IN THE COURT OF APPEAL FOR EAST AFRICA

AT NAIROBI

(Coram: Wambuzi P, Law L-P & Mustafa JA)

CIVIL APPEAL NO 33 OF 1975

NAKURU OIL MILLS LTD……...…….. PLAINTIFF

VERSUS

DK LAKHANI ……..…. DEFENDANT

JUDGMENT

The appellant (to whom I shall refer as "the plaintiff") filed a suit against the respondent ("the defendant") in the High Court, for damages representing the loss suffered by the plaintiff on the resale by him of a quantity of cottonseed oil cake which the defendant had contracted to buy but allegedly failed to take delivery of or pay for.

The defendant entered an appearance, and before taking any steps in the suit, applied under section 6 of the Arbitration Act to the High Court to stay the proceedings as the two contracts between the parties for the sale of the cake contained an arbitration clause. Nyarangi J, who heard the application, granted the application with costs, ordered that the proceedings be stayed and that the plaintiff should pay to the defendant half the costs of the suit. From that decision the plaintiff, with leave, has appealed.

The background to this appeal is as follows. By two contracts in writing, dated 3rd and 14th December 1973 respectively, the plaintiff agreed to sell and the defendant agreed to buy two consignments of 100 tons of cottonseed oil cake at Shs 1100 and 1300 a ton respectively. Delivery was to be made to a named warehouse in Mombasa, and payment was to be made as to 90 per cent of the purchase price "against documents" and as to the balance after weighing and analysis. Both contracts bore the following endorsement: "NB. In case of dispute or default this contract is governed by Mombasa Produce Exchange's Rules and Regulation." The relevant rules are rules 12 and 13 and read as follows:

12. Disputes. In default of fulfillment of contract by either party, the injured party, at his discretion, shall after giving 72 hours' notice in writing in the case of Kampala parties, or by telegram in the case of other parties, have the right to sell or purchase as the case may be, against the defaulter who shall make good the loss, if any, on such sale or purchase on demand. Any dispute as to loss or damage involved shall be referred to arbitration.

13. Arbitration. Any dispute shall be referred to arbitration in accordance with the arbitration rules of the exchange where the contract is registered. Application for arbitration shall be lodged with the secretary within seven days of receipt of property. In cases where it is necessary for the buyer to obtain an analysis certificate the time limit for claiming arbitration shall be extended provided buyer gives written evidence of application within five days of arrival of goods and claims arbitration within seven days of date of analysis certificate.

Payment of the 90 per cent of the sale price as due on receipt of documents was made by the defendant in the form of two cheques for Shs 99,000 and Shs 117,000 respectively. When presented for payment, the cheques were returned to the plaintiff by the defendant's bank, marked "Refer to Drawer". The plaintiff's advocates then wrote, to the defendant on 24th July 1974, a registered letter, correctly addressed, which was subsequently returned by the postal authorities marked "Unclaimed". This letter gave notice of the plaintiff's intention to exercise his right of resale as an unpaid seller, which is conferred by rule 12. On the 9th September 1974, the plaintiff's advocates again wrote, this time under certificate of posting, a letter claiming the loss made under the sale, failing which court proceedings would be instituted, and inviting the defendant to make known his intentions in the matter. The defendant did not reply. On 26th October 1974, the suit was filed, claiming Shs 96,349.05 being the loss on resale. The defendant entered an appearance. Before taking any further steps in the proceedings, he applied through his advocates under section 6 of the Arbitration Act for "the suit to be stayed and then dismissed with costs". In his affidavit in support, the defendant referred to the contracts and to the Mombasa Produce Exchange's Rules, which documents he exhibited. In paragraph 4 of his affidavit, the defendant stated:

That I have been at all times ready and willing to refer the matters in issue to arbitration as per agreement between parties hereto but the plaintiff has never alluded to this mode of procedure.

