referred to in the contract shall be borne by the obligor. In addition, the parties to such contracts are, as a general rule, substantial business firms who have entered into their contracts with open eyes. They do not rely upon judicially formulated doctrines of excuse to relieve one side or the other from obligations assumed. Since such parties are generally subjects of diverse systems of national law, they tend to rely far more heavily upon the terms of their contracts than upon general legal doctrines prevailing in one country or another. Sanctity of contract is their surest defence against peculiarities of legal rules developed in particular countries.

In Berman's view, the answer to the question of excuse from performance in the case of international trade contracts must be found in the contract itself, taken as a whole, and when no inference can be drawn from the express terms of the contract, the answer can and must be found in commercial understanding relating to the allocation of the risk of non-performance caused by the type of contingency that occurred.

> All courts and writers support the attempt to construe contractual terms in the light of commercial usage, business sense and the like. What is suggested here, however, is that the contract in dispute be compared with other contracts in the same trade in order to determine whether the contingency that occurred is usually or occasionally specified in the excuse clauses. If it is, the omission of it would indicate that its occurrence should not excuse. If it is not, the result should be the same unless the practice of the trade is to treat contract obligations generally as conditional upon the non-occurrence of abnormal risks. If there is substantial doubt about such practice, it would be appropriate to take expert testimony on commercial understanding in a particular trade relative to the allocation of the risk in the absence of specific reference to the contingency.[20]

In Trakman's view, the legal excuse of parties from performance is generally unjustified where the parties are attuned to and able to provide for non-performance risks themselves.

> To do otherwise is a potentially "misguided" judicial act; for it allows a promisor who has assumed a risk, in return for an equivalent concession or price advantage from the promisee, to benefit from his "bad" bargain by artificial means.[21] Thus, in Trakman's view, legal excuses from performance should only be allowed in business contracts where the following collective circumstances prevail: first, the promisor failed to reflect upon intervening risks at the time of contracting; secondly, his lack of risk perception was reasonable in the circumstances; thirdly, he was unable to avoid the harmful effects produced by such risk upon performance; and fourthly, the

19 [1959] 2 Lloyds Rep. 629.
20 *Supra* n.17, 1424.
21 *Supra* n.12, 50.

> economical waste arising from performance was outweighed by the economic benefit that flowed from permitting non-performance. In each case, the nature and extent of the promisor's right to a non-performance arises under the contract. In each case what is reasonable in the circumstances should be determined by the commercial background, the trade negotiations and the drafting abilities of the parties.[22]

(b) English and Australian courts hardly need any admonishment from Berman and Trakman. They have consistently insisted that the frustration principle should be applied within narrow limits and should not allow a party to escape a bad bargain. There are numerous statements to this effect. Thus, it has been said 'frustration is not to be lightly invoked as a dissolvent of a contract.'[23] Again, it has been said:

> frustration is a doctrine only too often invoked by a party to a contract who finds performance difficult or unprofitable, but it is very rarely relied upon with success. It is, in fact, a kind of last ditch and, as Lord Radcliffe says in his speech in the most recent case, "it is a conclusion which should be reached rarely and with reluctance."[24] And again more recently Lord Roskill affirmed in *Pioneer Shipping* that the frustration principle was 'not lightly to be invoked to relieve the contracting parties of the normal consequences of imprudent commercial bargains.[25]

Thus, English and Australian courts have insisted that a contract is not frustrated merely because performance has become more difficult or less advantageous for the party seeking to invoke the principle. In *British Movietone News*[26], Viscount Simon said: 'The parties to an executory contract are often faced, in the course of carrying it out, with a turn of events which they did not at all anticipate – a wholly abnormal rise or fall in prices, a sudden depreciation of currency, an unexpected obstacle to the execution of the like. This does not in itself affect the bargain which they have made.'[27]

Again, the classic statement in *Davis Contractors* of Lord Radcliffe: 'It is not hardship or inconvenience or material loss itself which calls the principle of frustration into play.'[28]

(c) It has been suggested that a possible reason why English judges have paid so much attention to the theoretical or juristic basis of the doctrine of frustration is that they feel the need to justify in some way their departure from the doctrine of absolute contracts.[29] It has also been shown that the various theories of frustration (that is, the implied term, just solution, foundation of the contract and construction theories) which English judges have said underlie the doctrine depend in the last resort on the construction of the contract.[30] Certainly, any theory which depends on the construction of the contract does permit a court to terminate a contract by reason of frustration in a manner which can be reconciled with the doctrine of sanctity of contracts. Lord Denning's views in the Court of Appeal in *British Movietone-news* that in frustration cases the court was really exercising a qualifying

22 *Ibid.*
23 *Per* Lord Radcliffe, *supra* n.1, 727.
24 *Per* Harman L.J. in *Tsakiroglou & Co. Ltd. v. Noblee & Thorl G.m.b.H.* [1960] 2 Q.B. 318, 370.
25 *Supra* n.4, 1046.
26 *British Movietone News Ltd. v. London and District Cinemas Ltd.* [1952] A.C. 166.
27 *Ibid.* 185.
28 *Supra* n.1, 729.
29 Treitel G.H., *The Law of Contract* (1983) 694.
30 *Ibid.* 696.

power in order to do what was just and reasonable in the new circumstances, was rebuffed in the House of Lords. Viscount Simon said:

> If, on the other hand, a consideration of the terms of the contract, in the light of the circumstances existing when it was made, shows that (the contracting parties) never agreed to be bound in a fundamentally different situation which has now unexpectedly emerged, the contract ceases to bind at that point – not because the Court in its discretion thinks it just and reasonable to qualify the terms of the contract, but because on its true construction it does not apply in that situation.[31]

Thus as Lord Reid was later to reiterate in *Davis Contractors*, the function of the Court is to construe the contract and not apply an overriding discretion. The fact of the matter, however, is that the 'true' construction may well be a 'just' construction.

Tipaldy in a recent article[32] considered the construction approach and the overriding discretion approach as alternative methods of adjudication by the courts in contract cases and expressed his clear preference for the former. In his view, the construction technique was to be preferred since it afforded greater predictability of the result of a judicial decision. He expressed the view that:

> Justice or fairness, though self-evident influences in the formulation and application of contractual principles, are not in themselves instruments of contract law. Nor can they be converted into doctrine under any synonym. They are, rather, descriptions of the way in which lawyers handle instruments of the law. There is a danger that, once seen as ends in themselves, judges will begin to make choices which they are ill-equipped to make. There is a danger that, though they know the word to start the sorcerer's broom, they will be unable to control it, or to estimate just how clean a sweep it will eventually make.[33]

THE CONCERN FOR FAIRNESS

(a) The *purpose* of the frustration principle in cases of a supervening fundamental change of circumstances is to provide a satisfactory method of allocating or distributing the loss caused by the supervening event.[34] Lord Hailsham in *National Carriers* indicated he regarded frustration cases 'as a sub-species of the class of case which comes so regularly before the courts, as to which of two innocent parties must bear the loss as the result of circumstances for which neither is at all to blame.'[35] Lord Roskill in the same case said: 'The doctrine is principally concerned with the incidence of risk: who must take the risk of the happening of a particular event, especially when the parties have not made any or any sufficient provision for the happening of that event.'[36]

