


# CANADIAN PROCUREMENT LITIGATION UPDATE 2008

Several important decisions by courts and the Canadian International Trade Tribunal will have a far-reaching impact on Canadian and American vendors involved in government procurements

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Over the past year there have been a number of procurement cases in Canada that will impact Canadian and American vendors alike. The following article highlights several significant cases heard by the Canadian International Trade Tribunal (CITT) and various courts such as the Ontario Superior Court of Justice, the Federal Court of Appeal and the Supreme Court of Canada during the past year. These cases are of particular importance to American and Canadian vendors who are actively participating in procurements conducted by the Canadian federal government.

## Design Services

In *Design Services Ltd. v. Canada* (2008, SCC 22), the

Supreme Court of Canada rejected the notion that a new duty of care should be recognized between purchasing institutions and subcontractors in the context of a tendering process. When the Supreme Court first granted leave to appeal, it was anticipated that the case might create new rights for subcontractors in Canada based on the principles of common-law negligence. However, the decision ultimately denied subcontractors the right to sue purchasing entities for negligence in the course of a tendering process.

Briefly, the facts were as follows. In May 1998, Public Works and Government Services Canada (PWGSC) launched a “design-build” tendering process for the construction of a building. (A “design-build” project involves a bid for both the design and the construc-

tion of the project.) PWGSC awarded the contract to a non-compliant bidder, and as a result a competitor and its intended subcontractors commenced litigation. In November 2004, the competitor settled its claim with PWGSC. Lacking privity of contract because the subcontractors were not themselves bidders, the subcontractors sued in tort in the Federal Court for their own economic loss.

At trial, the Federal Court determined that the subcontractors were not parties to the tendering process and therefore could not bring a claim against the Crown in contract (i.e. under the “contract A” scenario), but that the Crown did owe the subcontractors a duty of care in tort. This decision was appealed to the Federal Court of Appeal, which ruled that the Crown did not owe subcontractors in a tendering process a duty of care. The Federal Court of Appeal held that the relationship between the Crown and intended subcontractors did not justify recognizing a new duty of care because there was no direct relationship between them.

The Supreme Court of Canada subsequently granted leave to appeal to the subcontractors, which led to speculation that a new duty of care to subcontractors might be recognized, potentially creating a significant number of new, potential plaintiffs. However, in a unanimous decision, the Supreme Court of Canada rejected the notion that a new duty of care should be recognized between purchasing institutions and subcontractors in the context of a tendering process. The Supreme Court also found that because the tendering documents permitted the competing entity and its intended subcontractors to submit their bid as a “joint venture proponent,” which they did not do, the bidding entity was the only entity with which the Crown formed a contract and thus, the only entity that was owed a duty of care.

## Northrop Grumman Overseas Services

Another notable 2008 procurement case of particular interest to American suppliers is the decision by the Federal Court of Appeal in *Canada (Attorney General) v. Northrop Grumman Overseas Services Corporation and Lockheed Martin Corporation* (2008 FCA 187). This decision considered the circumstances under which the Canadian International Trade Tribunal (CITT) has jurisdiction to hear a complaint by an American supplier under the *Agreement on Internal Trade* (AIT).

In this case the Department of Public Works and Government Services Canada (PWGSC) issued a

Request for Proposal (RFP) and in response, bids were submitted by Northrop Grumman Overseas, Lockheed Martin Corporation and Raytheon Corporation. PWGSC awarded the contract to Lockheed Martin. On April 17, 2007, Northrop Grumman Overseas filed a complaint with the CITT, but prior to hearing the complaint, an issue arose as to whether Northrop Grumman Overseas had standing to bring a complaint before the CITT. PWGSC argued that Northrop Grumman Overseas did not have standing because it is not a Canadian supplier, a status which PWGSC argued must exist in order to complain under the AIT (this was the only trade agreement that applied in the circumstances of this case).

The CITT ruled that a company need not prove it is a “Canadian supplier” in order to be eligible to complain under the AIT, and proceeded to decide the complaint in favour of Northrop Grumman Overseas. In arriving at the decision to inquire into the Northrop Grumman complaint, the CITT undertook an extensive review of the applicable legislation and agreements. The Attorney General then sought judicial review of this ruling at the Federal Court of Appeal.