The affidavit is silent as to the existence of any dispute between the parties, or of any default on the part of the plaintiff, which could form the subject of arbitration. Up to this stage, the only dispute or default of which the plaintiff was aware was the defendant's unwillingness or inability to pay. The plaintiff filed a counter-affidavit, through a director, setting out the history of events leading to the filing of the suit, and pointing out that the defendant had at no time indicated the existence of any dispute which could be the subject of arbitration. In reply to the counter-affidavit, the defendant filed a further affidavit which, for the first time, identified various grounds of dispute, the principal one being that the goods had not been delivered in accordance with the contracts.

I would say in passing that I do not consider rule 13, quoted above, to be relevant to the instant appeal except perhaps for the first sentence. It provides for the arbitration of disputes arising after "receipt of property". The defendant denies having received the goods; he says they were never delivered to him. What we are concerned with is rule 12, which gives the buyer and the seller a right to buy or sell elsewhere "in default of fulfillment" of the contract by the other party, in which case "any dispute as to loss or damage involved shall be referred to arbitration", which arbitration, according to the first sentence of rule 13, shall be "in accordance with arbitration rules of the exchange where the contract is registered". The evidence available is silent as to whether the contracts giving rise to this appeal were registered. Assuming they were registered at the Mombasa Exchange, then, on the basis on which the matter was argued in the High Court, there clearly was in existence an arbitration agreement, under rule 12, for any dispute as to loss or damage involved in the sale elsewhere of the cottonseed cake, as happened in this case, to be referred to arbitration. The question for decision in this appeal is whether the defendant is entitled to have the plaintiff's suit for damages for loss on resale stayed and the matter referred to arbitration. To establish this entitlement, the defendant must satisfy the Court, under section 6(1) of the Arbitration Act, that there is no sufficient reason why the matter should not be referred to arbitration, and that he was at the time when the proceedings were commenced, and still remains, ready and willing to do all things necessary to the proper conduct of the proceedings. If he does so satisfy the Court, then under section 6(2) (b) of the Act, the Courts shall make an order staying the proceedings:

unless satisfied that the agreement for arbitration has become inoperative or cannot proceed or that there is not in fact any dispute between the parties.

The judge found that there was a dispute, and although the nature of this dispute was not revealed until the last possible moment, I am not prepared to disagree with the judge on this point. As regards the defendant's willingness to arbitrate, the judge held that the defendant, having applied for the proceedings to be stayed, "is deemed to have been ready and still remains ready to facilitate the proper conduct of arbitration". I have not found this reasoning easy to follow. The history of the matter, as revealed in the affidavits and by the conduct of the defendant before the suit was filed, makes it appear to my mind that the defendant was only too happy to rescind the contracts and to avoid any adjudication on them, whether

by arbitration or otherwise. The dishonour of his cheques on presentation, his refusal to take delivery of the registered letter giving him notice of plaintiff's intention to resell the goods and to hold him responsible for any loss, and his silence on receipt of the letter under certificate of posting informing him of the results of the sale and the consequent loss, all point to the defendant's inability to pay, to a desire for delay, and to unwillingness on his part to have the matter adjudicated. The plaintiff was, in my view, entitled to think that the defendant was not interested in arbitration, or for that matter in resisting the claim for damages.

There is, however, another aspect of the matter which was not argued in the court below, but of which notice was given by this Court to Mr Khanna and to Mr Gautama who appeared for the defendant and for the plaintiff respectively on this appeal; and we have had the benefit of hearing argument on the point from these experienced advocates. The point is whether the agreement for arbitration had become inoperative, in which case the proceedings should not have been stayed under section 6(2)(b) of the Arbitration Act. The point arises from a consideration, in the context of this case, of the effect and meaning of section 48(4) of the Sale of Goods Act. This subsection reads as follows:

Where the seller expressly reserves a right of resale in case the buyer should make default, and, on the buyer making default, resells the goods, the original contract of sale is thereby rescinded, but without prejudice to any claim the seller may have for damages.

