



## STAFF REPORT ACTION REQUIRED

### Policy on Limiting Vendor Liability for Procurements of Specialty Goods and Services for Toronto Water, Solid Waste Management Services and Technical Services (All Wards)

<b>Date:</b>	August 31, 2007
<b>To:</b>	Government Management Committee
<b>From:</b>	General Manager of Toronto Water, General Manager of Solid Waste Management Services, Executive Director of Technical Services and City Solicitor
<b>Wards:</b>	All
<b>Reference Number:</b>	

#### SUMMARY

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As a result of increased resistance by the specialized goods and services industry to the requirement by the City of unlimited indemnification from the vendor for every procurement, the City has experienced and will continue to experience a limited pool of vendors for the procurement of those goods and services, potentially depriving it of obtaining competitive pricing and technology from its calls. The recommended policy is intended to more realistically balance the City's needs and the specialized goods and services industry's realistic risk acceptance level. It is anticipated that the results of this draft policy will be to increase the competitiveness in the City's procurement calls for specialized goods and services to the City's benefit.

The purpose of this Report is to recommend a policy that utilizes a risk assessment approach to specialized Toronto Water, Solid Waste Management Services and Technical Services contracts to more appropriately balance the requirements for procurement of these goods and services with the specialized industries' realistic risk acceptance to ensure more competitive and economically viable procurements.

## **RECOMMENDATIONS**

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It is recommended that:

1. the appropriate Division Head, after consultation with the City Solicitor, be authorized to make such limitations on liability and indemnities in contracts for specialized goods and services for Toronto Water, Solid Waste Management Services and Technical Services, as they may deem appropriate in the interests of the City and in accordance with the draft policy attached to this report as Schedule A;
2. the draft policy attached to this report as Schedule A be adopted to introduce a risk assessment and due diligence approach to the procurement of specialized goods and services for Toronto Water, Solid Waste Management Services and Technical Services to more appropriately balance the requirements for the procurement of these goods and services with the industry's realistic risk acceptance to ensure more competitive and economically viable procurements; and
3. the appropriate City Officials be authorized and directed to take the necessary action to give effect thereto.

## **FINANCIAL IMPACT**

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There are no immediate financial impacts resulting from the adoption of this report.

## **ISSUE BACKGROUND**

Historically, the City has included in its procurements a requirement for “unlimited indemnification” from its vendors, as have many other levels of government, without provision for any limitation of the vendor’s liability to the City. This requirement has been imposed on the principle that the vendor should be wholly responsible for the goods and/or services it provides to the City. While this is in theory the best possible protection that the City could hope to achieve, it assumes willingness on the part of the vendor to provide it and assumes the economic ability of the vendor to make good on such a promise. As a practical matter, the requirement for unlimited indemnification has become more and more untenable where there are limited vendors for a specialized good or service such as, but not limited to, centrifuges, pumping equipment, digester mixing equipment, ozonation equipment, recycle carts, waste and litter audit services.

In recent years, it has been increasingly recognized by City staff that it has become necessary to re-examine the approach taken by the City regarding limitations of liability and unlimited indemnification in specialized procurements to balance acceptable risk, adequate protection, competitive pricing and effective service delivery. The policy recommended by staff in this report provides a risk-based approach to decisions regarding limitations of liability and indemnification that the City must make up-front in the procurement process for specialized goods and services for Toronto Water, Solid Waste Management Services and Technical Services.

## **COMMENTS**

In contractual matters, the City has generally required that a vendor be responsible for all risks and liabilities arising from the vendor's acts or omissions in its performance of the contract. The City has in the past departed from this approach in certain specialty contracts. Council, on April 25, 26 and 27, 2006, adopted the *Policy on Decision Making in Limiting Vendor Liability in City of Toronto Information and Technology Procurement Contracts* and, on September 25, 26, 27 and 28, 2006, approved the use, in the general conditions for contracts related to pre-selection or direct procurement of equipment, of a limitation on liquidated damages on equipment performance (related to operational and maintenance guarantees) to a minimum of 15 percent of the value of the capital cost of the equipment.

In 2003, the Federal Government, through the Treasury Board (TB) approved a new Policy entitled "Policy on Decision Making in Limiting Vendor Liability in Crown Procurement Contracts." The Federal policy's primary message is that reasonable effort must be made to determine the liability risks involved in procurement and that the vendor's capability to protect the Crown should be reasonably ascertained before a limitation of liability clause is to be included. It appears reasonable to apply a similar approach to municipal procurement.

Certain specialized goods and services have limited vendors or a single vendor for varying reasons including the use of patented technology, limited available expertise, high market entry costs or high capital costs to undertake a large, complex project. Over the past few years, with the increasing merger of companies providing specialized goods and services, the number of vendors providing those goods and services has been further limited.