The *justification* for the frustration principle has its roots in considerations of justice and fairness. Lord Simon of Glaisdale mentioned in *National Carriers* that the purpose of the various theories of the doctrine of frustration was 'to clothe the doctrine in juristic respectability.'[37] He stated: 'The doctrine has been developed by the law as an expedient to escape from

31 *Supra* 26, 185.
32 Tipaldy D. 'Judicial Control of Contractual Unfairness', (1983) *Modern Law Review* 601.
33 *Ibid.* 618.
34 *Supra* n.29, 667.
35 *Supra* n.3, 167.
36 *Ibid.* 184.
37 *Ibid.* 176.

injustice where such would result from enforcement of a contract in its literal terms after a significant change in circumstances. As Lord Sumner said, giving the opinion of a strong Privy Council in *Hirji Mulji v. Cheong Yue Steamship Co. Ltd.*[37a] "It is really a device, by which the rules as to absolute contracts are reconciled with a special exception which justice demands."'[38] Later his Lordship mentioned that the doctrine of frustration is 'on the face of it apt to vindicate justice wherever owing to relevant supervening circumstances the enforcement of any contractual arrangement in its literal terms would produce injustice.'[39]

Whilst Lord Roskill in the same case emphasized 'the doctrine is no arbitrary dispensing power to be exercised at the subjective whim of the judge by whom the issue has to be determined', nevertheless he acknowledged that the doctrine was 'flexible, to be applied whenever the inherent justice of the particular case requires its application.'[40] Lord Russell implicitly acknowledged that in his view a principle of achieving justice is at the root of the principle of frustration.[41]

(b) These affirmations by their Lordships in *National Carriers* of the judicial instinct and desire to do justice make it appropriate to reflect at this point upon Atiyah's thesis[42] that over the past 150 years there has been a weakening belief in the importance of principle and the hortatory function of the judicial process and an increasing judicial desire to do justice according to the particular circumstances of the case. (By hortatory function, Atiyah means that aspect of the judicial function which is designed to encourage behaviour in a positive manner, for example, in contract cases, the performance of the contract.) He characterizes this 'trend towards individualized justice' as a 'shift from principles to pragmatism'.

To demonstrate the tendency of the judicial process to be more pragmatic and less principled than that of the early 19th century, Atiyah points to the increasing tendency of the courts to use legal tools and techniques which have an 'inbuilt flexibility', the outstanding examples of which are the very wide use made today of the standard of reasonableness in tort cases and the process of construction in contract cases. 'In contract law, the tendency of modern courts to rely upon the process of construction has imparted a degree of flexibility which differs little from that involved in the use of standards of reasonableness.'[43]

As a further illustration of the trend to pragmatism, Atiyah mentions the emphasis on fact finding in the modern judicial process. Whereas the judicial process in the early 19th century was characterized by an unwillingness to investigate the facts of the case, the judicial process in modern times 'lavishes a care and time on fact finding which would have been inconceivable 150 years ago.'[44] He points out that reasonableness in tort cases

37a[1926] A.C. 497, 150.
38 *Supra* n.3, 176.
39 *Ibid.*
40 *Ibid.* 184.
41 *Ibid.* 181.
42 Atiyah P.S., 'From Principles to Pragmatism' An Inaugural Lecture delivered before the University of Oxford on 17 Feb. 1978.
43 *Ibid.* 12.
44 *Ibid.* 14.

and construction in contract cases are processes which depend on all the circumstances of the case.

> Now this emphasis on the detailed facts of the case makes it easier to do justice in particular circumstances of the case. But there is surely no doubt that it also makes decisions of much less weight for hortatory purposes. As factual issues multiply and the criteria of relevance broaden, the chances of finding other cases in which the facts are sufficiently close to be governed by the same rule—or by an exercise of discretion in the same way—obviously become more remote. This is why it is so much more common today to find courts insisting that the "test" for the application of this or that legal doctrine is a question of fact or of "degree". Moreover, even if after the event, it remains possible to match the facts of one case to those of another, it is certainly a great deal more difficult to do this in advance. The bulk of the law has grown exceedingly as the search for individualized justice has proceeded.[45]

Certainly Atiyah's observations as to the 'inbuilt flexibility' of the construction process in frustration cases and the emphasis on the particular facts and circumstances of the case is affirmed in the recent decisions of the House of Lords and the High Court.

(c) *A question of degree.* Aikin J. in *Codelfa* considered that the Lord Radcliffe formulation 'necessarily involves questions of degree.'[46] Lord Hailsham in *National Carriers* after having earlier emphasized the need for the doctrine of frustration to have a theoretical basis, admitted: 'In all fairness, however, I must say that my approach to the question involves me in the view that whether a supervening event is a frustrating event or not is, in a wide variety of cases, a question of degree . . .'[47]

In *Pioneer Shipping*, Lord Diplock said:

> Whether a particular event or series of events have made further performance something radically different from that which was undertaken by the contract involves, as is indicated by Lord Radcliffe's adverb and its oft used variant "fundamentally", a question of degree on which, though faced with the same facts, different opinons may not unreasonably be held by different men.[48]

Lord Roskill in the same case expressed a similar view and mentioned that often it will be a question of degree whether the effect of a supervening event or series of events will be such as to bring about frustration of a contract. 'Where questions of degree are involved, opinions may and often legitimately do differ. Quot homenies tot sententiiae.'[49]

In *Brisbane City Council*, Stephen J. said:

> It is no doubt true, as critics complain, that the various expositions of the true basis of the doctrine of frustration leave imprecise its actual operation when applied to the facts of particular cases. How dramatic must be the impact of an allegedly frustrating event? To what degree or extent must such an event overturn expectations, or affect the foundation upon which the parties have contracted, or, again, how unjust and unreasonable a result must flow or how radically different from that originally undertaken must a contract become (to use the language of some of the various expositions), before it is to be regarded as frustrated? The cases provide little more than single instances of solutions to these questions. These difficulties of application of the doctrine of frustration were keenly appreciated both by Latham C.J. and by Williams J. in their considerations of the doctrine in *Scanlan's New Neon Ltd. v.*

45 *Ibid.* 15.
46 *Supra* n.6, 476.
47 *Supra* n.3, 166.
48 *Supra* n.4, 1040.
49 *Ibid.* 1047.

> *Tooheys Ltd.* They are, perhaps, inevitable in questions of degree arising when a broad principle must be applied to infinitely variable factual situations.[50]

(d) *Attention to the facts.* Atiyah's observation as to the emphasis on fact finding in the modern judicial process is also affirmed in frustration cases. In *National Carriers* Lord Roskill mentioned that frustration 'is to be invoked or not to be invoked by reference only to the particular contract before the court and the facts of the particular case said to justify the implication of the doctrine.'[51]

Later in *Pioneer Shipping* after observing that the House of Lords had approved in *National Carriers* 'the now classic' statement of the doctrine of frustration by Lord Radcliffe in *Davis Contractors*, Lord Roskill continued:

> It should therefore be unnecessary in future cases, where issues of frustration of contract arise, to search back among the many earlier decisions in this branch of the law when the doctrine was in its comparative infancy. The question in these cases is not whether one case resembles another, but whether, applying Lord Radcliffe's enunciation of the doctrine, the facts of the particular case under consideration do or do not justify the invocation of the doctrine . . .[52]

Application of the Frustration Principle

The House of Lords' decision in *Tsakiroglou*[53] and the High Court's decision in *Codelfa*[54] allow us to compare a strict and more liberal application of the frustration principle.

