

COVID-19 FALLOUT: CONTRACT CONSTRUCTION IN THE MIDST OF A PANDEMIC

CASE NOTE: *Laundy Hotels (Quarry) Pty Limited v Dyco Hotels Pty Limited* [2023] HCA 6

By Mirren Waters*

Under the terms of a sale and purchase contract the vendor was obliged to “carry on the Business in the usual and ordinary course as regards its nature, scope and manner” during the period from the date of the contract to the completion date. During the intervening period the business was subject to NSW Public Health Orders which restricted trade and negatively impacted the value of the business. Did the imposition of and compliance with supervening law render a business fundamentally different from that which was contracted for?

A deal downed by the pandemic

On 31 January 2020, two of Sydney’s most prominent hoteliers, Laundy Hotels (run by Arthur Laundy and his sons Stuart and Craig) (**Laundy**) and Dyco Hotels (owned by Colin Michael Parras and his mother Daphne) (**Dyco**) entered into a contract (the **Contract**) for the sale by Laundy to Dyco of the Quarrymans Hotel in Pymont, Sydney (the **Hotel**).

Included in the sale of the Hotel was the hotel’s licence under the *Liquor Act 2007* (NSW) together with nine Gaming Machine Entitlements that were allocated to the business (the **Licences**) and the business records, goodwill, the contracts, stock, business name, domain name, Facebook and Instagram accounts and the lease (the **Business Assets**). The purchase price was \$11,250,000.¹ The parties agreed a completion date for the Hotel and Licences of 30 March 2020 and for the Business Assets of 31 March 2020.²

On 23 March 2020, in response to the COVID-19 pandemic, the NSW Health Minister made an order under the *Public Health Act 2010* (NSW) directing that pubs “must not be open to members of the public ... except for the purposes of ... selling food or beverages for persons to consume off the premises”.³ Between March and June 2020, the Hotel was subject to numerous public health orders that restricted trade to takeaway craft beer and food, followed by limiting customer numbers to ten people on the premises and then limits of 50 people in a separate seated food or drink area with physical distancing requirements.⁴

On 25 March 2020, Dyco wrote to Laundy saying that it would not complete the Contract because, in the circumstances, Laundy was not “ready willing and able to complete”. On 27 March 2020, Dyco further asserted that (a) the Contract had been frustrated or (b) that because of its breach of clause 50.1 of the Contract Laundy could not comply with any notice to complete issued by Dyco. In both circumstances Dyco would be entitled to terminate and sue for damages.⁵

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On 31 March 2020, Laundry confirmed that it was “ready, willing and able to settle”, a position that was restated on 6 April 2020.⁶ Laundry then gave notice calling for Dyco to complete by 12 May 2020. On 21 May 2020, after Dyco failed to complete, Laundry issued a notice of termination.⁷

In response, Dyco commenced proceedings in the Supreme Court of New South Wales claiming that the Contract was discharged by frustration and that, in the premises, the deposit of \$562,500 ought to be returned to Dyco.⁸ In the alternative, Dyco contended that were the Contract not frustrated, the purported termination by Laundry for non-completion by Dyco amounted to a repudiation of the Contract. Any such repudiation was accepted by Dyco. If found, repudiation would also entitle Dyco to return of the deposit.⁹

Key provisions of the Contract

The key provision at the centre of the dispute was clause 50.1 of the Contract, which provided for “Dealing Pending Completion” in the following terms:¹⁰

Subject to clause 50.2, from the date of this contract until Completion, *the Vendor must carry on the Business in the usual and ordinary course as regards its nature, scope and manner* and repair and maintain the Assets in the same manner as repaired and maintained as at the date of this Contract and use reasonable endeavours to ensure all items on the Inventory are in good repair and in proper working order having regard to their condition at the date of this Contract, fair wear and tear excepted (emphasis added)

The completion conditions in clause 51 of the Contract provided that completion was not to take place prior to the completion date and that:¹¹

if completion did not occur, *a party which was ready, willing and able to complete*, and was not in default, was permitted to serve the other party with a notice requiring the other party to complete the contract not less than ten business days after the date of that notice and making time of the essence. (emphasis added)

Relevantly, the Contract excluded warranties about the “present and future financial or income return to be derived from the Property or the Business” and Laundry gave no representations and warranties about “future matters, including the future financial position or performance of the Business”.¹²

The primary judgment

At first instance, Dyco’s contention that the Contract had been frustrated relied upon a construction that Laundry was “obliged to continue to carry on the business in the same manner that it was being carried on at the date of the contract, even though public health orders rendered such conduct wholly or partly illegal”.¹³ This argument failed. Darke J found that Laundry’s obligation to carry on the business could only be to the extent that it “remained possible to do so in accordance with the law”.¹⁴

Justice Darke rejected the argument that the Contract had been frustrated, finding that the actual performance of the sale and transfer of the assets under the Contract did not give rise to a fundamental commercial difference between actual and contemplated performance:¹⁵

In particular the promises to sell and transfer the assets in return for the agreed price in circumstances where no warranties were given as to future financial performance, are wide enough to apply to the new situation that emerged

Laundy was awarded \$900,000 being the difference between the Contract price of \$11,250,000 and the value of the Hotel on 21 May 2020.¹⁶

On appeal

Dyco was successful on appeal to the New South Wales Court of Appeal, Chief Justice Bathurst and Brereton JA finding for Dyco with Basten JA dissenting.