By a two-to-one decision (Justice Gilles Letourneau dissenting), the Federal Court of Appeal overturned the CITT decision, and held that the CITT had failed to consider adequately article 502 of the AIT, which indicates that the procurement should be “within Canada” where the procurement value is \$25,000 or greater. Using this section of the AIT as the basis for its decision, the majority opinion held that the CITT had erred in concluding that nothing in the AIT indicated the agreement applied only in respect of bids by Canadian suppliers. The majority found that in order to make a CITT complaint under the AIT, a vendor must demonstrate that it has “a sufficient presence in Canada to enable it to effectuate its obligations under the procurement contract from inside Canada.”

This does not mean that the goods being supplied cannot originate from outside Canada; however, they must be supplied to the Canadian government by a supplier who has a permanent establishment in Canada. This could potentially be done, for example, by an agreement between a parent and subsidiary under which goods created by a foreign parent are delivered to the government through the Canadian subsidiary.

In this case, the goods were to be manufactured by the American parent, Northrop Grumman Overseas,

which did have a Canadian subsidiary, Northrop Grumman Canada. However, Northrop Grumman Canada was not the bidding entity, and there was no contract between the two Northrop entities to supply the goods through Northrop Grumman Canada. The court thus referred back to the CITT the question whether Northrop Grumman Overseas itself qualifies as a “Canadian supplier” in accordance with the court’s reasons. As of the date of preparation of this article, the CITT has not rendered a decision on the issue remitted to it.

## Envoy Relocation Services

In May 2008, the Ontario Superior Court of Justice also released a decision of interest, in the case of *Envoy Relocation Services Inc. and National Relocation Services (Relonot) Inc. v. The Attorney General of Canada*, [2008] O.J. No. 1789 (S.C.J.). The court affirmed that, notwithstanding the creation of the CITT, the courts retain jurisdiction over actions against the federal Crown in tort and breach of contract arising out of tendering processes.

A complaint must be filed within 10 working days after the basis of the complaint became known, or reasonably should have become known, to the supplier.

In the *Envoy* case, which has yet to be tried on the merits, the plaintiffs asserted causes of action in tort and breach of contract in connection with a federal government procurement process that had previously been the subject of two CITT complaints and several

appeals to the Federal Court of Appeal. The Crown sought summary judgment dismissing the plaintiffs’ action on the basis that the action was barred by the principles of *res judicata*, issue estoppel and abuse of process. In addition, the Crown argued that the CITT had been created by Parliament to hear complaints in tendering cases, and thus the Ontario Superior Court of Justice lacked jurisdiction over the claim.

The Ontario Superior Court of Justice substantially dismissed the motion because there now existed evidence that had been unavailable to the plaintiffs during the CITT and Federal Court of Appeal proceedings. In addition, the court held that the causes of action asserted by the plaintiffs were separate and distinct from the types of complaint that the CITT may entertain. On the issue whether Parliament had intended to oust the jurisdiction of the courts over actions based in tort or breach of contract by creating the CITT, the court found that the defendant had not established this was the case. No such express language existed in the CITT Act.

This decision confirms that a party retains the right to sue the federal Crown for torts and breaches of contract regardless of the establishment of the CITT. The recognition of such a right is especially important in view of the numerous limitations inherent in the CITT process including:

- The CITT does not have a general power to receive complaints about all federal government contracts. Its jurisdiction is specific and limited. The CITT has only been given jurisdiction to decide if Canada is breaching its obligations under specified international and domestic agreements.
- The CITT does not have jurisdiction over alleged tortious conduct, breaches of contract, or legal obligations rooted in common law, since these causes of action are not subsumed in the terms of any of the trade agreements over which the CITT has been given jurisdiction.
- There are very short time limits for filing a CITT complaint. A complaint must be filed within 10 working days after the basis of the complaint became known, or reasonably should have become known, to the supplier.
- The filing of a complaint with the CITT is not like issuing a notice of action or a statement of claim. The written complaint comprises the claimant’s case, and it has to include all of the evidence in the complainant’s possession that is relied on by the complainant.