In *Tsakiroglou*, the relevant contract was made one month before the closure of the Suez Canal in 1956 and involved the sale of Sudanese groundnuts for shipment c.i.f. Hamburg 'during November/December 1956'. When the contract was made each party expected shipment would be via Suez but the contract did not expressly or by implication so provide. After the closure of the Canal the seller did not ship the goods on the grounds that the contract had been frustrated.

His plea was rejected by the House of Lords. Their Lordships held that upon the closure of the customary or usual route, the seller's obligation was to ship the goods to their destination by any reasonable and practical route available which in this case meant the Cape of Good Hope. Although shipment by the Cape would have taken almost three times as long and would have been twice as expensive as shipment by the Canal, their Lordships concluded that having regard to the terms of the contract and the surrounding circumstances, performance of the contract had not been rendered fundamentally different 'in a commercial sense'. In considering whether performance of the contract had been rendered fundamentally different, their Lordships Reid and Radcliffe both had regard to the change in the method of shipment in terms of time of arrival, condition of goods and increase in freight rates. They found that time was not material since the seller had the option of choosing any date within a two month period for shipment. There was no evidence that condition of the goods would suffer if

50 *Supra* n.5, 162-163.
51 *Supra* n.3, 184.
52 *Supra* n.4, 1046.
53 *Tsakiroglou & Co. Ltd. v. Noblee & Thorl G.m.b.H.* [1960] 2 All E.R. 160, 179.
54 *Supra* n.6.

they were shipped via the Cape. As to cost, although the freight rate was twice as expensive, it was not an 'astronomical' increase.

By their Lordships reasoning, it follows that if the goods had been perishable, or if a definite date for delivery (rather than shipping) had been fixed, or if the increase in the freight cost had been 'astronomical', the contract should have been frustrated.

Two factors not mentioned in the case give some insight into what some people might regard as a harsh decision. Firstly, Berman mentions[55] that there had been a strong reaction among London businessmen against the decision of the court at first instance in which the sellers had been excused. The contract had been entered into only one month before the closure of the Canal at a time when exporters, importers, ship owners, marine insurance underwriters and bankers engaged in international trade transactions were well aware of the possibility that the Suez Canal might be closed. There was also evidence that there was sufficient shipping available to carry the goods via the Cape. Secondly, Treitel mentions: 'It seems that the seller in the *Tsakiroglou* case would have made a profit if his plea of frustration had been upheld, for the market price of the goods had risen by more than the extra cost of carriage via the Cape of Good Hope.'[56] Lord Roskill in *National Carriers* appears to confirm that there was a rising market for the goods in the *Taskiroglou* case following the closure of the Suez Canal.[57]

The *Codelfa* case arose out of a contract for the construction of a section of the tunnel for the Eastern Suburbs Railway in Sydney. An Italian corporation was the successful tenderer (by agreement, its Australian subsidiary became the contracting party). The contract, which was in a standard form, deemed the contractor to have informed himself fully of the conditions affecting his carrying out the work. The work was to be completed within a stated period in accordance with a construction programme prepared by the contractor and approved by the Authority. The programme contemplated Codelfa operating on a three shift basis six days a week. Time was of the essence. There was provision for an extension of time for delays due to causes beyond the control or without fault or negligence of the contractor. The work generated considerable noise and vibration and the residents obtained an injunction against Codelfa preventing construction and work between 10 p.m. and 6 a.m. Both parties had assumed that Codelfa had a statutory immunity from liability for nuisance. Legal advice had been given to that effect and the Authority had represented to Codelfa that no injunction could or would be granted in respect of nuisance. The court which granted the injunction held Codelfa did not enjoy the statutory immunity. The parties thus 'shared an erroneous view of the scope of the immunity'.

After the injunction Codelfa continued to work on a two shift basis and claimed from the Authority an amount additional to the contract price in respect of additional cost and lost profits by reason of change in working conditions it was forced to adopt. The claim was put on a two alternative

55 *Supra* n.17, 1423.
56 *Supra* n.29, 685.
57 *Supra* n.3, 185.

bases, either there was an implied warranty for a breach of which Codelfa could claim damages, or there was frustration of the whole contract followed by an implied request by the Authority to continue to work, an implied promise to pay a *quantum meruit* and a failure to pay such sum. The implied warranty argument succeeded before the lower courts but failed in the High Court. However, a majority of four members of the High Court (Brennan J. dissenting) upheld the frustration argument.

Mason J. and Aikin J. with whom Stephen J. and Wilson J. concurred accepted the arbitrator's finding that there had been a common understanding between the parties that the work could and would be carried out on a three shift basis six days per week and that no injunction would be granted in relation to nuisance. They also accepted the arbitrator's finding that the work could not be carried out as the parties had agreed except on a three shift basis six days per week and that neither party foresaw the possibility of restrictions being imposed on the hours of work.

The majority found that the grant of the injunction had frustrated the contract. Mason J. said: 'Performance by means of a two shift operation, necessitated by the grant of the injunction, was fundamentally different from that contemplated by the contract.'[58] In the opinion of Aikin J., 'the grant of the injunction produced frustration in the true sense of that term. It had become unlawful to perform the work in a manner which would have complied with the requirement of the contract, a requirement well known to both parties.'[58a] In his dissenting judgment, Brennan J. also applied the Radcliffe test. His Honour's approach was that Codelfa had agreed to perform the contract irrespective of its difficulty. In His Honour's view, there had been no change in the circumstances in which Codelfa was bound to perform the contract works after the grant of the injunction. Both before and after the injunction Codelfa was required to avoid the commission of an actionable nuisance in performing the contract. The injunction 'did no more than enforce judicially a limitation by which Codelfa was already bound.'[59]

The High Court's treatment of the extension of time clause appears somewhat inadequate. Mason J. appears to have thought the extension of time clause did not apply in the case of the grant of an injunction.[60] It is not clear whether the other judges thought that the clause was not applicable at all to delay caused by the injunction or whether it was not to be taken as stating all the consequences of such an event.

The decision in *Codelfa* rests on its special facts. One wonders whether the decision would have been the same if any one of these special facts were missing: if there had been no misrepresentation, if the parties had not given any prior consideration to the possibility of a nuisance being committed by the contractor, if the extension time clause had been clearly applicable, if there had been no definite time for completion or if time had not been of the essence. In particular one wonders whether the decision would have been the same if Codelfa had withdrawn from the project altogether on the grounds the contract had been terminated.

58 *Supra* n.6, 468.
58a *Ibid.* 477.
59 *Ibid.* 489.
60 *Ibid.* 468.

> It is hard to resist the conclusion that the true reason for the decision in Codelfa's favour was that the plaintiff was a foreign contractor who was disadvantaged by having been induced to enter a contract by a misrepresentation concerning the law of New South Wales by a New South Wales Government authority.[61]

DIFFERENCES BETWEEN THE HIGH COURT AND THE HOUSE OF LORDS

A comparison of the views expressed in *Tsakiroglou*, *National Carriers* and *Pioneer Shipping* on the one hand and *Brisbane City Council* and *Codelfa* on the other, indicate that the House of Lords and the High Court have apparently diverged in two respects. Whereas the House of Lords has firmly adopted the Radcliffe formulation as the correct test for determining whether a contract has been frustrated, the High Court has expressed a preference for that formulation but has not committed itself exclusively to it.

