



STAFF REPORT ACTION REQUIRED

Limiting Liability of Service Providers under Contracts for Benefits Professional Services

Date:	October 26, 2015
To:	Government Management Committee
From:	Treasurer
Wards:	All
Reference Number:	P:\2015\Internal Services\ppeb\gm15009ppeb (AFS22069)

SUMMARY

The purpose of this report is to recommend adoption of a policy that will permit the Pension, Payroll & Employee Benefits Division, when calling for and considering bids for the provision of actuarial services and general benefits consulting, and when awarding the associated contracts, to set an upset limit on contractor liability. Setting liability clauses that take into account the industry's risk-management practices will allow for receipt of more competitive and economically viable bids.

RECOMMENDATIONS

The Treasurer recommends that:

- (1) City Council authorize the Treasurer, after consultation with the City Solicitor, to make such limitations on liability and indemnities in contracts for the provision of actuarial services and general benefits consulting, for Pension, Payroll and Employee Benefits as deemed appropriate in the interests of the City and in accordance with the policy attached to this report as Schedule A.

Financial Impact

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

The Deputy City Manager & Chief Financial Officer has reviewed this report and agrees with the financial impact information.

DECISION HISTORY

City Council, at its meeting on September 26, 2007, adopted GM7.11, "Policy on Limiting Vendor Liability for Procurements of Specialty Goods and Services for Toronto Water, Solid Waste Management Services and Technical Services", which allows the Division Heads of Toronto Water, Solid Waste Management Services and Engineering & Construction Services, in consultation with the City Solicitor to allow for limitations of liability and indemnities in contracts for speciality goods and services for those Divisions.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2007.GM7.11>

City Council, at its meeting on April 25, 26 and 27, 2006, adopted Administration Committee Report 2, Clause 10, "Policy on Decision Making in Limiting Vendor Liability in City of Toronto Information and Technology Procurement Contracts", which allows for a more risk-based approach to the acquisition of IT procurement, including the limitation of liability and indemnification.

<http://www.toronto.ca/legdocs/2006/agendas/council/cc060425/adm2rpt/cl010.pdf>

ISSUE BACKGROUND

In recent years, PPEB staff have become increasingly aware of the need to re-examine the approach taken by the City to indemnification obligations in contracts for Benefit Professional Services in order to balance acceptable risk, adequate protection, competitive pricing and effective service delivery. The policy proposed by this Report provides a risk-based approach to the decisions on indemnification that the City must make up-front in the procurement process for Benefit Professional Services.

Historically, the City has included a requirement for "unlimited indemnification" from its contractors, as have many other levels of government. While this requirement is, in theory, the best possible protection that the City could hope to achieve, it assumes willingness on the part of the contractor to provide it, and assumes the financial ability of the contractor to make good on such a promise. Some contractor operational risks are managed through the purchase of traditional liability insurance policies which in themselves provide protection limited to specific coverage amounts and to policy terms and conditions. As a practical matter, the requirement for unlimited indemnification has become more and more untenable. The Benefits Professional Services industry has been maturing as well as growing in size and scope, and in more recent years has been seriously questioning the reasonableness of a requirement for unlimited indemnification that goes well beyond their insurance protection. Many suppliers now refuse to accept unlimited liability. In other cases, the type or value of the procurement call makes unlimited liability unreasonable on its face.

This situation has had several impacts. One is that the larger, more solvent suppliers are refusing to bid, or are supplying conditional bids that the City cannot accept. It seems equally plausible that small operations may happily agree to unlimited indemnity since, as a matter of practical economics, they will never have to provide it because they cannot. The result is that the City's pool of suppliers becomes unacceptably limited and the City is not necessarily getting genuinely competitive pricing and the best available services through its Benefits Professional Services procurements.

Additionally, the City has moved to a shared-services model under which multiple Boards and Agencies issue joint calls for the provision of Benefit Professional Services in order to realize cost savings. The City's requirement of "unlimited liability and indemnity" does not align with that of some Boards and Agencies which require "*limited liability and indemnity*" typically set at Two Million dollars (\$2,000,000). This inconsistency may negatively affect future shared-services procurements as the City's requirement directly influences service-provider participation in procurement calls.

As an example, in June 2015 PPEB along with the Toronto Transit Commission and the Toronto Police Services Board jointly issued a Request for Proposal (RFP) for the provision of actuarial reports on non-pension benefits and general benefits consulting services. Five (5) service providers viewed the RFP, but only two (2) submitted a formal bid. Those providers who did not respond, including the City's current provider, were polled. In each case, the City's current "unlimited liability and indemnity" requirement was the key factor for the decision not to bid.

Although the City was successful in procuring a reputable provider for the actuarial reports on non-pension benefits, it may not have been on the most economic basis.

COMMENTS

Basic Premise:

As a basic contractual premise, contractors are responsible for managing risks and liabilities under their control. The City is likewise responsible for managing risks under its control for losses arising from those risks. Clauses that transfer all of the risk to a contractor, regardless of whether unlimited liability may exist, come at a cost, through increased cost of individual bids or through potential higher cost due to fewer bids, as potential bidders refuse to accept the risk.

In certain circumstances, it is in the public interest for the City to assume all or part of a contractor's potential liabilities. This transfer of potential risk or liabilities is set out in a limitation-of-liability or indemnification clause. The intent of the policy recommended in this report is to address the use of such clauses in contracts for Benefit Professional Services. The policy strives for a risk-based, administratively efficient management régime that responds to program delivery challenges, recognizes market place realities and supports effective stewardship of public funds. Again, it is a question of striking a balance that best meets the needs of the City.

