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Commercial Notes

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The GEC Marconi Decision – its Effect on Australian Government Contracting

GEC Marconi Systems Pty Limited v BHP Information Technology Pty Limited

Federal Court of Australia
12 February 2003 and 14 July 2003
[2003] FCA 50; [2003] FCA 688

The decision of Finn J in *GEC Marconi* discusses:

- limiting the ability to vary contracts
- the contextual nature of representations
- payment on entire completion of work
- varying a contract – its effect on existing rights
- the ability of a party to preserve its right to terminate

Background

Proceedings were initially commenced by GEC Marconi against BHP IT in September 1997. Subsequently, in December 1997 BHP IT brought an action against the Commonwealth seeking to be indemnified for GEC Marconi's claim, and seeking damages in its own right against the Commonwealth. There were two claims that totalled $85m against the Commonwealth. First there was BHP IT's direct claim of about $20.8m, and secondly there was GEC Marconi's indirect claim, that would have been passed on by BHP IT to the Commonwealth, of about $65m. The Commonwealth also brought a much smaller cross claim against BHP IT. The Commonwealth defeated the claims brought against it and succeeded in recovering just under $0.5m from BHP IT.

Finn J, although finding that the Commonwealth had in two minor respects breached its contractual obligations, found BHP IT were unable to establish any loss that flowed from such breaches. In the second decision Finn J said that BHP IT's misleading and deceptive conduct case would, in all probability, have failed.

The principal decision was handed down by Finn J on 12 February 2003. The second decision of 14 July 2003 dealt with the award of costs and interest in the proceedings.

The ADCNET project

In 1989 the Department of Foreign Affairs and Trade (DFAT) commenced a project to develop the Australian Diplomatic Communications Network (ADC Network) which would both revolutionise and modernise its system for diplomatic communications. The project ran for ten years and cost over $120m. The ADC Network provided for communications to occur between DFAT's Canberra office, its overseas missions, state offices, other select government departments, the Prime Minister and Minister for Foreign Affairs and Trade. One of the key imperatives that drove the ADCNET project was the need to replace its 'security gateway' system. A security

gateway system, as the name implies, allows only certain documents to move out of the secure network.

The initial contracts

After calling and assessing tenders for the Prime System Integrator, the Commonwealth entered into a contract with BHP IT for the provision of prime integration services. As part of BHP IT's tender it engaged GEC Marconi (in 1989 known as EASAMS) to develop the specialised software packages that would be integrated into the ADC Network. The contract between the Commonwealth and BHP IT and the contract between BHP IT and GEC Marconi were entered into at almost the same time and in all essential respects, except for price, were identical. BHP IT was the builder of the ADC Network, and GEC Marconi its sub-contractor.

The initial contract between BHP IT and the Commonwealth was on a 'time and materials' basis. Under the initial contract the ADC Network was established with rudimentary desktop software. DFAT decided that it was better to have the system operational with rudimentary software, than wait until the development of the ultimate software before bringing the ADC Network into operation.

The final phase of the project

Once the ADC Network had been established, the focus of DFAT, BHP IT and GEC Marconi turned to the final deliverable under the ADCNET project, the development of the ultimate release of software that would be incorporated into the ADC Network and the replacement of the previous security gateway system.

On 14 September 1994 the Commonwealth entered into a contract with BHP IT (the Head Contract) and similarly BHP IT entered into a contract with GEC Marconi (the Sub-contract). Like the initial time and materials contracts these subsequent contracts were identical in every material respect, except price. The Head Contract and Sub-contract were, however, fixed price contracts. The price under the Head Contract was $9.6m and under the Sub-contract $6.2m. These subsequent contracts provided for the development of the final release of software and the incorporation of this software (the ADCNET software) and specialised security devices known as STUBS devices into the ADC Network. The STUBS devices were the replacement for the security gateway.

STUBS devices

The STUBS devices were the invention of the Defence Science and Technology Organisation of the Department of Defence. The Department of Defence had granted to AWADI Defence Industries (AWADI) a licence to exploit the STUBS devices' technology.

The Defence Signals Directorate advised DFAT that if it used the new STUBS technology developed by the Defence Science and Technology Organisation, approval would be given for the ADC Network to carry classified information.