This has had several impacts. Many vendors of these specialized goods and services now refuse to accept unlimited liability. Companies with large capital assets and global businesses are declining to bid on City procurements for such goods or services, or are supplying non-compliant conditional bids that the City cannot accept. Conversely, vendors with substantially smaller assets may be willing to accept an unlimited indemnity because, as a matter of practical economics, they do not have the assets to cover any substantial liability and will never have to provide it simply because they cannot. They will become insolvent and the City ultimately will have to shoulder the excess liability. In the procurement of specialized goods and services, a requirement that there be no limitation on liability is likely to have an adverse impact on competition and value for money where vendors refuse to take part. The result is that the City's pool of vendors becomes unacceptably limited and the City is not necessarily getting competitive pricing and the best available goods and services.

In certain circumstances, it may be in the public interest for the City to assume part of a vendor's potential risks and liabilities. This transfer of potential risk or liabilities is set out in a limitation of liability or indemnification clause. The intent of the recommended policy, set out in Schedule A, is to address the use of these clauses in the procurement of certain specialized goods and services for Toronto Water, Solid Waste Management Services and Technical Services. The proposed policy strives for a risk-based, administratively efficient management regime that responds to program delivery challenges, recognizes market place realities, and supports effective stewardship of public funds. It ultimately seeks to strike a balance that best meets the needs of the City and adequately protects the City from liabilities and losses caused either by the vendor's performance of the contract or from the performance of the goods or services delivered.

To provide for the administratively efficient management of procurements of specialized goods and services for Toronto Water, Solid Waste Management Services and Technical Services that responds to program delivery challenges and appropriately balances the protection of the City against a recognition of market place realities for those particular goods and/or service, it is recommended that decisions on liability for the procurement of specialized goods and services should be made by the Division Head for whose division the particular goods and/or services are required for capital project or service delivery. These officials should determine if and how indemnification and limitation of liability clauses need to be adapted to the particular circumstances of the procurement. The decision of the applicable Division Head should only be made after consultation with the City Solicitor. The Manager of Insurance and Risk Management would be available as a consultative resource.

The Director of the Purchasing & Materials Management Division and Manager of Insurance and Risk Management were consulted in the preparation of this report.

## CONTACTS

Tony Pagnanelli  
Director, Engineering Services  
Works Facilities & Structures  
Technical Services  
Telephone: (416) 392-8245  
Fax (416) 392-4594  
e-mail: TPagnan@toronto.ca

Patrick Newland  
Director, Water Treatment and Supply  
Toronto Water  
Telephone: (416) 392-8220  
Fax (416) 392-3639  
e-mail: pnewlan@toronto.ca

Norm Lee  
Director, Policy & Planning  
Solid Waste Management Services  
Telephone: (416) 397-0207  
Fax: (416) 392-4754  
e-mail: NLee@toronto.ca

Michael Gouthro  
Solicitor  
Legal Services  
Telephone: (416) 392-8037  
Fax: (416) 397-5624  
e-mail: mgouthr@toronto.ca

## SIGNATURES

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Lou Di Gironimo,  
General Manager of Toronto Water

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Geoff Rathbone,  
General Manager of Solid Waste Management Services

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William G. Crowther,  
Executive Director of Technical Services

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Anna Kinastowski,  
City Solicitor

## ATTACHMENTS

Draft Policy on Limitations on Liability and Indemnities in the Procurement of Specialized Goods and Services for Toronto Water, Solid Waste Management Services and Technical Services

## Schedule A

### Draft Policy on Limitations on Liability and Indemnities in the Procurement of Specialized Goods and Services for Toronto Water, Solid Waste Management Services and Technical Services

#### 1.0 Statement of Policy Principles

The main objective of this policy is to protect the interests of the City and the public by ensuring that, when the City commences the process for the acquisition of specialized goods and services for Toronto Water, Solid Waste Management Services and Technical Services, the process achieves an appropriate balance taking into account the protection required by the City, actual market place conditions and risk protection in assuring capital works and service delivery results by the strategic identification and management of risks that exist in today's market conditions. This policy will result in the City obtaining an acceptable level of protection from liabilities in a cost effective manner consistent with effective program and service delivery to the public.

The City recognizes that to maximize the effectiveness of its procurement policies in the procurement of specialized goods and services, it is necessary for a risk assessment to be performed early in the planning stages of an acquisition to ascertain the appropriate level of risk protection required for the procurement.