Dyco challenged Justice Darke's conclusion that clause 50.1 of the Contract was limited to requiring Laundy only to carry out the business to the extent permitted by law and advanced that from the date of Public Health Order, Laundy had been unable to carry on the business as provided in clause 50.1 of the Contract.¹⁷ Dyco's submissions contended that non-compliance defeated the "commercial purpose of the clause...to protect the value of goodwill in the business".¹⁸ An inability to comply with clause 50.1 of the Contract, deprived Laundy of the entitlement to issue an notice to complete and as a corollary, any right to terminate when Dyco failed to comply with such notice.¹⁹

Chief Justice Bathurst found that it was not appropriate to imply that Laundy's obligations under clause 50.1 of the Contract were limited to the extent permitted by law.²⁰ His Honour considered that the issue of the Public Health Orders were a supervening event which rendered Laundy's performance of clause 50.1 of the Contract illegal. The supervening illegality suspended the contractual obligations under clause 50.1 of the Contract. Such illegality constituted an excuse for non-performance, albeit, while not frustrating the Contract.²¹ However, his Honour went on to find that clause 50.1 of the Contract was an essential term, and Laundy could not "deliver possession of the hotel as a going concern".²²

The Hotel, Licences and Business Assets could not be transferred as a going concern because of the Public Health Order.²³ That being so, Laundy was not ready or able to complete the Contract when it served a notice to complete on Dyco. The service of this notice amounted to a repudiation by Laundy that was accepted by Dyco.²⁴ Such repudiation entitled Dyco to the return of the \$562,500 deposit and the Court of Appeal so ordered.

Brereton JA agreed with Chief Justice Bathurst.²⁵ Brereton JA held that that the purpose of clause 50.1 of the Contract was to ensure that Dyco "acquired a business in the same condition "as regards its nature, scope and manner" as it was at the date of contract".²⁶ Further, Brereton JA reasoned that the parties agreement that risk would pass to Dyco on completion was a common intention of the parties inconsistent with a finding that Dyco were to bear the risk of a supervening legal impediment to the performance of clause 50.1 of the Contract.²⁷

In dissent, Basten JA agreed with the analysis of Darke J in the primary judgment.²⁸ Noting the highly regulated nature of the hotelier industry business,²⁹ Basten JA said the parties "expected and understood that the business would be carried on lawfully"³⁰ and that the "nature, scope and manner" in which the business was conducted was that which was permitted by law.³¹

Basten JA found the Contract was not frustrated by the Public Health Orders and that the requirements of clause 50.1 of the Contract "encompassed such alterations as might occur through changes in the legal regime under which the business operated".³² On these conclusions, there was no non-compliance with clause 50.1. In any event, Basten JA held that clause 50.1 was not an essential condition nor condition precedent to completion.³³

The High Court decision

In a single judgment of the High Court made up of Keifel CJ, Gageler, Gordon, Gleeson and Jagot JJ, the decision in the Court of Appeal was overturned. It was held that Laundry “was ‘ready, willing and able to complete’ and was not in default of its contractual obligations at the time it served the notice to complete”.³⁴ Moreover, there could be no obligation on Laundry to carry out its obligations under the Contract to the extent that such performance was unlawful.³⁵

The reasoning of the Court turned on analysing the proper construction of the Contract and in particular, clause 50.1 of the Contract:³⁶

It is well established that the terms of a commercial contract are to be understood objectively, by what a reasonable businessperson would have understood them to mean, rather than by reference to the subjectively stated intentions of the parties to the contract. In a practical sense, this requires that the reasonable businessperson be placed in the position of the parties. It is from that perspective that the court considers the circumstances surrounding the contract and the commercial purpose and objects to be achieved by it

In the context, the Court held that the requirement to:³⁷

“carry on the Business in the usual and ordinary course as regards its nature, scope and manner” incorporated an inherent requirement to do so in accordance with law. That is, the obligation imposed on the Vendor was to carry on the Business in the manner it was being conducted at the time of contract to the extent that doing so was lawful. There was no obligation (and could not have been an obligation) imposed on the Vendor to carry on the Business unlawfully.

The requirement to operate a hotel lawfully, in accordance with the legislative schemes applying to liquor licences and the operation of gaming machines, was central to the carrying on of the business by Laundry.³⁸

Further, the context of lawful operation was central to the Contract. The warranties given by Laundry “all related, directly or indirectly, to past, current, and anticipated future lawfulness of the operation of the hotel”³⁹ and “expose that the regulatory environment within which the Business operated was dynamic”.⁴⁰ In the specific context of the operation of the Hotel, clause 50.1 of the Contract:

Construed as it must be, as a single obligation subject to an overriding qualification of lawfulness, the relevant part of cl 50.1 reflects the commercial reality that ongoing legal compliance was essential to the Business.