Prior to DFAT entering into the Head Contract by which it was obliged to supply the STUBS devices to BHP IT, DFAT sought a verbal assurance from AWADI that at least a prototype of the STUBS devices would be provided to enable testing of the ADCNET software. This assurance was given and DFAT subsequently entered into the Head Contract.

At the time the Head and Sub-contracts were entered into all parties (DFAT, BHP IT and GEC Marconi) were aware that the Commonwealth had not entered into a contract with AWADI for the supply of the STUBS devices.

Emulation software

Under the Head Contract the ADCNET software was required to interface with the STUBS devices. The responsibility for the performance of the STUBS devices was a matter for DFAT and AWADI. Under the contracts neither BHP IT or GEC Marconi accepted this responsibility.

Well before the Head and Sub-contracts were executed DFAT expressed concern to both BHP IT

and GEC Marconi that if the STUBS devices were not available by the time acceptance testing of the ADCNET software was to occur, there needed to be an emulation of the STUBS devices to enable testing to proceed unimpeded.

Software emulation is a common strategy used by software engineers to overcome the unavailability of a hardware component. Emulation software was proposed by DFAT if the STUBS devices were not available for acceptance testing.

Performance of the Head and Sub-contracts

GEC Marconi's performance of the Sub-contract was flawed from the outset. The reasons for its inability to get on with the job are varied and many. When GEC Marconi entered into the Sub-contract (in September 1994) it expected to receive a profit of $620,000; by August 1996 GEC Marconi realised it would sustain a loss of $4.5m if it continued with the project and delivered the software it had contracted to provide.

After execution of the Head Contract, DFAT wrote to AWADI seeking confirmation of the verbal assurance it had been given in connection with the supply of the STUBS devices. AWADI did not respond to this request. DFAT became increasingly concerned that even if the STUBS devices came they would not be delivered in time for the development, integration and acceptance testing of the ADCNET software. In December 1994 DFAT raised with BHP IT and GEC Marconi the development of emulation software if the STUBS devices were not supplied in time for development, integration and acceptance testing of the ADCNET software.

Subsequently in the period June through to November (when it became apparent that AWADI would not supply the STUBS devices) the parties exchanged correspondence whereby it was agreed that emulation software would be developed to allow development, integration and acceptance testing of the ADCNET software.

Was there an Emulation Variation Agreement?

Finn J had to determine whether there was an agreement reached by the parties which varied the Head and Sub-contracts despite imprecision and the uninformative nature of the contractual documents upon which the contract variation rested. The variation contended for by BHP IT and the Commonwealth had the effect that neither the Commonwealth nor BHP IT had to supply the STUBS devices and instead the STUBS Emulation software was to be used to complete the contract (the Emulation Variation Agreement).

> *The terms ... were not to be found in a simple documentary exchange of an offer and an acceptance. Rather they were to be discerned from communications made and actions taken.* Finn J

Clause 45 of the Head and Sub-contracts required that any contractual variation would be in writing. GEC Marconi argued that the Clause 45 requirements had not been met and that this clause provided an exclusive method for the varying of the Sub-contract. BHP IT argued that:

- despite the uninformative description of the Change Request, there was sufficient compliance with Clause 45
- that it was not mandatory that the contract could only be varied by the method set out in Clause 45, it was possible for the parties to make an oral contract or impliedly by their conduct to vary the contract, and
- in any event GEC Marconi had, by its conduct, waived any right to insist on strict compliance with Clause 45.

Finn J posed the question this way [214]:

> … the submissions raise the question whether the legal effect of cl 45 was to render ineffective any subsequent implied or oral contract the purport or effect of which was to vary the Sub-Contract?

Finn J found that parties, despite stipulating that their contract would only be varied in accordance with certain specified procedures, could by their conduct vary their contract subject to the proviso that there was no requirement imposed as a matter of law that precluded such a variation. He says at [217]–[219]:

