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Limiting contractor liability

EFFECTIVE SEPTEMBER 1, 2003 the federal Treasury Board Secretariat, introduced a new policy, Decision Making in Limiting Contractor Liability in Crown Procurement Contracts, (www.tbs-sct.gc.ca/pubs_pol/dcgpubs/Contracting/dmlic-pdlr_e.asp), which replaces the interim policy, in place since 1995. The policy signals a change in the Crown's position, as reflected in the Standard Acquisition Clauses, from one of full indemnification, to remaining silent on indemnification.

The new policy applies to departments as defined in section 2 of the *Financial Administration Act* including the Canadian Forces, as well as other Crown procurement contracts subject to the *Government Contracts Regulations* and the Treasury Board's (TBS) contracting policy, which states:

- *Protection of the Crown.* The government will ensure that Crown procurement contracts provide for appropriate indemnification of the Crown.
- *Contractor responsibility.* Contractors are responsible for managing risks under their control and must retain financial responsibility for losses arising as a result of the work they perform under contract, and in particular for liabilities from third party claims.
- *Exceptional transfer of risk.* A substantive transfer of risk and potential liabilities of the contractor to the Crown, which would normally be the contractor's responsibility, should occur only in exceptional circumstances when there is a compelling reason in the public interest.
- *Risk-based implementation.* Indemnification and limitation provisions are to be implemented in a way that is risk-based and administratively efficient, and supports due diligence by the Crown and contractors in managing risk and contract performance."

The overall objective is to "achieve a balance amongst the protection required by the Crown when entering into Crown procurement contracts, market place conditions and conditions important for assuming program and service delivery results."

The policy describes four models, each tied to specific strategies for managing risk.

Model 1: Standard commercial or military products and services and construction contracts commonly available in the marketplace. Commodity groups have been identified to describe these types of contracts.

Model 2: Complex developmental products, services and construction contracts.

Model 3: Contracts where there is limited scope for negotiating liability provisions, such as government-to-government agreements, or where no other viable alternative to serve a program requirement exists.

Model 4: Highly specialized services contracts in support of the health, safety and economic well-being of Canadians.

In addition, the policy specifies ministerial authorities with respect to each of the risk models. For instance, if the contract is silent or contains standard clauses indemnifying the Crown, the decision to proceed may be made at the departmental level, by Public Works and Government Services Canada (PWGSC) or by way of approval by TBS. The policy sets specific risk management strategies and contractual clauses that are to be adopted with respect to specific commodity groupings. In those cases the authority to adopt the appropriate standard is delegated to departments or PWGSC. However, if the limitation of liability on the part of the contractor or on the part of the Crown is to deviate from the standard, authorization must usually be obtained from TBS. Similarly, limitations of any third party liabilities may require the approval of TBS. And, if it is decided that it would be appropriate to provide for Crown indemnification of the contractor, TBS approval is required.

The TBS policy on risk management is now complemented by a *Desk Book* (issued by PWGSC, not available online). It is to be used by PWGSC procurement officers in implementing the policy. The *Desk Book* identifies factors that informed the decision by TBS to develop this policy. In particular, there has been a recognition that many suppliers are refusing to accept unlimited liability. Also, with the advent of the trade agreements covering government procurement, there is recognition of the international nature of government procurement – in the United States, companies are not required to give the US government protection against the company's negligence as long as they are prepared to offer discounted prices. As well, in certain industries – such as information technology and information management – the industry norm does not provide for full indemnification.

The *Desk Book* sets out the commodity groupings to be used to limit liability for certain classes of commodities so that TBS approval, as discussed above, is not required. PWGSC has developed 21 commodity groupings, 11 of which are for information management and information technology contracts. The other 10 are for armaments, aerospace and marine goods and services.

The *Desk Book* expands on the decision-making process providing procurement officers with a series of questions to ask themselves when reviewing a contract in order to determine whether the policy applies or not, and what standard should be adopted with respect to the limitation of liability. It also contains a new limitation of liability article, to be used in information management or information technology contracts that come within the special authorities that have been established for PWGSC under Model 1. *mm*

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