Further, in their respective applications of the Radcliffe formulation, the House of Lords has placed an emphasis on the need for 'a change in the obligation' to be performed, whilst, in the High Court, Stephen J. and Mason J. have placed an emphasis on the need for 'a fundamentally different situation' and Aikin J. has placed an emphasis on the need for 'a change in the significance of the obligation'. The High Court's interpretation may afford the Radcliffe test even more flexibility in its application and therefore the potential for a wider application than that which the House of Lords might be prepared to give the test.

The interesting question is whether these divergencies signify that the High Court may be willing to give more regard to considerations of justice, hardship and the impracticability of further performance and less regard to the notion of sanctity of contracts in determining whether a contract has been frustrated. Lord Simon of Glaisdale's formulation in *National Carriers*, which Aikin J. quoted in *Codelfa*[62], openly acknowledges that the question in frustration cases is whether it is just to hold the parties to their bargain in the changed circumstances. The contract is discharged if, because of changed circumstances, justice requires it. Furthermore, it has been said:

> If it is true that there is occurring in the law a shift from "principles to pragmatism" and that in particular both legislatures and judges are nowadays paying less regard to the notion of sanctity of contracts, such trends are likely to have implications for the doctrine of frustration. It may be expected that the emphasis in the future in frustration cases will tend to be on whether justice, rather than the true construction of the contract, requires a dissolution.[63]

House of Lords

Chitty[64] states that both Lords Reid and Radcliffe in the *Davis Contractors'* case:

> emphasized that the first step was to construe "the terms which are in the contract, read in the light of the nature of the contract, and of the relevant surrounding cir-

61 Swanton J.P., 'Discharge of Contracts by Frustration' (1983) 57 *Australian Law Journal* 201, 219.
62 *Supra* n.6, 475.
63 *Supra* n.61, 212.
64 *Chitty on Contracts* (1983) para. 1526.

> cumstances when the contract was made". From this construction the court should reach an impression of the scope of the original obligation, that is, the court should ascertain what the parties would be required to do in order to fulfil their literal promises in the original circumstances . . . Having discovered what was the original "obligation" and what would be the new "obligation" if the contract were still binding in the new circumstances, the last step in the process is for the court to compare the two obligations in order to decide whether the new obligation is a "radical" or "fundamental" change from the original obligation. It is not simply a question of whether there has been a radical change in the circumstances, but whether there has been a radical change in the "obligation" or the actual effect of the promises of the parties construed in the light of the new circumstances. Was "performance . . . fundamentally different in a commercial sense". (The concluding quotation is from Lord Reid's Judgment in *Tsakiroglou* p. 118.)

Lord Roskill in *Pioneer Shipping* emphasized that it is not the nature of the supervening event which matters so much as the effect of the supervening event on the performance of the obligations which the parties have assumed one towards the other.[65] It should be noted that despite his Honour's extensive quotations from Lord Reid's judgment in *Davis Contractors*, Stephen J. in *Brisbane City Council* did not mention that Lord Reid had also said in *Davis Contractors* 'the question is whether the causes of delay or delays were fundamental enough to transmute the job the contractor has undertaken into a job of a different kind which the contract did not contemplate and to which it could not apply.'[66] In *Tsakiroglou* Lord Reid also confirmed the need for there to be a fundamental change in the original obligation:

> If the appellants are right, the question whether the contract is ended does not depend on the extent to which the parties or their rights and obligations are affected by the substitution of the new route for the old route. If the new route made necessary by the closing of the old is substantially different, the contract would be at an end, however slight the effect of the change might be on the parties. That appears to me to be quite unreasonable.[67]

Later his Lordship indicated the issue was whether performance of the contractual obligation had become fundamentally different 'in a commercial sense.'

The High Court

In *Brisbane City Council* Stephen J. quoted extensively from Lord Reid's judgment in *Davis Contractors* but omitted as mentioned above the reference to 'the transmutation of the job':

> What I understand his Lordship's approach to involve is, then, a comparison between the contemplated situation, as revealed by the terms of the contract on its true construction, and the situation in fact resulting from the frustrating event. If they be 'fundamentally different' the contract is frustrated subject, of course, to the frustrating event not being the fault of the party seeking to rely on the doctrine.[68]

Indicating a preference to follow the approach of Lord Reid and Lord Radcliffe in *Davis Contractors*, he stated: 'It should, however, be

65 *Supra* n.4, 1048.
66 *Supra* n.1, 723.
67 *Supra* n.53, 186.
68 *Supra* n.5, 160.

noted that Lord Radcliffe tends rather to concentrate on a change in obligation.'[69] Later Stephen J. mentioned:

> As already mentioned, the change in obligation tests proposed by Lord Radcliffe, no doubt apt enough in most frustration situations, seems to be inapplicable here, as it was in the so-called coronation cases, of which *Krell v. Henry* is the leading example. But I do not understand his Lordship to say that without change in obligation there can be no frustration: it is "the occurrence of any unexpected event that, as it were, changes the face of things", that gives rise to frustration. His Lordship's emphasis upon change in obligation is, I think, to be understood in the context of the factual situation under discussion in the *Davis Contractors'* case.[70]

According to His Honour, the case before him was not one in which performance of contractual obligations had been rendered impossible or more onerous by the frustrating event. Thus, as His Honour openly acknowledged, the facts could not be accommodated very comfortably with any formulation which required there to be a change in the significance of the obligation.[71] The facts in that case were that a company which owned land which it wished to develop for residential purposes, had agreed with the Brisbane City Council that if the Council made an application for re-zoning of the land, the company would carry out a variety of development works in respect of the land. Much of this work was, however, external to the land. The land was resumed and the subdivision became impossible. Stephen J. found that although the developer remained able to perform the bulk of the development works, being that part of the works which was not to be undertaken on the resumed land and although that work would not have changed in character nor become more onerous, nevertheless the resumption had 'wholly destroyed [the developer's] purpose in undertaking any obligations at all'.[72]

His Honour mentioned he preferred to express his conclusion that the contract had been frustrated in terms of Lord Reid's 'approach' in *Davis Contractors*, but:

> however expressed, the conclusion should, I think, be that this contract has been frustrated. There has arisen, as the result of the "resumption" such a fundamentally different situation from that contemplated when the contract was entered into that it is properly to be regarded as having come to an end at the date of [the resumption].[73]

His Honour rationalized his decision thus: from the developer's point of view, the resumption completely overturned its subdivisional development. From the Council's viewpoint frustration of the contract rendered it no commercial disadvantage since after the resumption the Council had no need for the development works. As to the obligations to be performed, whilst those works on the resumed land became impossible of execution, most of them, namely, those off the resumed land 'must surely now be impractical or unnecessary.'[74]

In *Codelfa* far from making any attempt to distinguish or qualify the correctness of Stephen J.'s decision in *Brisbane City Council*, the majority

69 *Ibid.*
70 *Ibid.* 161.
71 *Ibid.* 157.
72 *Ibid.* 158.
73 *Ibid.* 162.
74 *Ibid.* 163.

firmly endorsed His Honour's views. Mason J. agreed 'with Stephen J.'s acceptance of the approach adopted by Lord Reid and Lord Radcliffe in *Davis Contractors*.'[75] Aikin J. after mentioning that Stephen J. had considered the question of frustration in *Brisbane City Council* said His Honour had 'reviewed many of the cases in a manner with which I respectfully agree.'[76] Later His Honour mentioned that apart from giving the more extensive quotation from Lord Radcliffe's speech which he gave in his judgment 'I cannot do better than refer to and adopt all that Stephen J. had said.'[77]