> The relevant principle, for present purposes, was stated concisely by Ellicott J in the *Crothall Hospital* case [(1981) 36 ALR 567] in the following terms (at 576):
>
> *"It is open to the parties to a written contract to vary it. This may be done in writing or, except where the contract is* ***required by law*** *to be evidenced in writing, by oral agreement. The agreement to vary may be express or implied from conduct."* Emphasis added.
>
> The common, often fatal, difficulty experienced by a party in seeking to make out a contract to vary has been the evidentiary one of proof of the contract itself: see *Liebe v Malloy* (1906) 4 CLR 347; *Trimis v Mina*, [1999] NSWCA 140 at [64].
>
> For an alleged subsequent variation to be contractually effective notwithstanding non-compliance with the written modification requirement, it must itself otherwise satisfy the requirements of a valid contract, ie "the terms of the arrangement must be certain, and … there must generally be real consideration for the agreement: *Ermogenous v Greek Orthodox Community of SA Inc* (2002) 187 ALR 92 at 99"
>
> Internationally, the law varies widely as to the efficacy of what are commonly described as "no oral modification" clauses (a description I will use hereafter). The common law rule in the United States has traditionally denied effect to such clauses: eg *Bartlett v Stanchfield* 19 NE 549 (1889); Farnsworth, *Contracts*, §7.6 (3rd ed). As Cardozo J observed in *Beatty v Guggenheim Exploration Co* 122 NE 378 (1919): "Whenever two men contract, no limitation self-imposed can destroy their power to contract again".

Finn J concludes at [250]:

> ... my own view is that what was agreed was no less than the Emulation Variation Agreement ... The terms of that contract were not to be found in a simple documentary exchange of an offer and an acceptance. Rather they were to be discerned from communications made and actions taken ... I do not consider that, in their setting, those communications and actions admit of any other conclusion than what was agreed was the Emulation Variation Agreement.

Are Representations by Australian Government Agencies Contextual?

BHP IT's main argument on the misrepresentation case against the Commonwealth was that the Commonwealth, through DFAT, had misled BHP IT by not advising it of the real reasons why the STUBS devices could not be procured. DFAT had merely said that AWADI had cancelled the STUBS devices project. BHP IT alleged that DFAT did not advise it that AWADI's decision to cancel the STUBS devices' project arose as a direct consequence of the Department of Defence's decision not to procure the devices.

... representations made by one Australian Government agency are to be considered in the context of that agency's responsibilities and not assumed to have wider implications for the Commonwealth. Finn J

BHP IT argued that the Commonwealth's conduct taken as a whole was misleading when DFAT's conduct and the Department of Defence's position were considered together. BHP IT said DFAT had given the impression that the decision by AWADI to cancel the STUBS project was made by AWADI. Finn J found that this was, in fact, literally true [1360–1362].

> I am not satisfied, though, that such lack of candour would have had independent contractual significance for present purposes. All parties were aware that the Commonwealth in two different manifestations, ie DFAT and DoD, was interested in procuring STUBS. Those two departments furthered differing aspects of the public interests served by the Commonwealth, ie foreign affairs and defence. Though BHP-IT was formally dealing with the Commonwealth in the ADCNET contract, it was perfectly well aware that it was dealing with the Commonwealth in the discharge of its foreign affairs responsibilities. It was for this reason that the intentions of DFAT were the operative intentions of the Commonwealth in relation to matters affecting the ADCNET contract.
>
> The furtherance of the Commonwealth's defence responsibility was no part of the ADCNET contract. Though a bona fide defence-related decision may (as here) have impacted upon the Commonwealth's ability to perform some part of the ADCNET contract, BHP-IT in dealing with the Commonwealth was not reasonably entitled to expect that the Commonwealth would not so act in discharging its defence-related responsibilities – even if this put the Commonwealth in a breach of the ADCNET contract or rendered part of its performance impossible. BHP-IT equally was not entitled to expect that in the conduct of its defence responsibility the Commonwealth would have regard to an aspect of its foreign affairs responsibility, ie the performance of the ADCNET contract.
>
> The DoD decision may have been the practical cause of AWADI's cancellation of STUBS. However, for the reasons I have given above, I do not consider that its taking rendered the conduct of the Commonwealth unfair or unreasonable in relation to its obligation to supply STUBS under the Head Contract.

The significance of Finn J's decision on this point is that representations made by one Government agency are to be considered in the context of that agency's responsibilities and not assumed to have wider implications for the Commonwealth.

Affirmation by Election

As noted above DFAT was required under the Head Contract to provide the STUBS devices. BHP IT in turn had to supply GEC Marconi with the STUBS devices. DFAT, to overcome its contractual obligation to supply the STUBS devices, proposed that emulation software be developed to allow the development, integration and acceptance of the ADCNET software to occur without the actual STUBS devices.

