

**Consolidated Clause in Administration Committee Report 2, which was considered by City Council on April 25, 26 and 27, 2006.**

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**Policy on Decision Making in Limiting Vendor Liability in City of Toronto Information and Technology Procurement Contracts (All Wards)**

*City Council on April 25, 26 and 27, 2006, adopted this Clause without amendment.*

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**The Administration Committee recommends that City Council adopt the staff recommendations in the Recommendations Section of the report (February 22, 2006) from the Chief Corporate Officer and City Solicitor.**

Purpose:

The purpose of this Report is to recommend a policy that utilizes a risk assessment approach to Information Technology (IT) contracts to more accurately balance the requirements of an IT procurement with the IT industry's realistic risk acceptance to ensure the receipt of more competitive and economically viable IT procurements.

Financial Implications and Impact Statement:

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

Recommendations:

It is recommended that:

- (1) the draft policy attached to this report as Schedule A be adopted by the City of Toronto to introduce a risk assessment approach to Information Technology (IT) contracts to more accurately balance the requirements of an IT procurement with the IT industry's realistic risk acceptance to ensure the receipt of more competitive and economically viable IT procurements; and
- (2) the appropriate City Officials be authorized and directed to take the necessary action to give effect thereto.

Background:

Over the past few decades, Information Technology has become an integral part of virtually every aspect of the City's businesses. IT procurement has been evolving along with it. 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 to indemnification in IT contracting in order to balance acceptable risk, adequate protection, competitive pricing and effective service delivery. The proposed policy in this Report provides a risk-based approach to the decisions on indemnification that the City must make up-front in any IT procurement process.

#### History:

Historically, the City has included a requirement for “unlimited indemnification” from its IT contractors as have many other levels of government. While this 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 economic ability of the contractor to make good on such a promise. As a practical matter the requirement for unlimited indemnification has become more and more untenable. The IT 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 in every IT call. Many suppliers now refuse to accept unlimited liability. In other cases, the type or value of the acquisition makes unlimited liability unreasonable on its face.

This 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 because, 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 competitive pricing and the best available technology from its IT calls.

#### Comments:

In 2003, the Federal Government, through the Treasury Board (TB) approved a new Policy entitled “Policy on Decision Making in Limiting Contractor Liability in Crown Procurement Contracts.” The Information Technology Association of Canada (ITAC) worked with the Federal Government for several years to resolve limitation of liability issues. According to its website, together with its affiliated organizations across the country, ITAC represents 1300 Canadian companies in the information and communications technology industry in all sectors. The Federal policy’s overarching message is that reasonable effort must be made to determine the liability risks involved in procurement and that, if a limitation of liability clause is included, the contractor’s capability to protect the Crown has been reasonably ascertained. It appears reasonable to apply this same approach to municipal procurement.

#### 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.

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 this recommended policy is to address the use of these clauses in IT procurement. It 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. 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 vendor.

(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 setting 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).

On its website, ITAC is clear about the damages that concern the IT industry: "The two areas of concern were : Eliminating inference of third party rights such as economic, indirect or consequential loss and Capping first party liability." Because of the nature of much of the City's business – Emergency Services, water, health – the potential for both direct and indirect or consequential damages or loss can be very high.

The draft policy in Schedule A to this report incorporates many of the principles enunciated by the studies done by the Federal Government which include input from ITAC. It is anticipated that the results of this draft policy will be to increase the competitiveness in the City's IT calls to the City's financial and technological benefit.

Conclusions:

As a result of increased resistance by the IT industry to the requirement by the City (and other purchasers) of unlimited indemnification from the Vendor for every IT procurement, with no regard to realistic risk assessment and acceptance, the City's pool of suppliers risks becoming limited, depriving it of obtaining competitive pricing and technology from its IT calls. The recommended Policy is intended to more realistically balance the City's needs and the IT industry's realistic risk acceptance level.

The Executive Director of Information and Technology and the Manager of Risk Acceptance, Finance Division have been consulted and are in agreement with the proposed policy.

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Schedule A

Draft Policy on Limitations on Liability and Indemnities in  
Information Technology Agreements

Statement of Policy Principles

The City recognizes that in order to maximize the effectiveness of its procurement policies in the procurement of Information Technology goods and services, it is necessary for a potential risk assessment to be performed early in the planning stages of an acquisition.

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 Information Technology goods and services, the process achieves a balance amongst 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 e-City culture.

Policy

That a systematic risk assessment with respect to potential risks in any IT procurement shall be completed by the division initiating the call at an early stage of the procurement process.

This policy supplements the Purchasing Chapter of the Municipal Code. The Purchasing Chapter governs in the event of any conflict.

1.0 Application of the Policy

This policy applies to all acquisitions of computer-related equipment, software and services. It does not replace insurance requirements.

## 2.0 Exceptions

### 2.1 Intellectual Property Infringement

A vendor should remain fully responsible for losses or damages to the City caused by the infringement of the intellectual property rights of a third party. Only in the most exceptional cases should there be any deviation.

### 2.2 Injury To Person And Damage To Property

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

## 3.0 Elements of Risk Assessment

Early in the planning stages of a proposed acquisition, divisions are to systematically assess potential risks. This assessment is to be supported by the early engagement of the appropriate City expertise (i.e. financial, risk, technical, legal, purchasing) and should include, among others, the following elements as they relate to the potential acquisition:

- (1) cost estimates and cost impact assessment;
- (2) internal and external risk factors, such as externally imposed deadlines, the division's experience in managing this type of contract, untested technology, environmental issues, late delivery, security, contingencies and City-furnished resources;
- (3) technical requirements of the division;
- (4) potential project management experience and technical capacity required;
- (5) potential vendor financial capacity to meet liabilities specified in the assessment/review;
- (6) impact on, and of, the City's programs, operations and budgetary considerations for the project to be delivered; and
- (7) impact on the business of the City should a project fail partially or substantially.

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. Divisions shall apply a standard of reasonableness.

Divisions shall make a determination of the appropriate level of liability or indemnity that should apply to a 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. In cases of negotiations in non-competitive situations, decisions with regard to the applicable indemnification regime are to be taken before the start of negotiations.

## Examples

The following are some examples of acquisitions where it may be in the public interest to limit a vendor's liability:

- (1) when the City is imposing on the vendor a liability in excess of the financial protection available at a reasonable cost to the vendor by virtue of the risk inherent in the nature of the relationship captured in the contract or work being performed;
- (2) when the risks are clearly non-insurable or when the cost of insurance is prohibitive;
- (3) where clearly no other viable alternative exists to serve a program or service delivery requirement;
- (4) where it is determined that the actual risk of loss is minimal as compared to the gain to be achieved from the acquisition.

In each case, the division requesting the acquisition must consider the potential for direct loss, consequential loss, the degree of risk that the loss might occur, 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.