

Ottawa, Thursday, September 7, 2000

File No.: PR-99-020

IN THE MATTER OF a complaint filed by IBM Canada Ltd. under subsection 30.11(1) of the *Canadian International Trade Tribunal Act*, R.S.C. 1985 (4th Supp.), c. 47;

AND IN THE MATTER OF a determination pursuant to subsections 30.15(2) and (3) and 30.16(1) of the *Canadian International Trade Tribunal Act*, recommending, as appropriate, compensation for lost profits and awarding IBM Canada Ltd. its reasonable costs incurred in relation to filing and proceeding with its complaint.

ORDER

INTRODUCTION

In a determination made on November 5, 1999, the Canadian International Trade Tribunal (the Tribunal) recommended, pursuant to subsections 30.15(2) and (3) of the *Canadian International Trade Tribunal Act*,¹ that the Department of Public Works and Government Services (the Department) reevaluate IBM Canada Ltd.'s (IBM) proposal received in response to Solicitation No. EN869-9-4022/A. In the event that IBM was declared the successful bidder by the Department in accordance with the evaluation and award provisions set out in the solicitation documents, the Tribunal further recommended that the contract awarded to Amdahl Canada Limited be terminated and, instead, be awarded to IBM.

In the alternative, the Tribunal recommended that the Department present to the Tribunal a proposal for compensation developed jointly with IBM that recognizes the profit that it lost in being deprived of the contract.

Pursuant to subsection 30.16(1) of the CITT Act, the Tribunal awarded IBM its reasonable costs incurred in relation to filing and proceeding with its complaint.

The Department reevaluated the proposal presented by IBM in accordance with the Tribunal's direction and declared IBM the successful bidder. During the reevaluation, IBM was asked to confirm its bid price of \$808,911. Discussions to arrive at a jointly developed proposal for compensation took place between the Department and IBM during the months of January and February 2000. However, the parties have been unable to arrive at a settlement for compensation. In a letter to IBM dated February 25, 2000, the Department proposed to compensate IBM for lost profits in the amount of \$255,616. The offer was not accepted. In correspondence dated February 29, 2000, the Department advised the Tribunal of IBM's offer to settle and the Department's counteroffer and requested that the Tribunal award compensation to IBM in the amount of \$255,616. At the Tribunal's request, on March 3, 2000, IBM submitted to the Tribunal its claim for compensation for the profit that it lost in being deprived of the contract. IBM included, in its claim, contributions to overhead costs attributable to the initiative and the expenses that it incurred in retaining outside counsel. The Department sent comments on IBM's claim on March 21, 2000. In response to the

1. R.S.C. 1985 (4th Supp.), c. 47 [hereinafter CITT Act].

Tribunal's request of March 31, 2000, IBM sent comments on April 7, 2000. On April 18, 2000, the Department provided comments on the last submissions made by IBM. The Tribunal wrote to IBM on July 7, 2000, requesting additional supporting information to substantiate its claim of lost profit, as outlined in the Tribunal's draft *Procurement Compensation Guidelines* (the Compensation Guidelines). IBM responded to the Tribunal's request on July 14, 2000.

TOTAL COSTS

The Department confirmed IBM's bid price of \$808,911 in response to the solicitation. In its February 16, 2000, letter to the Department, IBM claimed [amount removed] for the profit that it could have made on the sale of its equipment, maintenance, financing, its variable expenses, the cost of outside counsel, plus the cost of preparing its bid in response to the solicitation and its costs for filing a complaint with the Tribunal. In its letter of March 3, 2000, to the Tribunal, this amount had increased to [amount removed] due to the additional work required by IBM's outside counsel between February 16 and March 3, 2000. Out of this amount, IBM claimed [amount removed] in lost profits, [amount removed] for overhead and \$21,661 for the services of outside counsel.

IBM's figure for lost profits, [amount removed], was derived by subtracting IBM's costs to acquire the equipment, perform the maintenance and borrow the money required to finance the lease, i.e. [amount removed], from an amount of [amount removed], the selling value of the equipment.