> *… this is a clear case of affirmation and that GEC Marconi's purported termination was an attempt, opportunistically and too late, to avoid a "regretted decision" it had long since made.* Finn J

This proposal 'appeared' to be accepted by both GEC Marconi and BHP IT. Later GEC Marconi tried to use the non-provision of the STUBS devices as a means of escaping the Sub-contract. DFAT raised a change request which led to a contract variation for the development of the STUBS emulation software. For reasons that remain unexplained, whilst the Commonwealth and BHP IT varied the Head Contract, a similar contract variation did not seem to be effected under the Sub-contract.

There was no question however, that all the parties proceeded on the basis that the STUBS devices would not be available for the further development, integration and acceptance testing of the ADCNET software. Suggestions from GEC Marconi to the contrary were rejected by Finn J. At [389–390] he makes this telling observation:

> Mr Sharp [GEC Marconi's CEO] went on to admit that he had read the Sub-Contract carefully and that in or shortly prior to March 1996 he had fastened upon the failure to provide STUBS as an opportunity for GEC Marconi to escape from its obligations under the contract.
>
> As Mr Hilton SC [the Commonwealth's Counsel] happily put the matter, GEC Marconi was "content to proceed [with the contract notwithstanding the non-provision of STUBS]. Mr Wishart gave evidence to that effect. That's what the documents say. It's only when the businessmen took over the management of the contract that a commercial decision was made to escape from the obligations … [B]y then it is just too late".

The actual Change Requests and the formal Contract Amendment were uninformative and did not spell out the agreement reached by the parties that Finn J ultimately found. They simply provided by their terms for the development of the STUBS emulation software.

Before the Commonwealth and BHP IT had raised the STUBS emulation software Change Request there was a plethora of correspondence between the parties about the need to develop the STUBS emulation software as the actual STUBS devices would, it was initially thought, be late and as subsequently advised not be provided at all.

The specifications for the STUBS emulation software were discussed in detail so that it could be used to allow for the continued development, integration and acceptance testing of the ADCNET software. The correspondence in this period was against the backdrop of the notifications by the Commonwealth, initially that it could not supply the STUBS devices at the times required by the Head Contract, and then not at all.

Once GEC Marconi had developed the STUBS emulation software it was demonstrated to both BHP IT and the Commonwealth in February 1996. The Commonwealth advised that it appeared suitable for the purposes of acceptance testing. The Commonwealth paid BHP IT for the software. BHP IT in turn paid GEC Marconi.

BHP IT (and the Commonwealth) argued that if by its failure to deliver the STUBS devices it was in breach of the Sub-contract which entitled GEC Marconi to terminate that contract, GEC Marconi had, by its subsequent conduct, lost that right. It was argued that GEC Marconi's conduct in progressing the development of the ADCNET software, in developing the STUBS emulation software, and making changes to various project documents, were acts that were an unequivocal election to affirm the contract.

The relevant legal principles concerning affirmation by election are set out at [356]–[364] of the judgment. In particular, Finn J says at [364]:

> Distinct rationales have been advanced to support various of the principles that make up the law of election. Because of their relevance to the present matter, I would note the following two matters. First, the requirements that the election be made within a reasonable time (or, in the US, promptly), and that it be irreversible have been said to prevent the elector speculating on the future progress of the contract at the other party's risk ... that other party, having no control over the choice finally made, being vulnerable necessarily to the party having the power of election. In consequence, these requirements have been seen as having the capacity to help keep together ongoing transactions, for example, construction contracts, in which a breach has occurred sufficient to give rise to the right to terminate. Secondly, and correspondingly, the requirement that the election be communicated to the party affected by the choice made has been said to have no doubt been adopted:

> "in the interests of certainty and because it has been thought to be fair as between the parties that the person affected is entitled to know where he stands and that the person electing should not have the opportunity of changing his election and subjecting his adversary to different obligations": [*Sargent v ASL Developments Ltd* (1974) 131 CLR 634 at 656].

Finn J concludes at [368]:

> …this is a clear case of affirmation and ... GEC Marconi's purported termination was an attempt, opportunistically and too late, to avoid a "regretted decision" it had long since made. The non-provision of STUBS was not a "sleeper" that GEC Marconi could awaken for its own advantage five months after the cancellation of STUBS was announced … Given the nature of the contractual relationship and what transpired in the intervening five months, GEC Marconi had lost its right to resort to cl 40 of the Sub-Contract to precipitate a termination.