Mason J. mentioned '*The critical issue* then is whether the situation resulting from [the supervening event] is fundamentally different from the situation contemplated by the contract on its true construction in the light of the surrounding circumstances.'[78] After reciting and discussing various aspects of the relevant contract in that case, His Honour stated: 'I come back then to the question of whether the performance in the new situation was fundamentally different from performance in the situation contemplated by the contract.'[79]

Unlike Mason J.'s emphasis on a fundamentally different situation, Aikin J. emphasized a change in the significance of the obligation. His Honour mentioned that the doctrine of frustration 'is now generally expressed as depending on changes in the significance of the obligations undertaken and the surrounding circumstances in which the contract was made.'[80] After quoting Stephen J.'s statement in *Brisbane City Council* that Lord Radcliffe's emphasis upon change in obligation is to be understood in the context of the factual situation under discussion in *Davis Contractors*, Aikin J. indicated that he thought Stephen J. used the expression 'change in obligation' in the same sense that Lord Radcliffe had used the expression 'change in the significance of the obligation'[81].

It would be an overstatement to say that the House of Lords and the High Court have irretrievably diverged in their respective interpretations of Lord Radcliffe's test. No doubt in most cases the same result would be achieved by a court which applied the Radcliffe test with an emphasis on a change in the obligation 'in a commercial sense' and a court which applied the same test with an emphasis on a change in the significance of the obligation. In fact, the different approaches of the two courts confirm 'the inbuilt flexibility' of the test.

Further, in *Tsakiroglou* the House of Lords was dealing with a sale of goods contract where the seller, as Lord Roskill in *National Carriers* observed[82], was seeking to invoke the principle on a rising market merely because the mode of performance contemplated when the contract was made had become impossible although another and not fundamentally different mode of performance remained available. By contrast, the High Court was not dealing with a sale of goods contract in either *Brisbane City*

75 *Supra* n.6, 465.
76 *Ibid.* 475.
77 *Ibid.*
78 *Ibid.* 467.
79 *Ibid.* 468.
80 *Ibid.* 474.
81 *Ibid.* 476.
82 *Supra* n.3, 185.

Council or *Codelfa*. Nevertheless, a reading of *Codelfa* leaves an impression that the High Court is not wedded to the Radcliffe test to the same degree as Their Lordships and that the High Court has intentionally preserved for itself considerable flexibility in its attitude to frustration.

TERM CONTRACTS

The views expressed by their Lordships in *National Carriers* in their consideration of whether the 10 year lease in that case had been frustrated will be particularly relevant in any case involving the alleged frustration of a trade contract for a term. The case involved a 10 year lease of a warehouse. During the fifth year of the lease an access road was closed by the local authority thereby denying the lessee vehicular access to the lease premises. At the time of the hearing, it was assumed that the road would only be closed for a total of 2 years. The lessee had stopped paying rent on the grounds that the lease had been frustrated by the closure of the access road.

Lord Wilberforce and Lord Simon of Glaisdale both considered whether the lease had been frustrated by reason of the road closure. Both concluded that it had not on the grounds that out of a 10 year term the lessee would have lost under 2 years, use and that there would be nearly 3 years left after the interruption had ceased.

In Lord Wilberforce's view, even though the road closure meant the lessee could not use the lease premises during the period of the interruption and had severely dislocated his business, the interruption 'did not approach the gravity of a frustrating event.'[83]

Lord Simon of Glaisdale considered after 'weighing all the relevant factors' the lessee had not demonstrated the road closure so significantly changed the nature of the outstanding rights and obligations under the lease from what the parties could reasonably have contemplated at the time of execution that it would be unjust to hold them to the literal sense of its stipulation.

Both their Lordships Wilberforce and Simon of Glaisdale mentioned the lease contained a clause providing for suspension of rent and for termination of the lease at the lessor's option in the case of the destruction of the premises by fire. Lord Simon pointed out that it must have been within the reasonable contemplation of the parties that the use of the premises might be interrupted by some cause in addition to fire.

FUTURE DEVELOPMENTS

(a) *Impossibility and Impracticability:* It has been pointed out that the original basis of frustration, namely, impossibility to perform, is something of a relative term.[84] What is impossible to perform depends in many instances on the trouble and expense to which one is prepared to go to perform. For this reason, the trend in the United States has been to substitute 'impracticability' for 'impossibility'; a change which is said to represent an intention to widen the scope of the doctrine of discharge by supervening events.[85] 'Impracticability', under Uniform Commercial Code section

83 *Ibid.* 173.
84 *Supra* n.29, 662.
85 *Ibid.*

2-615, includes 'extreme and unreasonable difficulty, expense injury or loss to one of the parties'. It is mentioned that: 'Increased cost alone does not excuse performance . . .'—but is suggested that a price increase 'well beyond the normal range' could lead to discharge.

By contrast, the House of Lords has said 'a wholly abnormal rise or fall in prices' does not in itself alter the contract[86]. Nevertheless, in this context, the remarks of Wilberforce L.J. in the House of Lords' decision in *Bremer v. Vanden*[87] are significant. Under an ordinary c.i.f. contract for the sale of generic goods, a seller can perform his contract one or two ways: by shipping goods of the requisite description himself, or by purchasing goods afloat. In *Bremer v. Vanden*, the House of Lords upheld the decision of Lord Denning M.R. in *Tradax v. Andre*[88], that a seller under an ordinary c.i.f. contract is not obliged to buy afloat in the event of *force majeure* where a 'large number of buyers [are] chasing very few goods and the price would reach unheard of levels.'[89] In *Bremer v. Vanden* Lord Wilberforce indicated that when dealing with 'an export embargo which would create a maximum of buyers chasing a minimum of goods, I am of the opinion that the existence of duty to buy afloat is impracticable and commercially unsuitable.'[90]

Treitel mentions that it should be emphasized that the *Bremer* and *Tradax* cases were not concerned with discharge under the general doctrine of frustration, but with discharge under express contractual provisions for supervening events. In his view, the fact that such a provision may, on its true construction, cover 'impracticability' does not support the view that the same circumstances would frustrate a contract which contained no such provision.[91]

However, with respect to the learned author, it is submitted that there is nothing to suggest that their Lordships' decision in *Bremer v. Vanden* would have been different on this issue if there had been no prohibition of export clause in the relevant contract. On the contrary, there are several statements in their Lordships' judgments which indicate that they would have regarded the contract as frustrated if the contract had not contained that clause (see Lord Wilberforce p. 114 1st col. and Lord Salmon p. 128 2nd col.). Notwithstanding what significance *Bremer v. Vanden* may have for the future regarding abnormal price increases (and it is acknowledged that no mention of that decision was made by the House of Lords in *National Carriers* or *Pioneer Shipping*), the correct approach for English courts and the preferred approach for Australian courts remains Lord Radcliffe's test: by reason of a supervening event or events, there must be such a change in 'the significance of the obligation' that the thing undertaken would if performed be a different thing from that contracted for.

