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How Frustrating – The building crisis and contractual issues regarding downstream suppliers and subcontractors

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The construction industry is facing major difficulties following the Covid-19 pandemic, the long-lasting effects of which continue to bring about various unanticipated challenges.

A major industry disruption continuously in the headlines is the liquidation of multiple, large, and well-known head contractor building firms.

Recently, the ABC reported that the latest data from ASIC shows more than 2,500 construction companies have already entered into some form of liquidation since mid 2021.

Principal head contractors that have gone into liquidation are leaving downstream subcontractors, suppliers and sub-subcontractors in the lurch with respect to the status of their subcontracts.

There are remedies available at law that allow a party to a subcontract to terminate in circumstances where the subcontract becomes impossible to perform due to an unanticipated event beyond the control of either party (also known as a **frustration event**).

An example of a frustration event may be that a site becomes inaccessible due to a Principal Head Contractor becoming insolvent, in circumstances where the relevant subcontract has no terms or conditions regarding what is to happen upon the insolvency of a party.

The relevant legal principle is called “the doctrine of frustration”.

What is the “the doctrine of frustration”?

The effect of a contract being frustrated is that it will be at an end (or terminated).

The principles of the legal doctrine of frustration are as follows.

In the High Court of Australia case of *Firth v Halloran* [1926] HCA 24 (at [265]), the Court in summary stated (by reference to previous cases) the principle of frustration of a contract that applies to circumstances where:

(a) the performance of the contract becomes impossible because of the cessation of (or a stop to) the existence of the subject matter of the contract;

(b) the event which makes the contract incapable of performance is the cessation of (or stop to), or non-existence of, the state of things going to the root of the contract; and

(c) the event which makes the contract incapable of performance is the cessation of (or stop to) an express or implied term or condition of the contract.

In the High Court of Australia case of *Codelfa Construction Pty Ltd v State Rail Authority of NSW* (1982) 149 CLR 337, the Court stated (by reference to previous cases):

(a) that a contract would be at an end if its terms were not wide enough to apply to a new situation, read in light of the nature of the contract and of the relevant surrounding circumstances;

(b) frustration is the termination of a contract by the operation of law on the emergence of a fundamentally different situation;

(c) frustration occurs whenever the law recognises 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; and

(d) a contract will be frustrated when the parties enter into it on the common assumption that some particular thing or state of affairs essential to its performance will continue to exist or be available, neither party undertaking responsibility in that regard, and that common assumption proves to be mistaken.

In the more recent NSW Civil and Administrative Tribunal Appeal Panel matter of *Snowtime Tours Pty Ltd v Rundle* [2022] NSWCATAP 253, the Tribunal confirmed that frustration of a contract will occur:

(a) if the frustration event causes the contractual obligation owed by either party under the contract to become impossible or radically different from the obligation contemplated at the time that the parties entered into the contract;

(b) the frustration event was not the fault of either party; and

(c) the contract does not deal with what will happen on the occurrence of the alleged frustration event.

The Court has a high threshold for determining whether a contract has been frustrated so it is best to seek legal advice to find out if the doctrine applies in your circumstances.

Payment for work undertaken up to frustration

Section 7 of the F*rustrated Contracts Act 1978 (NSW)* (**FCA**) essentially states that a party is liable to reimburse a subcontractor/supplier for work performed up to the time of frustration of a contract.

Conversely, section 11 of the FCA requires a subcontractor/supplier to repay any amounts that were paid in advance, and which relate to works that were not performed as a result of the frustration of a contract.

Key takeaways

1. Remedies are available to downstream suppliers, subcontractors and sub-subcontractors affected by the insolvency of a principal head contractor upstream, by way of frustration and/or termination of the contract;

2. A claim may be available to contractors who have part paid for works relating to a project subject to a frustrated contract, and to sub-subcontractors who have undertaken work up to a frustration event and not been paid for that work; and

3. Seek legal advice regarding whether the doctrine of frustration applies, and to draft the appropriate notice(s) with respect to terminating a frustrating contract.

CONTACT US

For further information, please do not hesitate to contact **Anish Wilson** on **(02) 8239 6500.**