Entire Obligation Contracts

The keystone to any finding whether a contract is an entire obligation contract, is rooted firmly in the construction of that contract. This is an important issue so far as software development and entire system (hardware, software and firmware) contracts are concerned. It was DFAT's avowed intention that the Head and Sub-contracts be entire obligation contracts until such time as the ADCNET software was delivered at Milestone 5000.

An entire obligation contract is one when the *right to payment* arises only when the goods are delivered or the services completely performed. In these contracts there is no entitlement to payment if only part of the goods are delivered or only part of the services are provided. The goods and services must be entirely provided. Finn J found that the Head and Sub-contracts were not entire obligation contracts.

In the Head and Sub-contracts the entire obligation was founded *solely* on the words 'Subject to achievement of Milestone 5000' in Table 8.1 of Schedule 8. At Milestone 5000, the ADCNET software for the Canberra based system would be delivered and at that time DFAT would have something of value under the contract. Apart from this reference there was no other reference made in the contract to the entire obligation.

If a contract or obligation is to be found to be entire notwithstanding that the contract or obligation provides for payment by instalments, the contract on its proper construction must indicate that the instalments are nonetheless conditional upon complete performance of the contract or obligation, ie that they are refundable if this does not occur because of the default of the party that is to render the performance. Finn J [706]

Under the Head and Sub-contracts unconditional financial guarantees arose in favour of the customer at each point the customer made a milestone payment to the contractor. If the software did not meet acceptance the guarantees could be called upon. Nothing was said in the clauses of the Head and Sub-contracts that created the guarantees which linked these clauses to Table 8.1 in Schedule 8, and which contained the words 'Subject to achievement of Milestone 5000'.

The omission to create the entire obligation in the clauses of the Head and Sub-contracts was considered by Finn J to be fatal. He said at [710]:

> … the language of Table 8.1 provides a most oblique way of achieving a most important effect for the contractors if its purpose was to evidence an intention to make the obligation an entire one.

and at [714]:

> The reason I consider a clear and unambiguous provision to the contrary would be necessary is because I consider the actual terms and tenor of the Sub-Contract were quite inconsistent with the obligation of entire performance proposed by BHP-IT and the Commonwealth.

Finn J said that while each contractual milestone was an entire obligation he was not satisfied that each of the payments at the milestones that preceded Milestone 5000 were conditional upon the achievement of Milestone 5000. He found that the contract price had been apportioned to particular phases of work in the development of the software which were the milestones. Table 8.1 had two purposes, first to prescribe planned contract Acceptance Dates for the Project deliverables and secondly to provide a Payment Plan under the Head and Sub-contracts.

Finn J rejected the submission that an entitlement to payment in favour of GEC Marconi did not arise until Milestone 5000; its entitlement to payment arose when it reached each milestone.

Until the software was delivered at Milestone 5000 there was nothing of value to the Commonwealth. What was delivered at each preceding milestone to 5000 were documents. Some 80% of the value of the contract was paid prior to Milestone 5000. This was not a case where if some work had started it could be picked up and completed by another person. Software is not like a building you can see, touch and construct.

Implications for contracting

In light of this decision specific clauses that provide the protection of the entire obligation concept will need to be embodied in software and systems development contracts.

If a contract or obligation is to be found to be entire, notwithstanding that the contract or obligation provides for payment by instalments, the contract on its proper construction must indicate that the instalments are nonetheless conditional upon complete performance of the contract or obligation; that is, the payments are refundable if completion does not occur because of the default of the party rendering performance.

The Legal Effect of Variation Agreements

The Commonwealth brought a cross-claim against BHP IT for the losses it incurred as a result of not having the benefit of the ADCNET software.

Its losses principally concerned:

- the cost of having to maintain and relocate the old security gateway system;
- the cost of having to accelerate the development of part of the ADCNET software to allow the IBM Classified System to be switched off;
- the cost of further project management services for the December 1997 Variation Agreement – as it turned out, the Commonwealth ought to have claimed the expenditure it wasted in performing the Head Contract prior to entry into the December 1997 Variation Agreement; and
- the cost of accommodation for BHP IT's project team in performing the December 1997 Variation Agreement – but should have claimed the cost of wasted expenditure in providing accommodation for the BHP IT project team before the December 1997 Variation Agreement was entered into.