(b) *A U.N. Sponsored Model*: Under the auspices of the United Nations Commission on International Trade Law (UNCITRAL) another Convention on Contracts for the International Sale of Goods was adopted at a diplomatic conference held in Vienna in 1980. The Convention opened for signature at the conclusion of the conference on 11 April 1980. It will come

86 *Supra* n.26, 185.
87 (1978) 2 Lloyds Rep. 109.
88 (1976) 1 Lloyds Rep. 416.
89 *Ibid.* 423.
90 *Supra* n.87, 115.
91 *Supra* n.29, 663-664.

into force one year after the tenth instrument of ratification is received. To date this number of ratifications has not occurred, although the Convention has been signed (but not ratified) by a number of major trading nations representing a wide range of legal systems, such as U.S.A., China, France, Sweden and both the Federal Republic and Democratic Republic of Germany. Whether Australia should become a party to the Convention is presently under consideration by the Australian Government.

The relevance of the Convention for present purposes is that it may apply in the future (in a manner yet to be determined) to international contracts for the sale of goods between parties from different countries and more to the point addresses the subject under discussion in a clear manner.

Article 79 of the Convention provides:

> 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. . . .
> 3. The exemption provided by this article has effect for the period during which the impediment exists.
> 4. The party who fails to perform must give notice to the other party of the impediment and its effect on his ability to perform. If the notice is not received by the other party within a reasonable time after the party who fails to perform knew or ought to have known of the impediment, he is liable for damages resulting from such non-receipt.
> 5. Nothing in this article prevents either party from exercising any right other than to claim damages under this Convention.

It will be recognized the exemption only relates to a party's liability for damages and only applies if the party relying on the exemption so notifies the other party within a reasonable time. Ultimately, it is incumbent upon a party seeking the protection of this exemption to prove the failure to perform satisfies the criterion set forth in paragraph 1 of the clause.

Article 79(1) reflects the civil law concept that a party seeking to be exempted from liability in damages for its failure to perform must demonstrate that it is not at fault as regards the impediment to performance. Provided the event preventing performance is beyond the control of the party relying on it, the exemption is available where either the party did not foresee it even if it could have avoided its consequences or where the party did foresee the event but could not avoid its consequences.

Article 79 only exempts the party concerned from a damages claim for the period during which performance is impeded in the manner described. There is no provision that the contract may be avoided if the impediment would otherwise constitute frustration. Thus under the Convention it is open for a buyer to take the chance that the impediment to performance will be removed and then insist on performance, regardless of the cost to the seller.

IMPLIED TERM

If our seller for whom performance has become more onerous or our buyer for whom performance has become less advantageous, cannot achieve termination of the contract on the grounds of frustration, he will

also have great difficulty in convincing the court (in circumstances not amounting to rectification) that a term should be implied in the contract to overcome the hardship or disadvantage arising under the contract. Recourse to an implied term was the alternative ground in *Codelfa*, but it failed. As Mason J. said:

> For obvious reasons courts are slow to imply a term. In many cases, what the parties have actually agreed upon represents the totality of their willingness to agree; each may be prepared to take his chance in relation to an eventuality for which no provision is made. The more detailed and comprehensive the contract the less ground there is for supposing that the parties have failed to address their minds to the question at issue. And then there is the difficulty of identifying with any degree of certainty the terms which the parties would have settled upon had they considered the question. Accordingly, the courts have been at pains to emphasize that it is not enough that it is reasonable to imply a term; it must be necessary to do so to give business efficacy to the contract.[92]

In *BP Refinery Pty. Ltd. v. Hastings Shire Council*[93], a majority of the High Court laid down the conditions necessary to ground the implications of a term as follows:

1. It must be reasonable and equitable.
2. It must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it.
3. It must be so obvious that 'it goes without saying'.
4. It must be capable of clear expression.
5. It must not contradict any express term of the contract.

In *Codelfa* the lower courts were prepared to imply a term into the contract to the effect that extra remuneration would be available to Codelfa if it was prevented by an injunction from carrying out the works on a three shift continuous basis. The High Court extensively considered whether any such term should be implied and resolved that it should not.

The High Court's approach was that although the general rule is that extrinsic evidence is not admissible for the construction of a written contract, nevertheless evidence restricted to the factual background known to the parties at or before the date of the contract, including the 'genesis' or 'aim' of the transaction, was admissible. This opinion had been expressed in the *BP Refinery* case where the Privy Council said that in deciding whether to imply a term the court should look at the 'matrix of facts' in which the contract was set. This meant that it was open to the High Court in *Codelfa* to take into account the arbitrator's findings of fact that there was a common understanding or belief shared by the parties that the work done should and would be carried out on a three shift continuous basis, that the Authority had represented to Codelfa that no injunction could or would be granted in relation to noise or other nuisance and that the works could not be carried out in accordance with the methods and programmes agreed between the parties unless the contractor worked on a three shift continuous basis.

However, the High Court concluded that these matters of common contemplation between the parties were not enough in themselves to justify the implication of a term. In rejecting the implied term found by the lower

92 *Supra* n.6, 461.
93 (1977) 52 A.L.J.R. 20.

courts, the High Court concluded that Codelfa had not satisfied the requirement that the suggested term was 'so obvious that it goes without saying'. As Mason J. said:

> This is not a case in which an obvious provision was overlooked by the parties and omitted from the contract. Rather it was a case in which the parties made a common assumption which masked the need to explore what provision should be made to cover the event which occurred. In ordinary circumstances negotiation about that matter might yield any one of a number of alternative provisions, each being regarded as a reasonable solution.[94]

ADJUSTMENT CLAUSES

Introduction

There are of course now three main categories of adjustment clauses:

(i) the *force majeure* clause,
(ii) the price review clause, and
(iii) the hardship clause.

The search for the one single perfect *force majeure*, price review or hardship clause is perhaps unnecessary. What is appropriate in one contract may be totally inappropriate in another. What is appropriate is that which gives effect to the aims and aspirations of the parties in the particular circumstances of the contract in hand, be it a long or short term contract or a 'spot sale', be it a contract between producer and end user or between traders. Given the reluctance and uncertainty of judicial intervention to adjust or terminate a contract by reason of changed circumstances, it goes without saying that a party seeking to include, or agreeing to the inclusion of, an adjustment clause should ensure that the ambit and operation of that clause is clearly defined and prescribed. Uncertainty external to the contract should hardly be replaced or compounded by uncertainty within the contract itself.

Any adjustment clause of the type mentioned above will be construed with due regard to the nature and general terms of the contract and with regard to the precise words of the clause itself.[95] Obviously, careful attention should be given to the precise words of the clause itself. However, the clause should not be considered in isolation; on the one hand, the other clauses of the contract may affect its operation, and on the other hand, the adjustment clause itself may affect the operation of the other provisions of the contract. For example, a price review clause providing for short term periodic price reviews may well affect the operation of a hardship clause. Further, a hardship clause and price review clause may well evince an intention on the part of each party to remain bound in a fundamentally different situation and thereby further limit the scope for a party to claim frustration.

The following comments are intended to highlight some aspects of the effectiveness and enforceability (or lack thereof) of the adjustment clauses mentioned above.

94 *Supra* n.6, 465.
95 *Lebeaupin v. Richard Crispin & Co.* [1920] 2 K.B.714, 720.