- During the CITT process, a complainant has no right to oral or documentary discovery of the procuring entity. There are no affidavits or lists of documents produced. This non-disclosure creates serious obstacles for a complainant, since critical documentation is often uniquely in the possession of the procuring entity and not the complainant.
- Given the short time frames that the CITT has to decide a complaint, there are seldom

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oral hearings held. The complainant does not have the right to an oral hearing under the CITT Act or Regulations. There is little or no opportunity to challenge the procuring entity's credibility or question the extent of the defendant's documentary disclosure to the CITT. The written hearing process does not allow for *viva voce* testimony or cross-examination, and is thus ill-suited to resolving disputes where credibility is in issue.

- The remedy that is obtained from the CITT is not an adequate alternative to a judgment of a court. In an action for damages in court, a

plaintiff is establishing an entitlement to be compensated for financial loss, and receives an enforceable judgment that can be executed upon. There is no provision of the CITT Act that enables a complainant to register a CITT determination as an order of the court and enforce it as such.

- If a complaint is upheld, the CITT is not bound to recommend what a complainant seeks, and may recommend any remedy that the CITT itself considers appropriate, including no remedy at all. Unlike a court, the CITT has a regulatory role to play, and does not grant remedies based on common-law principles as does a court.
- Whereas the outcome of an action is an enforceable judgment against the procuring entity, the CITT can only issue a recommendation to the procuring entity if the complaint is upheld. The procuring entity then has 20 days to advise the CITT of the extent, if any, to which it intends to implement the CITT's recommendation. If the procuring entity advises the CITT that it does not intend to implement the recommendations, then it must give his reasons but there is nothing that the CITT can do in the event of the government's non-implementation.

It should be noted that the conclusion of the Ontario Superior Court in *Envoy* is also consistent with an earlier decision of the Federal Court in *AgustaWestland International Ltd. v. Canada*, 2006 FC 767, at para. 46, in which the Federal Court rejected the Crown's argument that the CITT provided an "adequate, alternate remedy" to a damages action. In light of these two decisions, this particular issue has now, hopefully, been definitively put to rest.

## Zenix Engineering

A fourth case of note this past year was *Defence Construction (1951) Limited v. Zenix Engineering* (2008 FCA 109), in which the Federal Court of Appeal established that a procuring entity cannot unilaterally terminate negotiations with a top-ranked bidder and that a procuring entity can be found liable for prematurely terminating contract negotiations.

In this case, the Federal Court of Appeal upheld a decision by the CITT, which determined that a federal Crown corporation, Defence Construction (1951) Limited (DCC), was liable for awarding a contract to the second-ranked proponent following a Request for Abbreviated Proposal (RFAP), when it had already

informed the complainant, Zenix Engineering, that its proposal had received the highest overall score.

The RFAP was issued by DCC on behalf of the Department of National Defence (DND) on July 13, 2006 with a closing date for receipt of bids of August 17, 2006. In response to the RFAP, Zenix and five other bidders submitted proposals. On August 30, 2006 Zenix was informed that it had received the highest overall score and that it had been selected for negotiations with DCC. In November 2006, Zenix was informed that because it had modified its price offer after the negotiations began, that its proposal had now been rejected.

Zenix filed a complaint with the CITT in December 2006. The CITT issued its determination in April 2007 in which it found Zenix's complaint was valid and ordered that Zenix be compensated for the amount of profit it would have earned had it won the procurement. DCC sought judicial review of the CITT's determination on the basis that the CITT did not have jurisdiction under NAFTA to hear Zenix's complaint, and that the CITT had erred in finding that the applicant had breached the AIT and NAFTA by failing to disclose DND's budget limits to Zenix during the negotiations.

On March 31, 2008, the Federal Court of Appeal upheld the CITT's determination that DCC was liable for prematurely terminating contract negotiations with the top-ranked proponent. Interestingly, the court agreed that the CITT had committed an unreasonable error in finding that DCC was required to disclose the monetary limit of DND's budget authority. The court therefore preserved the government's ability to withhold its budget limits when conducting contract award negotiations. Nevertheless, the court dismissed DCC's application because there was "no factual basis that would allow the applicant to come to the conclusion that the negotiations had failed and that the parties could not agree on a maximum price."