There were two main findings by Finn J that made a deep cut in the Commonwealth's damages claim. These were a finding concerning the legal effect of the December 1997 Variation Agreement and a factual finding concerning DFAT's inability to make decisions, in Finn J's view, expeditiously. It is the first of these matters that we are concerned with in this Briefing.

The effect of the December 1997 Variation Agreement

After GEC Marconi had repudiated the Sub-contract in December 1996, the Commonwealth and BHP IT entered into discussions as to the best way to complete the Head Contract and provide for the delivery of the ADCNET software. These negotiations culminated in the December 1997 Variation Agreement.

Under the terms of the Head Contract the Canberra based system was to have been delivered by February 1996. The balance of the ADCNET software was to have been delivered by the end of May 1996, at which time the contract would have been completed.

The Commonwealth, in effect, set new contractual milestone dates for the development of the ADCNET software. Both BHP IT and the Commonwealth accepted that the work that GEC Marconi had undertaken under the Sub-contract was of little or no value and that to develop the ADCNET software, such work would have to start from scratch.

BHP (the parent company) had given both financial and performance guarantees for the performance of the Head Contract in favour of the Commonwealth. As part of the December 1997 Variation Agreement terms, the Commonwealth agreed not to take any action under those guarantees for defaults that had occurred to date.

The terms of the variation agreement

The material terms of the December 1997 Variation Agreement were:

2. Effect

This Amendment will take effect from 19 December 1997.

…

4. Reservation of Rights

4.1 The Commonwealth and BHPIT both reserve any rights that they may have under the original contract in relation to any claim that EASAMS, BHPIT or the Commonwealth may bring against the other. In particular, the Commonwealth and BHPIT agree that except as specifically provided for in this Amendment they have not waived any claim against each other.

5. Release from Further Work

The Commonwealth hereby release BHPIT from any further obligation to perform the work as required under the original contract.

6. Work still to be Performed

The Parties agree that BHPIT will perform the work under the Agreement as amended.

7. Undertaking by The Broken Hill Proprietary Company Limited

The Commonwealth agrees that it will not take any action in respect of the original contract against The Broken Hill Proprietary Company Limited (BHP).

8. Liquidated Damages

The Commonwealth waives all rights to liquidated damages under the original contract.

…

12. Excusable Delay

BHPIT agrees to waive all claims against the Commonwealth under the original contract for delay costs except those that are found by a court or as a result of arbitration or mediation to which the Commonwealth is a party to have arisen from a claim by EASAMS on BHPIT and to have been the direct result of an action or omission of the Commonwealth.

BHP IT's Arguments against the Commonwealth's cross claim

There were four principal arguments advanced to defeat the Commonwealth's cross claim:

- BHP IT argued that Clause 5 operated retrospectively to release BHP IT entirely from its obligations under the Head Contract – once released any right to damages that the Commonwealth had for delay in the delivery of the ADCNET software *was extinguished*.

- Alternatively, the Commonwealth by entering into the December 1997 Variation Agreement effectively *limited its right of recovery* for delay in the delivery of the ADCNET software to the date of effect of that agreement.

- BHP IT in addition argued that Clause 8 of the December 1997 Variation Agreement extinguished any rights the Commonwealth had to claim for delay – the Clause 8 argument.

- GEC Marconi argued that the changes made between the Sub-contract and the December 1997 Variation Agreement were so substantial and significant that a completely different obligation was imposed by the later agreement, thereby rescinding from the outset the Sub-contract, or at least from the date the December 1997 Variation Agreement was entered into.

The Commonwealth's response

The Commonwealth said that:

- BHP IT had failed to deliver the developed software at the times required by the Head Contract;

- despite this failure, it had not terminated the Head Contract; and

- accordingly, BHP IT's obligation to deliver the ADCNET software remained.

The December 1997 Variation Agreement was not a new agreement but a variation of the Head Contract.

Consequently the Commonwealth was entitled to sue for any damage suffered as a result of the late delivery of the ADCNET software: *Carr v J A Berriman Pty Ltd* (1953) 89 CLR 327. This was the position at the time the December 1997 Variation Agreement was entered into. This right remained unaffected by the December 1997 Variation Agreement and was specifically preserved by Clause 4.1 of that agreement. All that the December 1997 Variation Agreement relevantly did was fix a new date for delivery of the ADCNET software.