It appears to cover exactly the position which has arisen in the case now under consideration. The plaintiff, the seller under the original contracts, had an expressly reserved right of resale; if the defendant, the buyer, made default when his cheques were dishonoured, or otherwise, and the plaintiff resold the goods, then the result was that the original contracts were automatically rescinded. Did this rescission have the effect of cancelling the arbitration clause incorporated into the original contracts? If so, the proceedings instituted by the plaintiff for damages on resale ought not to have been stayed, as there was no longer an arbitration agreement in existence to justify a stay of those proceedings, and the jurisdiction to order a stay ceased to exist. Mr Gautama relied on *Chandu Lal Parma Nand v Grahams Trading Co Ltd*, 23 ILR (Lahore) 788, in which it was held that the defendant having exercised the right of resale, the contract was annulled completely as laid down in section 54(4) of the Indian Sale of Goods Act (which is identical with section 48(4) of the Kenya Sale of Goods Act) except with regard to the seller's claim for damages which could be enforced under the ordinary law, and that the arbitration clause, being an integral part of the contract, must be taken as abrogated along with the contract which was rescinded by operation of law. Tek Chank J who delivered the leading judgment held that, for the purposes of section 54(4) of the Indian Act, rescission meant "annulment" or "complete destruction", and that where contract had been rescinded by virtue of that subsection, the position of the parties was as it would have been had the contract never existed, except for the seller's right to claim damages, which is specifically saved. Tek Chand J cited with approval extracts from the judgment of the Privy Council delivered by Lord Sumner in *Harji Mulji v Cheong Yue Steamship Co Ltd* [1926] AC 497. In that case it was held that there had been frustration of a charter party which forthwith brought an end to the whole contract, including the submission to arbitration. In Lord Sumner's words:

… a contract that has determined is in the same position as one that has never been concluded. It founds no jurisdiction. … An arbitration clause is not a phoenix that can be raised again by one of the parties from the dead ashes of its former self. By its very terms, as well as by the fact that it was only one part of the indivisible charter, it has come to an end also.

In his supporting judgment in the *Chandu Lal Parma Nand's* case Beckett J said:

It is possible that under English law the arbitration clause might have to be considered as still alive so far as the claim for damages is concerned; but here we have to be guided by the wording of the Indian statute and the relevant provision seems sufficiently clear. I agree that the arbitration clause must be regarded as an integral part of the contract; and if the contract is rescinded by the operation of law, the arbitration clause must go with it. To assume that the contract is to be regarded as rescinded in part only would mean reading something into the statute which it does not contain. All that is reserved is the claim for damages …

Mr Khanna submitted that *Chandu Lal Parma Nand's* case should not be followed by this Court, as in his view it represented bad law. He submitted that an arbitration clause, wide in its scope as was the one now under consideration, survived on the rescission of the contract in which it was contained. He submitted that the word "rescinded" in section 48(4) of the Kenya Sale of Goods Act did not mean rescinded *ab initio,* but merely determined at a certain stage; and he relied on a passage in the judgment of Mocatta J in *Henck v Andre Cie SA* [1970] 1 Lloyd's Rep 235 at 241, that:

The words in this arbitration clause are indubitably words of very considerable width, which have been held wide enough to cover disputes arising when the whole contract has been destroyed by reason of circumstances giving rise to the application of the doctrine of frustration.

We are not, however, concerned in this appeal with a contract, which has been determined or destroyed by frustration, in which case its further performance is automatically ended. The contract in the case of frustration ceases to exist as from the time that supervening and uncontemplated events strike away the foundations of the contract. In such a case, an arbitration clause in the contract may well survive and regulate the resolution of disputes arising out of the contract before it was destroyed by frustration. What we are concerned with in this appeal is the effect on a contract of its rescission by operation of law, in this case section 48(4) of the Sale of Goods Act. I would agree with the judges in *Chandu Lal Parma Nand's* case to this extent, that when a contract for the sale of goods has been rescinded by reason of the operation of that section, it is annulled and ceases to be operative. If this were not so, it would not have been necessary to save the seller's right to claim damages. Nothing else is saved. All the other terms, including an arbitration clause, are annulled on rescission. To hold otherwise, in the words of Beckett J cited above, would be to read into the subsection something, which it does not contain.

The subsection preserves in existence the right to claim damages, and nothing else, out of the rescinded contract. The arbitration clause having gone with the contract, the jurisdiction to stay a suit for damages for loss on resale, and to refer the dispute to arbitration, has ceased to exist.

