Article Information

Author: Peter Dwyer, Maria Capati
Service: Commercial Contracts, Corporate & Commercial
Sector: Hospitality, Tourism & Gaming, Private Clients

Frustration of contract due to COVID-19: Special leave to the high court granted

The New South Wales Court of Appeal allowed an appeal by purchasers of a hotel affected by COVID-19 public health restrictions. The Court held that there was no frustration of the sale contract due to the public health orders, but the vendor still could not force completion of the contract: Dyco Hotels Pty Ltd v Laundy Hotels (Quarry) Pty Ltd (2021) 396 ALR 340.

Key takeaways

- Supervening illegality will not always frustrate a contract, but may still excuse non-performance
- If bargaining power allows it, purchasers of businesses should seek warranties for future performance
- Uncertainty continues to be a key issue in 2022, and parties should prioritise drafting that allows them to respond to changes

Background to the proceedings

In January 2020, the purchaser (**Dyco**) signed a contract to purchase The Quarryman's Hotel in Pyrmont, NSW from the vendor (**Laundy**) for $11,250,000 including a deposit of $562,500 (sale contract).

According to cl 50.1 of the sale contract, the hotel had to 'carry on the business in the usual and ordinary course as regards its nature, scope and manner' until completion. It also required that the sale was for the supply of a 'going concern'. This effectively meant that the hotel had to be transferred to Dyco in a state where it was able to meet all its financial obligations. Essentially, Laundy had to maintain the hotel in the usual manner until the sale was complete.

One week before settlement, the government introduced public health orders, forcing the hotel to modify its business. It had to rely on take-away business and accommodation only.

At settlement, Dyco argued that the sale contract was frustrated because the public health orders meant the business could not operate in the 'usual and ordinary manner' set out in the sale contract. Laundy issued a Notice to Complete and then a Notice to Terminate when Dyco refused to complete the sale.

Dyco sued for return of its deposit and Laundy counterclaimed for breach of contract.

The essential question was whether Laundy was entitled to terminate the sale contract.

Decision of the Supreme Court at first instance

The Supreme Court considered whether the sale contract had been frustrated. This depended on whether, due to the new restrictions, there was a fundamental commercial difference between what was contemplated by the sale contract and what eventuated.

Frustration occurs when, without fault of either party, a contractual obligation can no longer be performed without the outcome being radically different from what the parties agreed to.

The Court found that the sale contract was not frustrated, as the commercial changes were not fundamentally different

enough. Although the value of the hotel had dropped by nearly $1 million, the Court noted that it was still less than 9% of the total purchase price. Laundy's obligation to carry on the business was secondary to the main purpose of transferring assets for an agreed price. The fact that Dyco agreed to the contract price without a warranty as to future financial returns indicated that it was a risk of a type they were prepared to take.

The Court also found that cl 50.1 was limited to carrying on the business according to law, and so Laundy did not breach its obligations under this clause.

Decision of the Court of Appeal

The majority of the Court of Appeal overturned the decision. Although the primary judge's conclusion that there was no frustration was not disputed, the Court noted that supervening illegality can be an excuse for non-performance of a contractual obligation even if it does not frustrate the sale contract. Supervening illegality occurs when a new law or regulation makes performing an obligation illegal. The public health orders were a supervening illegality as they made the cl 50.1 obligation illegal to carry out.

They found that cl 50.1 was not limited in the way suggested by the Supreme Court, and that "selling craft beer in takeaway vessels from a takeaway window and food on limited occasions from the same window with a skeleton staff" was not carrying on the business in the usual and ordinary course.

The Court found that the hotel could not be conveyed as a going concern due to the public health orders. Laundy would have been excused for non-compliance with cl 50.1 due to the supervening illegality. However, because of the non-compliance, Laundy was not ready, willing and able to complete the sale contract at the time of serving the Notice to Complete or at termination and this was a pre-condition to serving the Notice both according to law and another clause in the contract.

Therefore, the Court found that Laundy had repudiated the sale contract as they were not entitled to terminate. The Court ordered that the security deposit be returned to Dyco.

The decision is now **pending appeal** in the High Court.