Force Majeure Clause

In drafting or construing a *force majeure* clause, as mentioned, one should be aware that the courts will construe the clause with due regard to the nature and general terms of the contract and with regard to the precise words of the clause.[96] Also, the party claiming the benefit of the clause has the onus of showing that he falls within that clause. The Mississippi grain embargo cases illustrate the extent of this onus.[97]

(a) *Conditions Precedent*

Very often a *force majeure* clause requires that certain procedures are to be followed or notices to be given by the party claiming the benefit of the clause. The issue in drafting or construing such stipulations is whether they are a condition precedent on which the availability of the protection provided by the clause depends or merely an intermediate term, the non-compliance with which does not deprive a party of his right to rely on the clause although such non-compliance may make him liable in damages to the other party.

The classification depends, as Lord Wilberforce said in *Bremer v. Vanden*[98], on '(i) the form of the clause itself, (ii) the relation of the clause to the contract as a whole, (iii) general considerations of law'.

In that case, the House of Lords had to consider two such provisions in a c.i.f. contract. The first was an export prohibition clause, the first sentence in which provided for the cancellation of the contract in the event of such a prohibition. The second sentence was to the effect that in the event of shipment proving impossible by reason of an export prohibition, sellers were to advise buyers 'without delay'. This was held to be indeterminate term. As Lord Salmon said:

> Had it been intended as a condition precedent, I should have expected the clause to state the precise time within which the notice was to be served, and to have made plain by express language that unless the notice was served within that time, the sellers would lose their rights under the clause. The clause is concerned with writing into the contract what is to occur should it be frustrated at common law. No doubt the contract supersedes the common law but it cannot, in my view, be construed as taking away from the sellers what would have been their protection at common law unless it does so in plain terms. And in this, it conspicuously fails.[99]

The second provision, which took effect upon a number of events of *force majeure*, established a timetable of fixed periods within which (i) sellers were to notify buyers of the occurrence in the event of *force majeure* and give certain information and, (ii) buyers had an option to cancel the contract. It was held that since the clause was 'a complete regulatory code in the matter of *force majeure*', in the absence of a waiver from the buyers, sellers would not be entitled to the protection of the clause unless they punctually and accurately complied with its stipulations.

(b) *The Principle of Reasonable Distribution*

A not uncommon contingency arising under trade contracts is the

96 *Ibid.*
97 As a useful starting point, see *Andre v. Tradax* (1983) 1 Lloyds Rep. 251, 254.
98 *Supra* n.87.
99 *Ibid.* 128.

situation where by reason of an event of *force majeure* seller has sufficient product to satisfy any one individual buyer but not enough to satisfy all of his buyers in full. A seller anxious to maintain cash flow by making at least limited deliveries should ensure that the *force majeure* clause gives him the right to maintain partial deliveries and in his desired manner as stipulated in the *force majeure* clause.

Under the Sale of Goods Act[100] where the seller delivers a quantity of goods less than he contracted to sell, the buyer may reject them (subject to any usage of trade, special agreement or course of dealing between the parties). Apart from this statutory provision, the position at law is far from settled, such decisions as there are, arguably, turn on the construction of the particular excuse clause before the court. In *Bremer v. Continental Grain Co.*[101], the English Court of Appeal approved, although somewhat diffidently, 'the principle of reasonable distribution.'[102] Where a seller can claim the protection of a clause which protects him where fulfilment is prevented or hindered by the excepted peril, subsequent delivery of part of his available stock to other customers will not be regarded as an independent cause of shortage, provided that in making such delivery the seller acted 'reasonably in all the circumstances of the case'.

> This is because, in the absence of any contractual term to the contrary, the buyer under a contract containing such a clause must contemplate that the seller has other customers besides himself, and must also contemplate that the seller will take reasonable steps to fulfil the needs of other customers; and the reasonable action so taken by the seller should not in these circumstances be regarded as a cause of shortage independent of the peril[103].

The Court of Appeal acknowledged that the principle was consistent with authorities such as *Tennants v. Wilson*[104].

Thus the elements of the emerging principle appear to be that no single buyer is entitled to insist upon delivery in full and although seller is entitled to rely on the excuse clause contained in the relevant contract, he has an obligation to distribute the available goods in a reasonable manner amongst his several buyers. It will be noted that the Court of Appeal did not specify any particular mode by which the seller was to divide the available supplies amongst his buyers: the seller must simply act 'reasonably in the circumstances'. In *Intertradex v. Lesieur*[105], Lord Denning M.R. approved the view that the seller should appropriate the available goods 'in a way which the trade would consider to be proper and reasonable—whether the basis of appropriation is *pro rata*, chronological order of contracts, or some other basis.'[106] To overcome any doubts as to how the seller should act in these circumstances it is more than desirable that the *force majeure* clause should state what the seller is required to do and what the buyer is entitled to expect in these circumstances.

100 See s.33 Sale of Goods Act, 1923 (N.S.W.) as amended, and its equivalent.
101 (1983) 1 Lloyds Rep. 269.
102 *Ibid.* 292.
103 *Ibid.*
104 [1917] A.C. 495.
105 (1978) 2 Lloyds Rep. 509.
106 *Ibid.* 513.

Export Approvals

Under Regs. 9 and 11 of the Commonwealth's Customs (Prohibited Exports) Regulations, the permission of the Minister for Trade and Resources is required for the export of the vast majority of our mineral and petroleum products. In New South Wales under the Joint Coal Board's Order No. 30, the Board's consent is also required for each shipment of coal through Newcastle, Sydney or Port Kembla. The Board's approval is required on a ship by ship basis, whilst the Minister's approval is generally sought on an annual basis.

A party responsible for obtaining the abovementioned approvals would be well advised to ensure that his contract contains an appropriate provision to the effect that his performance is conditional upon those approvals being obtained. In this regard, note that under a c.i.f. or f.o.b. sales contract, in the absence of a contrary provision, the seller undertakes at his own risk and expense to obtain any export licence or other governmental authorization necessary for the export of the goods.[107]

When at the time the contract is entered into export approval is required but the contract does not contain any provision to the effect that performance is conditional upon the necessary export approval being obtained, the party responsible for obtaining that approval is clearly at risk if the approval is not granted. The legal issues arising in these circumstances are very close to the New South Wales coal exporters. Until 1981 Joint Coal Board approval for shipment under Order No. 30 had been regarded as 'a mere formality'. However, in that year, by reason of port congestion, the Board imposed quotas on some exporters and thereafter only issued Order No. 30 approvals to those exporters in accordance with their respective quotas.

Two issues are involved. The first is whether on the true construction of the relevant contract the party responsible for obtaining the approval undertook absolutely that the approval would be obtained or whether he simply undertook to use all due diligence to obtain it. (*Peter Cassidy Seed Co. Ltd. v. Oswstukkukaupa Ltd.*[108]). In that case Devlin J. construed the words in the contract before the court 'Delivery; prompt, as soon as export licence granted' as meaning the seller had undertaken absolutely that a licence would be granted, it was only a question of time before the licence would issue. Accordingly, the seller was held liable in damages for failing to deliver under the contract when he could not obtain an export licence by reason of the fact that he was not lawfully entitled to hold one.