In addition, there were no warranties given by Laundry as to the continuing value of the Hotel, Licences or Business Assets between the contract date and completion.⁴¹ Instead, the warranties given in the Contract acknowledge that the continued operation of the Hotel “was and would be subject to ongoing and potentially changing regulatory requirements”.⁴²

It was not available for Dyco to rewrite clause 50.1 of the Contract “into a form of warranty by the Vendor as to how the Business would operate at Completion”.⁴³

A finding that Laundry was in compliance with clause 50.1 of the Contract and thereby entitled to serve notice to complete on Dyco and to terminate the Contract, retain the deposit and sue for damages in the event of Dyco’s non-compliance rendered immaterial consideration of “any supposed doctrine of the suspension of a contractual promise temporarily incapable of being satisfied by reason of supervening illegality”.⁴⁴

The appeal was dismissed with costs and Dyco was ordered to repay the deposit and interest thereon.

Takeaways

Where purchasers want protection in respect of the maintenance of specific value of an asset between contract and completion this is best dealt with by the inclusion of specific warranties. The risk of not including specific language is that the Court will then be required to determine the scope of the obligations, implying terms and conditions based upon the industry and regulatory background as well as the context of the contractual intention of the parties. 'Continued dealings' provisions expressed in general terms will not be rewritten by the Courts as warranties.

Changing regulatory requirements that affect the performance of a business will not have the effect of permitting a purchaser to delay or not complete a contract for sale where such changes do not have the effect of frustrating the contract, particularly where the business operates within a regulated environment.

The High Court did not further explore whether supervening illegality of the kind engendered by the imposition of Public Health Orders as a result of the COVID-19 pandemic had the effect of suspending contractual promises. For now, the extent of this doctrine remains unsettled.

¹ *Laundy Hotels (Quarry) Pty Limited v Dyco Hotels Pty Limited* [2023] HCA 6 at [3].

² *Ibid* [4].

³ *Public Health (COVID-19 Places of Social Gathering) Order 2020 (NSW)*, s 5(1)(a)(i) cited in *Laundy Hotels (Quarry) Pty Limited v Dyco Hotels Pty Limited* [2023] HCA 6 at [15].

⁴ *Ibid* [16]-[17].

⁵ *Ibid* [18].

⁶ *Ibid* [19].

⁷ *Dyco Hotels Pty Ltd v Laundy Hotels (Quarry) Pty Ltd* [2021] NSWSC 504, at [66] (Darke J).

⁸ *Ibid* [7].

⁹ *Ibid* [9].

¹⁰ *Laundy Hotels (Quarry) Pty Limited v Dyco Hotels Pty Limited* [2023] HCA 6 at [9].

¹¹ *Ibid* [11].

¹² *Ibid* [5].

¹³ *Dyco Hotels Pty Ltd v Laundy Hotels (Quarry) Pty Ltd* [2021] NSWSC 504, at [88] (Darke J).

¹⁴ *Ibid* [84].

¹⁵ *Ibid* [110].

¹⁶ *Ibid* [138].

¹⁷ *Dyco Hotels Pty Ltd v Laundy Hotels (Quarry) Pty Ltd* [2021] NSWCA 332; 396 ALR 340, [34] (Bathurst CJ).

¹⁸ *Ibid* [112] (Basten JA).

¹⁹ *Laundy Hotels (Quarry) Pty Limited v Dyco Hotels Pty Limited* [2023] HCA 6 at [22].

²⁰ *Dyco Hotels Pty Ltd v Laundy Hotels (Quarry) Pty Ltd* [2021] NSWCA 332; 396 ALR 340, [51] (Bathurst CJ).

²¹ *Ibid* [66].

²² *Ibid* [72].

²³ *Ibid* [73].

²⁴ *Ibid* [77].

²⁵ *Ibid* [141] (Brereton JA).

²⁶ *Ibid* [143].

²⁷ *Ibid* [161].

²⁸ *Ibid* [91] (Basten JA).

²⁹ *Ibid* [126].

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- ³⁰ Ibid [127].
- ³¹ Ibid.
- ³² Ibid [140].
- ³³ Ibid.
- ³⁴ *Laundy Hotels (Quarry) Pty Limited v Dyco Hotels Pty Limited* [2023] HCA 6 at [2].
- ³⁵ Ibid.
- ³⁶ Ibid [27], citing *Ecosse Property Holdings Pty Ltd v Gee Dee Nominees Pty Ltd* (2017) 261 CLR 544 at 551 [16], citing *Electricity Generation Corporation v Woodside Energy Ltd* (2014) 251 CLR 640 at 656-657 [35] and the cases therein cited at fnn 58 and 60.
- ³⁷ Ibid [28].
- ³⁸ Ibid [30].
- ³⁹ Ibid.
- ⁴⁰ Ibid [37].
- ⁴¹ Ibid [41].
- ⁴² Ibid [36].
- ⁴³ Ibid [46].
- ⁴⁴ Ibid [51].