There are different levels and types of risk that must be considered:

(i) Direct Damages

Direct damages are a loss to the City that results immediately, is foreseeable and is proximate (very near in time or space) to the act or omission of the service provider.

(ii) Indirect or Consequential Damages

Indirect damages, also known as consequential damages, arise from the results of damage rather than from the damage itself. Indirect or consequential damages can be proximate (*i.e.*, the natural and probable effect of the wrongful conduct sets in operation the intervening cause from which the loss directly results) or it can be remote (*i.e.*, the loss is not the natural and probable effect of the wrongful conduct).

It is anticipated that the results of this policy will result in increased competitive and economically viable procurements of Benefits Professional Services by PPEB.

Conclusions:

As a result of increased resistance by the Benefits Professional Services industry to the requirement by the City (and other purchasers) of unlimited indemnification from the service provider, with no regard to realistic risk assessment and acceptance, the pool of acceptable providers for such services has dwindled, depriving the City of genuinely competitive pricing. The recommended policy is intended to balance the City's needs with the Benefits Professional Services industry's general level of risk acceptance on a realistic basis.

The Director, Purchasing & Materials Management, the Director, Insurance & Risk Management and the Acting Director, Accounting Services, have been consulted and are in agreement with the proposed policy. In addition, Legal Services has been consulted and provided advice in the development of the attached policy.

CONTACT

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SIGNATURE

Mike St. Amant
Treasurer

ATTACHMENT

Attachment 1: Schedule A - Draft Policy on Limitations on Liability and Indemnities in Professional Services Agreements relating to Benefits

Schedule A

Draft Policy on Limitations on Liability and Indemnities in Professional Services Agreements relating to Benefits

1. Application of the Policy

This policy applies to all procurements by the Pension, Payroll & Employee Benefits (PPEB) of professional services relating to benefits provided to City employees, elected officials and retirees (“Benefit Professional Services”), including actuarial services, experience studies and general benefits consulting services, but does **not** replace insurance requirements.

2. Statement of Policy Principles

(1) The City recognizes that in order to maximize the effectiveness of its procurement of Benefit Professional Services, it is necessary for a potential risk assessment to be performed early in the planning stages of an acquisition.

(2) The purpose of this policy is to protect the interests of the City, the public and persons participating in the procurement process by ensuring that when the City commences the process for the acquisition of Benefits Professional Services, the process achieves a balance among the protection required by the City, market place conditions, and conditions important for assuring program and service delivery results by the strategic identification and management of risks that exist in today’s provision of benefits professional services.

3. Policy

(1) In connection with any proposed procurement by PPEB of Benefits Professional Services, it shall at an early stage of the process perform a systematic assessment of potential risks in accordance with the Elements of Risk Assessment specified below, including a determination, on the basis of a cost-benefit analysis, of how large a deviation from full coverage of the assessed risk would be acceptable, but subject to the Exceptions specified below.

(2) This policy supplements the Purchasing Chapter of the Municipal Code, and in the event of any conflict, that Chapter shall govern.

4. Elements of Risk Assessment

(1) Early in the planning stages of a proposed procurement of Benefit Professional Services, PPEB must perform a systematic assessment of potential risks which is supported by the early engagement of the appropriate City expertise (*i.e.*,

financial, risk, technical, legal, purchasing) and which includes, among any other appropriate elements, the following elements as they relate to the proposed procurement:

- (a) cost estimates and cost impact assessment;
- (b) internal and external risk factors, such as externally imposed deadlines, the division's experience in managing services of the proposed type, untested technology, environmental issues, late delivery, security, contingencies and City-furnished resources;
- (c) technical requirements of the division;
- (d) potential project management experience and technical capacity required;
- (e) potential financial capacity of the services provider to meet liabilities specified in the assessment;
- (f) impact on, and of, the City's programs, operations and budgetary considerations for the services to be delivered; and
- (g) impact on the operations of the City should there be a partial or substantial failure of the services.

(2) The assessment is to identify the risks that need to be addressed specifically by limitation of indemnification provisions in the contract, the potential cost of expected losses that might arise as well as their probability and the circumstances under which such losses might arise.

(3) PPEB shall in performing any assessment

- (a) apply a standard of reasonableness;
- (b) consider
 - (i) the potential for both direct loss and consequential loss;
 - (ii) the degree of risk that the loss might occur;
 - (iii) the nature and type of the proposed services;
 - (iv) the reasonableness of requiring the service provider to take responsibility for the losses and the impact same would have in the market place;

- (c) make a determination of the appropriate level of liability or indemnity that should apply to the procurement call prior to the release of the call documents but in no event later than the time for issuance of any addendum under the call;
- (d) in non-competitive situations, make decisions with regard to the applicable indemnification régime before the start of negotiations.

5. Examples

The following are some examples of Benefit Professional Services procurements for which it may be in the public interest to limit the service provider's liability:

- (a) where the City is imposing on the service provider liability in excess of the financial protection available at a reasonable cost to the provider by virtue of the risk inherent in the nature of the services to be performed;
- (b) where the risks are clearly non-insurable or when the cost of insurance is prohibitive;
- (c) where clearly no other viable alternative exists to satisfy a program or service delivery requirement;
- (d) where it is determined that the actual risk of loss is minimal as compared to the gain to be achieved from the performance of the services.

6. Exceptions

Intellectual Property Infringement

(1) A services provider should remain fully responsible for losses or damages to the City caused by the infringement of the intellectual property rights of a third party, and only in the most exceptional cases should there be any departure from such responsibility.

Injury to Person and Damage to Property

(2) A services provider should remain fully responsible for losses or damages to the City where the provider's actions or inactions have caused injury to a person and/or damage to property.