It is necessary to consider what would have been the position had section 48(4) of the Sale of Goods Act and the persuasive authority of *Chandu Lal Parma Nand's* case been brought to the notice of the judge in the court below as should have happened. In my view the judge must have refused to stay the suit, which was based on an alleged right of resale exercised after alleged default on the part of the defendant in failing to make payment for or to take delivery of the goods under the contract.

Prima facie section 48(4) applies, in which case the original contracts have been rescinded, and only the right to sue for damages in respect of loss on the resale survives. *Prima facie* the arbitration clause has gone together with the original contracts. If this turns out to be the case, then there would have been no jurisdiction to stay the suit. That the contracts reserved a right of resale is not in question. If it transpires, in the course of the hearing of the suit, that the defendant was not in default, then the plaintiff's right to claim damages under section 48(4) for loss on resale will not have been established, and the suit will be dismissed. If, on the other hand, the plaintiff established that he properly exercised his right of resale on the defendant making default the original contracts, then he will be entitle to damages. The original contracts will have been rescinded, together with the arbitration clause.

An order for stay could only have been made, in my opinion, if the judge, in the course of hearing the application, had been able, on the evidence available to him, to make a finding that the defendant had not been guilty of any default, so that section 48(4) of the Sale of Goods Act did not apply, in which case he could have enforced the arbitration clause.

For these reasons I do not think the order staying the suit should have been made. I would allow this appeal. I would set aside the order staying the proceedings, and the order that the plaintiff do pay the defendant half the costs of the suit. I would order that the proceedings be re-instated and that the suit proceed to hearing. I would leave the costs of the application to the discretion of the court below in the light of the eventual determination of the suit.

As this appeal succeeds, in my view, on a ground not raised by the plaintiff, as it should have been, in the

court below, but raised by this Court as affecting the jurisdiction of the High Court to make the order the subject of this appeal, I would leave the parties to bear their own costs of this appeal.

Wambuzi P. I had the benefit of reading in draft the judgment prepared by Law V-P and I agree with his conclusion. As a matter of emphasis, however, I would like to comment one or two matters in this case.

First the trial judge found as a fact that there was a dispute because "one party was averring something which was denied by the other" and he considered the failure of the defendant to respond to written communications to him, namely the two letters from the plaintiff's advocates inviting him to make known his intentions as regards their claim, as part of the dispute. With respect, I find this reasoning a little contradictory. If the defendant said nothing, how would he have denied the plaintiff's assertions? Surely the defendant was not entitled to sit back, say and do nothing until an action was filed against him and then, at the very last moment, claim that there was a dispute which must be referred to arbitration. I would agree, however, that if at the hearing of the application there was an apparent dispute, then the Court had to decide whether or not there was sufficient reason why the matter should not be referred to arbitration. Even then, I would not consider silence on the part of the defendant who had been threatened with court proceedings to recover the loss suffered on the resale as showing readiness and willingness to do all things necessary to the proper conduct of an arbitration. Identification of any areas of dispute must be one of such matters. I would not go so far as to say either, that there must be clear evidence that a party intended to waive his right to arbitration, as the judge put it, but rather that party must show that he was at the time of commencement of the proceedings ready and willing, and still is, to go to arbitration. I cannot see on the facts of this case that there was that readiness or willingness on the part of the defendant.

Secondly, the effect of section 48(4) of the Sale of Goods Act really hinges on the meaning of the word "rescind". This word unfortunately is not defined in the act. The Indian case *Chandu Lal Parma Nand v Grahmas Trading Co Ltd*, 231 L R (Lahore) 788 is of great persuasive value, particularly as it deals with an identical provision. However, I would not agree as Tek Chand J put it that rescission in the context of the section means "complete destruction", that thereafter the contract is nothing but dead ashes or that the position is as if the contract was never made. If this were so, I am unable to see how any Court could possibly adjudicate on any claim by the seller for damages, which claim is expressly reserved. I should think that any claim for damages must relate to the terms of the contract. If this is so then, with respect, I doubt if any Court can find much in the dead ashes of the contract as a basis for the award of any damages.