In considering whether to include a limitation of a vendor's liability in a procurement document, the applicable Division Head should apply the following general principles in making a determination:

- *Protection of the City* – the procurement contracts should ensure appropriate indemnification of the City.
- *Vendor responsibility* - vendors should be responsible for managing risks under their control and should retain financial responsibility for losses and liabilities arising as a result of the work they perform under contract.
- *Compelling Public Interest prior to Transfer of Vendor's Risk and Liability to City* - a transfer of the vendor's risk and potential liabilities to the City (which would normally be the vendor's responsibility) should occur only when there is a compelling reason in the public interest.
- *Risk-Based Implementation* - Indemnification and limitation provisions should be implemented in a way that is risk-based and administratively efficient, and is consistent with due diligence approach by the City and vendors in managing risk and contract performance.

Only where there is a compelling reason in the public interest based on the objectives of this policy and the risk assessment should the appropriate Division Head consider a limitation on the vendor's liability and assume potential vendor liabilities.

## **2.0 Application of the Policy**

This policy is intended to apply to the acquisition of specialized goods and services for Toronto Water, Solid Waste Management Services and Technical Services which include the following:

- Complex construction contracts where the absence of a limitation on liabilities may substantially limit participation of bidders in the competitive procurement process;
- Highly specialized goods and services contracts where there are limited vendors in the market; and
- Contracts where there is limited scope for negotiating liability provisions, such as sole source contracts where patents, copyrights or other exclusive rights or proprietary information are held by a single vendor or where for technical reasons highly specialized knowledge or experience is required or when an emergency arises and a delay to seek approval of the limitation or indemnification would be injurious to the public interest.

This policy is intended to be independent of and does not replace any insurance requirements in a procurement. The insurance requirements are intended to secure a financial resource from which liabilities incurred by vendors, which fall within the scope of the coverage, can be satisfied. Insurance requirements in a procurement are relevant to this policy only to the extent of the financial capacity of potential vendors to meet liabilities, as part of the risk assessment.

## **3.0 Delegation of Authority to Consider Limitation of Liability**

To provide for the administratively efficient management of procurements of specialized goods and services that responds to program delivery challenges and appropriately balances the protection of the City against a recognition of market place realities for those particular goods and/or services, decisions on liability and indemnification for the procurement of specialized goods and services for Toronto Water, Solid Waste Management Services and Technical Services are delegated to the applicable Division Head for whose division the particular goods and/or services are required for capital works or service delivery. The Division Head shall determine if and how indemnification and limitation of liability clauses shall be applied to the particular circumstances of the procurement. The applicable Division Head should make their decision only after consultation with the City Solicitor. The Manager of Insurance and Risk Management would be available as a consultative resource.

## **4.0 Approach to Liability**

### **A. *When to consider liability issues***

A risk and due diligence assessment with respect to potential risks and liability issues in any specialized goods and services procurement should be considered and completed by the Division initiating the procurement as early as possible in the process – e.g., when sourcing the market. Decisions with respect to the appropriate level of liability or indemnification that should apply to a procurement or with respect to clauses to limit or

exclude liability of vendors should be made prior to release of the applicable procurement call document but, in no event, later than the time allowed for issuance of any addendum under the call. In cases of negotiations in non-competitive (sole source) situations, decisions with regard to liability limitation and indemnification should be taken before the start of negotiations. Should the transfer of risk sought by a vendor be too great or the potential liabilities too high, the Division Head should consider whether to proceed with the procurement.

Early in the planning stages of a proposed acquisition and prior to implementing any decision to limit a potential vendor's liability or indemnification of the City for a procurement call, the appropriate Division Head should:

- systematically assess potential risks
- develop appropriate strategies to manage risk, including an appropriate performance management regime for the contract, supported by the appropriate City expertise (i.e. financial, risk, technical, legal and purchasing)
- obtain appropriate legal advice and risk assessment and risk management advice prior to decision making, particularly in complex or higher risk situations

#### ***B. Risk and Due Diligence Assessment***

In applying this policy, a risk and due diligence assessment should be undertaken by the Division.

The assessment should identify the risks associated with a limitation of liability/indemnification and the probability and potential cost of losses to the City that might arise as a result.

In each case, the Division requesting the acquisition should also consider the nature and type of acquisition, the reasonableness of requiring the vendor to take responsibility for those losses and the impact it would have in the market place.

It is vital that, at all stages of a project, proper risk management systems are in place and that all approaches to risk sharing, other than limiting liability, are fully considered such as project management controls, insurance and, where appropriate, bonding and other forms of security.

In the event that the Division Head is proceeding with a limitation of liability/indemnification in a procurement, the assessment and rationale for the limitation must be reduced to writing and retained by the Division Head.

#### **Summary**

This policy will result in the City obtaining an acceptable level of protection from liabilities in a cost effective manner consistent with effective program and service delivery to the public through the strategic identification and management of risks and marketplace conditions. The assessment of risks and marketplace conditions should be addressed as soon as possible in the procurement process.