CLIFFORD CHANCE

Briefing note

July 2013

Supplier Beware: An abnormal increase in costs will not frustrate a contract

Singapore High Court takes pragmatic approach and rules against concrete supplier in favour of Japanese contractor in latest 'Sand Ban' case (*Alliance Concrete Singapore Pte Ltd v Sato Kogyo (S) Pte Ltd [2012] SGHC 127*).

Sand is an essential ingredient for the production of ready-mixed concrete. In February 2007, the Indonesian authorities issued a ban on the export of sand resulting in major disruption to the Singapore construction industry due to a spike in costs for sand and granite here. This resulted in a spate of cases between ready-mixed concrete suppliers and building contractors based on the doctrines of frustration and *force majeure* finding their way into the Singapore Courts. Significantly, in this latest ruling the Singapore High Court found in favour of the contractor.

The facts

The Defendant in this action Sato Kogyo (S) Pte Ltd (**SK**) was the main contractor in Singapore for the extension of Boon Lay MRT, a teaching and laboratory facility at Nanyang Technological University (**NTU**) and a six story building at Harbourfront. In 2006, SK entered into three separate agreements with the Plaintiff, Alliance Concrete Singapore Pte Ltd (**Alliance**) for the supply of ready-mixed concrete (**RMC**) for these projects. On 23 January 2007, the Indonesian authorities announced a ban on the export of sand to Singapore (the **Sand Ban**) that was due to take effect from 5 February. In response, on 31 January 2007, the Building and Construction Authority of Singapore (**BCA**) announced that from 1 February 2007 it would release sand from its stockpile to contractors with ongoing projects and that government agencies would absorb 75% of any increase in costs of sand for existing projects with the balance of 25% of any increase to be shared between the main contractor and the RMC supplier.

On 29 January 2007, Alliance unilaterally decided that it was no longer bound by the original terms of its three agreements with SK and wrote to SK announcing its intention to increase the price of RMC " ..*in view of the sharp prices in raw materials."*

On 9 February 2007, Alliance sent SK a quotation with new terms for the supply of RMC for the projects, which SK rejected as it wished to rely on sharing the increased cost of sand in accordance with the BCA's cost-sharing agreement and was not prepared to rewrite the contracts. Alliance supplied quantities of RMC to SK on an intermittent basis after the Sand Ban came into effect but stopped supplying SK in late February 2007 as senior management of both parties were unable to resolve their differences on new prices for RMC. On 22 June 2007, Alliance commenced proceedings against SK for failing to pay for RMC supplied under the three contracts and SK counterclaimed that Alliance had breached / repudiated these contracts by failing to supply RMC after the Sand Ban.

The legal arguments

Alliance founded its claim for the increased price of RMC supplied on three arguments:

(i) it was no longer bound by the terms of the original contracts due to the doctrine of frustration arising from the Sand Ban;

(ii) the application of alleged *force majeure* clauses in the NTU and Harbourfront contacts; and

(iii) that the contracts had been superseded or varied by fresh agreements entered into between itself and SK entered after the Sand Ban.

Had the contracts been superseded?

Tan Lee Meng J, found in favour of SK, holding that the contracts had not been superseded. Firstly, Alliance's Sales director, Mr Patrick Hong confirmed on cross-examination that the parties had still not agreed a new price for the RMC even as late as May 2007. Secondly, the judge found that Alliance's invoices to SK also did not support its case that the contracts had been superseded, as Alliance had issued one set of invoices under the original contracts and a second set of invoices for the surcharges and this was confirmed in Hong's testimony.

The frustration argument

Tan Lee Meng J held that the key test for this argument to be effective was

> " ...*whether or not the Sand Ban radically altered the nature of Alliance's obligations under the Contracts or merely made it more expensive or onerous for it to fulfil its obligations to SK."*

A key fact in this case was that sand was obtainable from the BCA stockpile as SK was a main contractor on existing projects and SK had made it clear to Alliance that it was prepared to comply with the BCA procedure to obtain sand to enable Alliance to manufacture the required RMC for their projects, provided that Alliance followed the BCA's cost-sharing arrangement.

