

# Applying the Law of Government Contracts – CASE STUDY

## When regretted decisions and poor contract management collide

By: Irene Zeitler, March 2003

While the law is generally not concerned with ethics in business, it does concern itself with broken contractual commitments. The distinction between business ethics and contractual breach can, however, become blurred as a decision handed down by Finn J in the Federal Court of Australia demonstrated

The case of GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Limited and ors concerned a customer, a head contractor and a sub-contractor and involved the development of complex communication network software. Finn J had no hesitation in finding certain contractual breaches by each of the parties. In relation to the sub-contractor, His Honour held further that it had:

*'manipulated and knowingly misinterpreted contractual obligations and engaged in disingenuous conduct to avoid having to complete the Sub-Contract which, from at least July 1996, it had no intention of doing'.*

The customer's conduct on the other hand could be explained:

*'in part to a mentality quite unattuned to contract management' and also 'an apprehension that openness ... could prove costly to the Department'.*

The genesis of this litigation which resulted in a judgment of nearly 500 pages is aptly explained by the Judge in his opening remarks to the effect that the customer and sub-contractor had made contractual commitments which they subsequently regretted and sought to resile from.

### **Facts**

The background to this litigation is complicated. However, in late 1994, the Department of Foreign Affairs and Trade (DFAT) had entered into a head contract with BHP Information Technology Pty Limited (BHP-IT) for the development of certain communication network software. BHP-IT at the same time entered into a 'back-to-back' contract with EASAMS (Aust) Limited, a company that was subsequently acquired by GEC Marconi Systems Pty Ltd (GEC), under which the sub contractor assumed responsibility for the performance of the bulk of BHP-IT's contractual obligations to DFAT.

Under the head contract, DFAT was required to deliver a boundary security device to BHP-IT known as the STUBS (supplied by another Commonwealth agency) which BHP-IT (through GEC) was required to integrate with the developed software. DFAT failed to deliver STUBS and ultimately negotiated a variation to the head contract. GEC was involved in these negotiations but corresponding formal changes to the sub-contract were not attended to.

GEC subsequently rendered an invoice for the completion of a milestone known as 'Milestone 4000'. When that invoice was not paid, GEC purported to terminate the sub-contract for breach by BHP-IT. This termination effected BHP-IT's ability to meet its obligations under the head contract. The consequences of these events were that:

- GEC sued BHP-IT for breach of the sub-contract in failing to provide STUBS and pay for the completion of Milestone 4000.

- BHP-IT in its defence successfully argued that there was no obligation to provide STUBS because the variation of the head contract dealing with this issue also bound GEC.
- BHP-IT also successfully argued that Milestone 4000 had not been fulfilled on the basis that the relevant clause in the sub-contract required not only delivery of the relevant items but also a satisfactory review of the items. The latter had not occurred at the time the invoice was rendered.
- BHP-IT succeeded in its cross-claim that GEC had repudiated the sub-contract and was therefore liable to pay damages to BHP-IT (which included lost profits and liabilities incurred to DFAT).
- BHP-IT succeeded in the cross-claim against DFAT that in respect of a certain period of time at least the Commonwealth had breached several clauses in the head contract which required DFAT to report any identified risks which might have a significant effect on the implementation of the implementation plan and to act in a fair and reasonable manner in discharging certain of its obligations under the head contract.
- BHP-IT failed in its claim against DFAT for misleading and deceptive conduct under the Trade Practices Act. Finn J held that DFAT had engaged in misleading and deceptive conduct by representing that it was willing and able to supply STUBS, however, in order for the Trade Practices Act to apply those representations must have been made in the course of carrying on a business. His Honour held that DFAT was not carrying on a business.
- DFAT succeeded in its counterclaim against BHP-IT in respect of losses incurred as a result of the late delivery of software under the head contract.

### **Lessons to be learnt**

The case before Finn J is illustrative of the significant risks which all parties face in committing to complex IT contracts.

For head contractors, a key risk is of becoming the 'meat in the sandwich' if either or both the customer and a sub-contractor failed to perform.

For all parties, the case highlights the dangers of 'sitting' on a breach or an identified risk. In relation to these dangers, Finn J makes some interesting observations on what a contractual obligation to act in a 'fair and reasonable manner' might entail. While His Honour did not consider that a party could be in breach of such an obligation simply because something could 'have been done more openly, more expeditiously or in a more effective way', he found that DFAT had breached its obligation by acting covertly and without regard to the interests of BHP-IT.

While the focus of IT contracts is frequently the contract negotiating process itself, the case demonstrates that the story does not end once the contracts have been signed. IT contracts which are complex and long term require active project management – the recent Report of the Victorian Auditor-General on RMIT University's management of its electronic student records system which has given rise to a budget blow out of approximately \$47 million is another recent example of where project management was mishandled.

Effective project management means, among other things, that any variations to a head contract which flow on to a sub-contract must be documented and any risks to the project such as non-delivery or late delivery of key deliverables must, once identified, be promptly dealt with, taking particular care not to mislead the other parties as to the true state of affairs. A business culture which values and rewards commitment to mutually rewarding business relationships and more open communication is an essential backdrop to effective

project management. Industry players need to understand this in order to avoid costly and time consuming litigation.