The second issue is whether there has been a supervening event after the making of the contract (*e.g.* a change of governmental policy with regard to the issue of export approvals) such that that event falls within the *force majeure* clause contained in the relevant contract or otherwise frustrates the contract. In *Walton (Grain) Ltd. v. British Trading Co.*[109], Diplock J. was not prepared to hold that the seller in that case had undertaken absolutely that the export licence would be obtained and held the Government proclamation that no further export licences would be issued constituted a governmental prohibition on export falling within the *force*

107 *Incoterms* (1977 Ed.) 28, 42.
108 (1957) 1 W.L.R. 273.
109 (1959) 1 Lloyds Rep. 223.

majeure clause contained in the subject contract. He further mentioned that if the contract had not contained a *force majeure* clause he would still have found in favour of the seller on the grounds that the Government announcement frustrated the contract.

A far more restrictive approach was adopted by the court in the *Congimex* cases[110] where the Portuguese buyer argued on similar lines in relation to a change in the Portuguese Government's policy which thereafter prevented him from obtaining import approvals which at the time his contracts had been made was a 'mere formality'. The seller was also unsuccessful in *Partabmull Rameshwar v. K.C. Sethia*[111], the House of Lords holding in that case that on a true construction of the relevant contract the seller had agreed absolutely to deliver.

Price Review Clauses

It has been observed that by including price review and hardship clauses in long term sales contracts the parties attempt 'to create a system of "internal regulation" designed to protect the financial equilibrium of their agreements from the undesired effects of a constantly changing economic environment.'[112] Given the uncertainty and reluctance of the courts to intervene where performance has merely become more expensive or where there has only been an increase or decrease in market price, contracting parties are clearly entitled to be concerned that the contract itself should provide protection against economic change.

The need for a price review clause in a term contract is not questioned. However, the value of a hardship clause particularly one which is drafted in imprecise terms may be questioned.

A common price review clause inserted in contracts today will provide for the price to be reviewed by negotiation at the end of each given period and for the consequences of a failure to agree, those consequences usually being an arbitral or expert determination, or termination of the contract.

It is clearly noticeable that the period between price reviews has become increasingly shorter over the last 10 years in many contracts. Whereas many export contracts entered into before 1980 would provide for a price review every 3 or 5 years, many contracts today provide for a price review by negotiation every 1 or 2 years.

We should appreciate that when a contracting party is determining the length of the period between price reviews or even the scope of his hardship clause, he is in fact trading both with himself and with the other party the certainty and benefits of fixed prices against the inponderables of price fluctuations and cost increases. A commercial judgment of market risk is involved. The issue is whether to assume the risk as to which way the market price or performance costs may go or to share those risks with the other party.

110 *Congimex v. Continental Grain Export Corp.* (1979) 2 Lloyds Rep. 346, and *Congimex v. Tradax* (1983) 1 Lloyds Rep. 250.

111 (1951) 2 Lloyds Rep. 89.

112 Kemp K., 'Applying the Hardship Clause' (1983) 1 *Journal Energy Resources Law* 119.

Hardship Clauses

To date a typical hardship clause in an Australian export contract has been to the effect that if a party claims 'hardship' or 'a problem arising from unforeseen circumstances', the parties will meet and 'in good faith' ('or in a spirit of mutual understanding and collaboration') use their best endeavours to mitigate the hardship or solve the problem, as the case may be. The clause is often silent on what follows if the parties do not agree on the course of action to be taken to mitigate the hardship or to solve the problem.

There are at least two aspects of a hardship clause which we should consider. Firstly, it has been mentioned many times that if the clause does not provide for arbitration, suspension of contractual obligations or some other 'sanction', in the event the parties fail to reach agreement, the clause constitutes no more than agreement to negotiate and as such is unenforceable.[113] Thus, 'without teeth', the clause is ineffectual in legal terms (although not necessarily so in commercial terms).

Secondly, as illustrated by the recent decision in *Superior Overseas Development Corporation v. British Gas Corporation*[114], careful regard should be had to the actual words used in these clauses. The hardship clause in that case was in the following terms:

(a) If at any time or from time to time during the contract period there has been any *substantial change in economic circumstances* relating to this Agreement and (notwithstanding the effect of the other relieving or adjusting provisions of this Agreement) either party feels that such change is causing it to suffer *substantial economic hardship* then the party shall (at the request of either of them) meet together to consider what (if any) adjustments in the prices in force under this Agreement . . . are justified in the circumstances in fairness to the parties to offset or alleviate *the said hardship* caused by such change.

(b) If the parties shall not within ninety (90) days after any such request have reached agreement on the adjustments (if any) in the said prices . . . which are to be made then the matter may forthwith be referred by either party for determination by experts to be appointed in the manner set out in Article . . .

(c) The experts shall determine what (if any) adjustments in the said prices . . . shall be made for the purposes aforesaid and any revised prices . . . so determined by such experts shall take effect six (6) months after the date on which the request for the review was first made.

There were two issues before the court. Firstly, the buyer argued that 'the said hardship' in paragraph (a) meant the said substantial economic hardship and accordingly only the substantial element of 'substantial hardship' should be offset under the clause, leaving the seller to endure mere hardship. The seller naturally argued that any price adjustment should be such to offset the whole of his hardship. The majority of two found in the

113 *Courtney & Fairbain Ltd. v. Tolaini Bros. (Hotels) Ltd.* (1975) 1 W.L.R. 297.
114 (1982) 1 Lloyds Rep. 262.

seller's favour. It should be noted however that one member of the Court of Appeal and the lower court had held in the buyer's favour.

The second issue related to the period of hardship which the experts in their determination under paragraph (c) should alleviate. The buyer argued that only future hardship (that is, the hardship existing after the date upon which the experts' decision took effect) was to be alleviated. All three members of the Court of Appeal held that the experts should alleviate the hardship arising from its inception.

The majority emphasized that the clause only operated if the 'trigger mechanism' or threshold test was satisfied. Thus, the clause did not operate if the party invoking the clause was mistaken in thinking that there had been a substantial change in economic circumstances or that such a change was causing it to suffer substantial economic hardship.

As to the meaning of 'substantial economic hardship' Donaldson L.J. noted that this phrase was subjective in terms of the party invoking the clause. His Lordship interpreted 'substantial' as meaning something weighty or serious, rather than merely something more than minimal:

> but more than that cannot be said without being guilty of redrafting the parties' agreement and usurping the judgment of the experts. No doubt in the border area, one panel might reach one conclusion and another a different one, but that is always true when judgment and, particularly economic judgment, is involved.'[115]

Clearly as his Lordship indicated, subjective and vague terms such as 'hardship', let alone 'substantial economic hardship', invite dispute and are pregnant with litigation. Thus, where a contracting party considers it sufficiently important that his contract should include a hardship clause, the prudent course would be to define these and similar concepts in the interests of avoiding any doubt as to the operation of the clause. Any definition of 'hardship' and similar phrases will of course depend on the circumstances of the particular contract. In the *Superior* case, the experts in a prior determination under the hardship clause mentioned above had determined 'substantial economic hardship' in terms of seller's achieved rate of return on capital (ARR) falling below the minimum acceptable rate of return (MARR). They had decided that the seller who was also the gas producer would suffer subtantial economic hardship if the ARR fell below MARR by 2% or more.

As has been recently said, 'contracting parties wishing to save themselves the expense and aggravation of going to court, would be well advised to ensure that their hardship clauses are drafted with greater precision.'[116]

CONCLUSION

We are indebted to Michael Wright for the excellent way in which he has raised for our consideration the many legal and commercial issues underlying this topic. Thanks to his efforts, this commentator has been able to concentrate on some particular aspects of those issues.

115 *Ibid.* 269-270.
116 *Supra* n.112, 122.