DECISION OF THE TRIBUNAL

The Tribunal recommended that IBM be awarded the contract or that IBM be compensated in an amount that recognized its loss of profits in not being awarded the contract. The Tribunal asked IBM and the Department to try to arrive at a mutually acceptable amount in recognition of IBM's lost profits. Despite their efforts, they were not able to come to an agreement. Consequently, it is left to the Tribunal to decide an amount that fairly compensates IBM for lost profits.

Lost profit calculations are complex and take into account a wide variety of factors. In an effort to bring some coherence to the consideration of this issue, the Tribunal developed the draft Compensation Guidelines which, in this case, IBM was asked to follow. The Compensation Guidelines are intended as a guide to parties with respect to the "process that the Tribunal will follow in determining the appropriate amount of compensation and the substantive principles that may guide the Tribunal in arriving at that amount".² It gives the parties guidance on the type of information that the Tribunal wants from them to support the amount being claimed. The Compensation Guidelines expressly acknowledge that the Tribunal can depart from the principles and process contained therein where the circumstances warrant it.

According to the Compensation Guidelines, the Tribunal will base its decision on "credible economic, financial or other evidence, not on speculation and conjecture".³ Despite being asked to follow the Compensation Guidelines, IBM's claim for lost profits is not well documented, nor is it broken down into components that can be assessed.

In a submission to the Tribunal dated April 7, 2000, IBM states that it is reluctant to provide any breakout of the equipment costs which comprise the most significant component of the claim for lost profits

2. Para 1.3.

3. Para 2.2.

because to do so would reveal trade secrets. Even after the Tribunal wrote to IBM on July 7, 2000, reminding it that the Tribunal had established safeguards against the unauthorized disclosure of confidential information, no more “credible economic or financial” information was forthcoming.

The Tribunal is presented with two choices in respect of the amount of compensation. On the one hand, IBM claims [amount removed] for lost profits, overhead and counsel fees. On the other hand, the Department offers \$255,616.00. In the Tribunal’s opinion, neither of these amounts withstand reasonable scrutiny.

IBM claims that its profits lie, not in the revenue generated under the lease, but in the value of the equipment that was going to be used in providing the services required under the contract. In fact, IBM claims that the cash flow generated by the two-year lease is irrelevant in determining lost profits.⁴ IBM would also add an amount for maintenance and financing to the value of the equipment, and this would yield a “gross profit” of [amount removed]. The “gross profit” proposed by IBM is calculated by subtracting the cost to acquire the equipment from its selling price. The “gross profit” would also include an amount for maintenance which is calculated by subtracting the cost of servicing from the maintenance price. As well, the “gross profit” includes an amount for financing, which is the difference between the interest charged on the amount financed and the interest that it had to pay to borrow that amount. Nowhere does IBM apportion amounts to these three components. They are presented as a global figure.

The Tribunal does not rule out the prospect that profits can be derived in a variety of different ways by a service provider. Information can be presented that persuades the Tribunal that a particular methodology for profit determination ought to be accepted. However, the information presented in support of a particular approach must be credible enough to allow the Tribunal to come to a principled decision. Such information has not been presented in this case.

Even if IBM had presented credible information in respect of a particular methodology for profit calculation, the Tribunal would have to be satisfied that the loss suffered flows naturally from the Department’s breach. In other words, the loss suffered must not be too remote. The Tribunal does not need to consider this issue in this case, however, in view of its conclusion that no credible information has been presented to support IBM’s claim for lost profit.

IBM also claims compensation for overhead, or variable expenses, which it calculates at the rate of 8.05 percent, adding another [amount removed] to its claim. IBM acknowledges that part of the amount for overhead covers bid preparation as well as “the cost of having buildings for the staff, maintaining those buildings, providing the staff with the implements they need to do their work, paying the staff, providing outside counsel with the information required to hearing complaints to the Tribunal . . . [and the cost of] many hours spent by IBM staff in negotiating exercises in which [the Department] demonstrated less than [exemplary] good faith”.⁵

Broken down in this way, it is clear that many of these expenses are not recoverable. First, bid preparation costs were not part of the Tribunal’s award in this case. The Tribunal generally awards bid preparation costs where a successful complainant has not been awarded a contract or compensation in lieu of being awarded the contract, like the claim for lost profit. However, IBM does not break out these elements.