In respect of the Clause 8 argument put forward by BHP IT the Commonwealth said that although Clause 39.8 of the Head Contract was headed 'Liquidated Damages', it dealt with two distinct rights – the Commonwealth's right to liquidated damages and the right to general damages for delay. The Commonwealth under Clause 39.8 had to elect which right it would pursue. The wording of Clause 39.8 was such that the conditions of the exercise of one right precluded resort to the other right. There is some authority which suggests that pursuit of a right to liquidated damages forecloses a party's right to general damages for delay. The High Court has recognised this issue but has left it undecided: see *AMEV-UDC Finance v Austin* (1986) 162 CLR 170).

Finn J found that what was preserved by Clause 4.1 was only the existing right and not the right to future damages occasioned by the continuing delay in the delivery of the ADCNET software.

Relevant legal principles

Finn J sets out the relevant legal principles that govern the effect of a contract of variation at [1424]:

> The principles governing the effect a contract of variation may have on the contract it varies are settled, even if they do some violence to "strict logic": *Tallerman & Co Pty Ltd v Nathan's Merchandise (Victoria) Pty Ltd* (1957) 98 CLR 93 at 135; Wilken and Villiers, *Waiver, Variation and Estoppel*, paras 2.26-2.36. The variation contract may effect (i) a complete discharge of the original contract and the substitution of a new contract in its stead; (ii) a partial discharge of the original contract with or without new terms for those discharged; or (iii) the addition of new terms without any partial discharge. The determining factor is the intention of the parties as disclosed in the variation agreement: *Tallerman & Co Pty Ltd*, above, at 145; *Federal Commissioner of Taxation v Sara Lee Household & Body Care (Aust) Pty Ltd* (2000) 172 ALR 346; *Concut Pty Ltd v Worrell*, above, at 698-699.

Finn J's reasoning

Finn J accepted the Commonwealth's argument that Clause 8 of the December 1997 Variation Agreement which took away the Commonwealth's right to claim liquidated damages did not affect the Commonwealth's right to general damages as set out in Clause 39.8 of the Head Contract. He accordingly rejected BHP IT's Clause 8 argument.

Finn J accepted the Commonwealth's submission that the December 1997 Variation Agreement was a variation of the Head Contract, and not in itself a complete substitution for the Head Contract.

More problematic for him, and unfortunately the Commonwealth, was what effect should be ascribed to the variations to the Head Contract brought about by the December 1997 Variation Agreement.

Finn J rejected BHP IT's primary submission which revolved around Clause 5 of the December 1997 Variation Agreement. The entry into this agreement did not extinguish the Commonwealth's *existing* right to damages for delay. This right was preserved by Clause 4.1 of the December 1997 Variation Agreement.

Unfortunately for the Commonwealth, Finn J found that what was preserved by Clause 4.1 was only the *existing* right and *not the right to future damages* occasioned by the continuing delay in the delivery of the ADCNET software.

Finn J found that it was against the commercial reality of the situation that such a right should continue to exist. The December 1997 Variation Agreement was the means by which the ADCNET software was to be provided after GEC Marconi had wrongfully repudiated the contract. Finn J thought that it seemed commercially nonsensical that the parties would start afresh, preserve their existing rights and get on with the job at hand, but at the same time know that every moment was sounding in damages against one of them.

Tips for Agencies

- In a procurement contract, don't forget that the Commonwealth can be held accountable for its part of the bargain – agencies should carefully consider whether it is possible or appropriate for the Commonwealth to take on and satisfy any commitments provided for in a contract.
- Ensure that you have contractual arrangements in place with a supplier or other party before agreeing to any obligations or consider having the contractor purchase directly from the supplier.
- Don't forget that everyday interactions with contractors can result in variations to the contract even if they are not formally documented as such.
- When you do vary a contract, particularly where delay is involved, consider carefully how you envisage that this will impact on any right to damages including damages that would otherwise have been applicable for the period after the variation is signed.
- If you are making instalment or milestone payments but expect to recover these if the end product is not delivered, make sure that the contract is absolutely clear on this point – you can't rely on annotations against a milestone schedule or the mere fact of a performance guarantee to have this effect if the contract is not clear.

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