As a result, procuring entities would be well advised to clearly state in their solicitations the point at which they can end negotiations with a bidder and proceed to negotiations with the next-ranked bidder.

## CMI Interlangues

A fifth 2008 procurement case that is of interest is a complaint by CMI Interlangues to the CITT, *Re: A Complaint by CMI Interlangues, (CMI Interlangues Inc. v. Department of Public Works and Government Services,*

CITT File No. PR-2007-067). In this case, the CITT determined that a contract award notice (CAN) containing erroneous information constituted a breach of NAFTA.

The complainant alleged that PWGSC had improperly awarded a contract on a sole-source basis on behalf of the Department of Foreign Affairs and International Trade (DFAIT) for language training services. According to the complainant, potential suppliers were not advised in advance of DFAIT's intention to award a contract or that there was a need for language training services. In addition, the complainant alleged that the CAN contained errors. As such, it requested that the contract award be cancelled.

In its response to the complaint, PWGSC acknowledged that there were inadvertent errors in the CAN, including an incorrect description of the services being procured and an incorrectly identified contracting buyer. PWGSC also indicated in its response that the contract award to CMI's competitor, Graybridge, was only a bridging contract.

Upon reviewing PWGSC's response, CMI modified its requested remedy and no longer sought cancellation of the contract. However, CMI submitted that, in any event, there had been harm to the integrity of the procurement process even if no individual prejudice to CMI could be found. CMI also submitted that PWGSC breached the *AIT* and *NAFTA* as the CAN was fundamentally flawed and provided substantially erroneous information.

The CITT agreed that the complaint was valid and recognized that an incorrect CAN containing erroneous information can be a breach of article 1015(7) of NAFTA. The CITT found that the failure to provide correct information, including information as basic as a contact name and telephone number, was a breach of the Canadian government's obligation under NAFTA. The CITT accordingly recommended that PWGSC investigate the circumstances surrounding the publication of a notice containing erroneous information, and take measures to prevent such an occurrence in the future.

Finally, the CITT and the Federal Court of Appeal again confirmed the necessity of strict compliance with mandatory criteria in an RFP, no matter how insignificant the criteria may appear. The Federal Court of Appeal, in *Surespan Construction Ltd. v. Canada (Attorney General)*, 2008 FCA 57, affirmed a determination by the CITT upholding PWGSC's

decision to reject a proposal due to its non-compliance with certain criteria.

The complainant, Surespan, had argued that it was not a mandatory requirement of the Invitation to Tender (ITT) to include a face page signed by an authorized official, and that even if it was, the failure to include this signed cover sheet was an insignificant omission. In addition, Surespan claimed that if PWGSC found that this amounted to an irregularity, it should have engaged in an informal dispute resolution process to determine the significance of the defect. However, the CITT dismissed the complaint as invalid, finding that subsection 3.1 of the General Instructions to Tenderers (R000IT) of the Standard Acquisition Clauses and Conditions, which were incorporated by reference into the ITT, required that authorized signatures be affixed to the front page and that failure to comply with the terms and conditions would render a submission non-compliant.

On judicial review, the Federal Court of Appeal affirmed that there was no basis upon which the CITT's decision should be set aside. The court held that such a decision was within the CITT's expertise,

and there was no reason to intervene in the CITT's decision.

This case confirms once again that, when dealing with mandatory requirements, there are no allowances for what are arguably trivial oversights. A mandatory requirement is just that; once established, it cannot be ignored just because it is arguably a technicality. Even though Surespan argued that the omission of the signed cover page of the ITT was an insignificant omission of form, the CITT did not accede to this position. The CITT found that the Public Works had properly followed the terms of the ITT when it declared that Surespan's proposal was non-compliant, and therefore no valid basis of complaint existed.

## Conclusion

The law governing public procurements continues to evolve apace, with the courts continuing to enunciate and define the legal framework that governs the relationships between public entities, suppliers and subcontractors. As discussed above, 2008 produced a number of notable and important decisions that are going to have a far-reaching impact.



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