Mr Khanna's argument that the arbitration clause survives rescission by reason of the width of its scope is very persuasive in that, if the right to damages is saved, then the method of ascertaining the damages is also saved. However, the point here is not the scope of such a clause but its life. I subscribe to the view that where a word causes problems as to its meaning it should be given its ordinary meaning. The *Concise Oxford Dictionary* defines the word "rescind" as "abrogate, annul, revoke, cancel": and "abrogate" is defined "repeal, cancel (law or custom)". I cannot see that there is any element of destruction in the word "rescind" in its ordinary sense as defined. In any case, in the context of the section it could not have been intended to portray that sense because of the right of the seller to damages, which is saved. I would prefer, therefore to put it simply that a contract which is rescinded under the section ceases to have effect, it ceases to operate, except for the purpose of determining any damages for the seller. I think such interpretation would agree with the wording of section 6(2) (b) of the Arbitration Act to the effect that the Court shall make an order staying the proceedings "unless satisfied that the agreement for arbitration has become inoperative…" In my view the arbitration clause in this case is a term of the contract which does not assist any Court to ascertain the extent of the damage or loss suffered by the seller who has exercised his right of resale but rather an agreement by the parties to a method of ascertaining such damage or loss. Put in a different way, the parties agreed to exclude the jurisdiction of the ordinary Courts in favour of arbitration in certain circumstances. This agreement has nothing to do with the seller's right to damages as such, and in my view ceases to apply or becomes inoperative upon rescission of the contract. That leaves the question of damages to be determined by the ordinary courts. I would allow the appeal and I agree to the orders proposed by Law V-P and, as Mustafa JA also agrees, it so ordered.

Mustafa JA. I have read the judgment prepared by Law V-P in which the facts have been fully set out. I will only briefly deal with the point concerning the meaning and effect of section 48(4) of the Sale of Goods Act (hereafter called "the Act") which reads: Where the seller expressly reserves a right of resale in case the buyer should make default, and on the buyer making default, resells the goods, the original contract of sale is thereby rescinded, but without prejudice to any claim the seller may have for damages.

It is surprising that there is very little authority regarding the construction of section 48(4), which exists in identical terms in both the Indian and English Sale of Goods Acts. There is an Indian case *Chandu Lal Parma Nand v Grahams Trading Co Ltd* 23 ILR 23 ILR (Lahore) 788 in which it was held that when a seller had exercised his right of sale on a buyer making default and there was a reserved right of such resale, then the seller's claim for damages could be enforced in a suit in Court under the ordinary law, and the arbitration clause, being an integral part of the contract, must be taken to be abrogated together with the contract which was rescinded by operation of law. Tek Chand J who delivered the leading judgment held that "rescind" in the corresponding Indian section 54(4) meant "annul" or "complete destruction" and that on the rescission of a contract by virtue of that subsection, the position would be as if the contract had never existed, but without prejudice to the right of a seller to claim for damages. Beckett J in his supporting judgment held that the contract is rescinded *in toto*, not in part. With respect, I agree with the reasoning in *Chandu Lal Parma Nand's* case. I think "rescind" in the context of section 48(4) of the Kenya Act has the meaning given to it by Tek Chand J, and that once rescinded the contract is destroyed and becomes void *ab initio*.

It no longer exists. In my view, the right of a seller to claim damages in such an event is a right conferred by statute, by the Act, and does not flow from the defunct contract. In such circumstances a seller claims damages for any loss suffered by him arising from such resale according to the ordinary law in a Court, and will have to prove such loss in the ordinary way. He can do so by relying on letters and documents, invoices sent or admissions made, by oral evidence and by reference to proper books of accounts kept in the ordinary course of business and by any other method normally adopted in such claims. I do not think that the non-availability of the defunct contract can in any way seriously hamper him in proving such damages.

I agree that the appeal be allowed for the reasons stated by Law V-P and I agree with the order he proposes.

Appeal allowed; no order as to costs.

Dated at Nairobi this 14th day of January 1976.

S.W.W.WAMBUZI

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PRESIDENT

E.J.E LAW

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VICE - PRESIDENT

A.MUSTAFA

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JUDGE OF APPEAL