4. IBM’s confidential submission, 7 April 2000, at 2.

5. IBM’s confidential submission 7 April 2000, at 5.

Were it to have done so, to the extent that costs for bid preparation form part of the [amount removed], it would not have been allowed to do so.

It appears that the other factors to which IMB referred relate to costs incurred in advancing its complaint with the Tribunal. The Tribunal did award IBM its complaint costs. According to the Tribunal's *Procurement Cost Guidelines* (the Cost Guidelines), complaint costs are intended to cover the cost of submitting and advancing a procurement complaint. Generally, complaint costs are awarded to cover expenses above and beyond the complainant's fixed and variable costs, such as capital costs, salaries, etc. It seems that IBM is seeking reimbursement for items which are, according to the Compensation Guidelines, not compensable.

Most often, complaint costs will compensate a successful complainant for counsel fees, expert fees and disbursements incurred in putting forward its case. In this case, IBM has claimed counsel fees of \$21,661.58. The amount is composed of 80 hours of outside counsel time at \$250.00 per hour, for a total of \$20,000.00, disbursements of \$244.47 and GST of \$1,417.11. The Tribunal, having considered the complexity of the case, is of the view that the number of hours claimed is reasonable in the circumstances. However, the Tribunal considers the hourly rate claimed for IBM's outside counsel excessive.

The Tribunal's Cost Guidelines set out rates that it will, as a general rule, allow for legal and non-legal counsel services. In the case of legal counsel, the Cost Guidelines indicate that, as a general rule, it will reimburse a rate of \$150 - \$200/hour for senior legal counsel. The Tribunal sees no reason to depart from this figure in the present case. The complaint itself was not particularly complex or unique, warranting a departure from the Cost Guidelines. In light of IBM's outside counsel's years as a consultant and, in particular, his background in the procurement area, the Tribunal considers that a rate of \$150/hour is appropriate. The disbursements of \$224.47 appear reasonable in the circumstances, even though IBM has not provided a summary statement of disbursements as per the Cost Guidelines, and are therefore allowed. Accordingly, the total amount allowed for complaint costs is \$13,101.58. Other than this amount, the Tribunal is of the view that no other amounts claimed by IBM for overhead should be awarded.

Having considered IBM's proposal for compensation, the Tribunal will now consider the Department's proposal that the amount of \$255,616 be awarded to IBM. This figure is based on the gross margin of IBM's hardware segment as shown in its 1998 financial statements. The Department's comments are that this proposal would amount to a profit of 31.6 percent of the gross revenues that IBM would have received under the contract.

In the Tribunal's view, this sum is based on conjecture and speculation. The Tribunal was not presented with any information to substantiate this amount. Moreover, the Tribunal is hard pressed to understand how reference to financial statements can credibly yield a fair level of compensation in respect of a two-year lease contract.

The Tribunal cannot conclude that this approach is beyond speculation and conjecture. While it was an attempt to find a reference point for a principled decision, the Tribunal does not believe that the Department's approach should be followed.

The best information available to the Tribunal is the value of this contract, as determined in reference to the amount of revenues that it would have generated for IBM. That amount was \$808,911. Although IBM claims, in correspondence filed with the Tribunal, that the lease would likely have been extended for up to another three years (thereby generating more revenue), the Tribunal is not persuaded that its consideration of

the likely duration of the contract should be more than the two years originally contemplated in the Request for Proposal. Therefore, the Tribunal considers the total value of the contract to have been \$808,911.

The Tribunal is aware that the Department has established a guideline to determine an appropriate level of profit when negotiating contracts for the acquisition of commercial goods. That amount is 10 percent of the contract price. Accepting that the issue before the Tribunal in this case does not deal with a negotiated contract, the Tribunal nevertheless believes that 10 percent of the contract price is a fair amount of compensation.

CONCLUSION

The Tribunal hereby awards IBM costs in the amount of \$13,101.58 in relation to proceeding with its complaint and directs the Department to take appropriate action to ensure prompt payment. The Tribunal also establishes at \$80,891 the recommended compensation to IBM.

Arthur B. Trudeau

Arthur B. Trudeau
Presiding Member

Michel P. Granger

Michel P. Granger
Secretary