The judge also found that if necessary, Alliance could have sourced sand from other countries as it had been offered Vietnamese sand in May 2007, but rejected it for reasons relating to the price of the sand.

> *"... a party who agrees to supply goods or services for a fixed price would, in absence of terms to the contrary, be deemed to have taken the risk of any increase in the costs of supplying those goods or services...increased costs of performing contractual obligations do not, without more, frustrate a contract."*
>
> Tan Lee Meng J

The judge found that the Sand Ban had merely made it more expensive for the Plaintiff to manufacture RMC, but Alliance had not been rendered incapable of performing its obligations under the contracts at the material time and nothing had occurred that had radically altered the obligations undertaken by it under the contracts. The judge therefore rejected the frustration argument.

Although, Alliance had relied on previous Sand Ban cases where frustration arguments had succeeded, namely (*Holcim (Singapore) Pte Ltd v Kwan Yong Construction Pte Ltd [2008] SGHC 231, [2009] 2 SLR 193*) and *Precise Development v Holcim (Singapore) Pte Ltd [2010] 1 SLR 1083* Tan Lee Meng J, found that these cases were confined to their facts.

In contrast to the present case, in *Kwan Yong Construction,* the contractor had failed to assist the supplier to draw on sand from the BCA stockpile. In *Precise* the Court held that the contract had been frustrated as it was found to be impossible on the facts of the case for the supplier to meet orders of 100m^3 of RMC within two days after the order had been placed as required by the terms of that particular contract. In the present case there was no evidence that Alliance would not have been able to deliver RMC within two days.

The judgement held that:

"...*Precise (CA) and Kwan Yong, were decided on their own particular facts and need not be followed where, as in the present case, circumstances were different..."*

The *force majeure* argument

Alliance also pleaded that the NTU and Harbourfront contracts contained *force majeure* clauses which were triggered by the Sand Ban.

SK contended that it had not signed the particular documents which contained the *force majeure* clause but had made a counter-offer by issuing two separate purchase orders that did not contain *force majeure* clauses. These orders were signed by both parties.

Tan Lee Meng J found in favour of SK stating that:

> "...*in the 'battle of forms' in relation to offer and acceptance, SK fired the last shot*."

The NTU *force majeure* clause stated: "*We shall be under no obligation to supply the ready-mixed concrete if the products have been* ***disrupted*** *by virtue of ....shortage of materials ...or any other factors that could have arisen through circumstances beyond our control.*"

The alleged Harbourfront *force majeure* clause stated: "*In the event of any circumstance constituting Force Majeure which is defined as act of God, or due to any cause beyond ACS' control, such as raw material shortages...the* ***affected party*** *to perform its obligations shall be suspended or limited until such circumstance ceases*."

The judge went on to find that even if these clauses had been agreed, because Alliance had access to other sources of sand and because SK was willing and did procure sand from the BCA for Alliance, there was no *disruption* to Alliance. Further, the judge held that Alliance was not an *affected party* within the terms of the clauses as it had not taken sufficient steps to avoid the consequences of the Sand Ban.

Conclusion

The doctrine of frustration applies to the treatment of contractual obligations from the onset of an unforeseeable event. Frustration as a defence to enforcement of a contract will not be successful when there is merely an increase in costs of supplying goods or services, whether that be due to a currency fluctuation or an abnormal rise or fall in prices of raw materials.

A *force majeure* clause operates differently to the doctrine of frustration. It is an agreement as to how outstanding obligations should be resolved upon the onset of a foreseeable event. The effect of the clause will depend on its precise language and the actual facts of the case in question.

This case acts as a timely reminder that if you are to protect yourself against an abnormal increase in costs, you must ensure that your contract expressly provides for this.

The Singapore Courts take a pragmatic case-by-case approach when dealing with the various frustration and *force majeure* cases resulting from the Sand Ban by looking at the reasonableness of the parties' conduct in light of their particular contractual arrangements.

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