



Canadian International
Trade Tribunal

Tribunal canadien du
commerce extérieur

CANADIAN
INTERNATIONAL
TRADE TRIBUNAL

Procurement

RECOMMENDATION AND REASONS

File No. PR-2011-041

FreeBalance Inc.

v.

Canada Revenue Agency

*Recommendation and reasons issued
Wednesday, July 4, 2012*

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

AND FURTHER TO a recommendation made pursuant to subsections 30.15(2) and (3) of the *Canadian International Trade Tribunal Act* that FreeBalance Inc. be compensated for its lost opportunity in accordance with the Canadian International Trade Tribunal's *Procurement Compensation Guidelines*;

AND FURTHER TO the Canadian International Trade Tribunal's preliminary indication of the level of complexity for the complaint case and its preliminary indication of the amount of the cost award.

BETWEEN

FREEBALANCE INC.

Complainant

AND

THE CANADA REVENUE AGENCY

**Government
Institution**

RECOMMENDATION

The Canadian International Trade Tribunal hereby recommends that the Canada Revenue Agency compensate FreeBalance Inc. in the amount of \$194,570, which represents one half of the profit that it would reasonably have earned, had it been awarded the contract in Solicitation No. 1000299304.

Further to the Canadian International Trade Tribunal's award of costs to FreeBalance Inc. on January 24, 2012, the Canadian International Trade Tribunal has revised its preliminary indication of the level of complexity for this complaint case from Level 2 to Level 3, and its revised preliminary indication of the amount of the cost award is \$4,100. If any party disagrees with the revised preliminary indication of the level of complexity or the revised preliminary indication of the amount of the cost award, it may make submissions to the Canadian International Trade Tribunal, as contemplated in article 4.2 of the *Guideline for Fixing Costs in Procurement Complaint Proceedings*. The Canadian International Trade Tribunal reserves jurisdiction to establish the final amount of the cost award.

Stephen A. Leach
Stephen A. Leach
Presiding Member

Dominique Laporte
Dominique Laporte
Secretary

STATEMENT OF REASONS

INTRODUCTION

1. In its determination of January 24, 2012, the Canadian International Trade Tribunal (the Tribunal) determined, pursuant to subsection 30.14(2) of the *Canadian International Trade Tribunal Act*,¹ that the complaint filed by FreeBalance Inc. (FreeBalance) was valid. The complaint concerned an Advance Contract Award Notice (ACAN) for a sole-source procurement (Solicitation No. 1000299304) by the Canada Revenue Agency (CRA) for the modernization of its revenue management system. In the ACAN, the CRA stated its intention to award a contract to SAP Canada Inc. (SAP), which it proceeded to do in December 2011, on the basis that SAP was the only firm capable of meeting its requirements.

2. In terms of remedy, the Tribunal recommended, pursuant to subsections 30.15(2) and (3) of the *CITT Act*, that the CRA compensate FreeBalance for its lost opportunity. The parties were given 40 days from the date of the Tribunal's determination to agree on the amount of compensation, but they were unable to do so.

3. The Tribunal is therefore left with determining the amount of compensation.

4. In these compensation proceedings, FreeBalance filed a brief on April 5, 2012, making a preliminary estimate of compensation in the amount of \$3,124,250.97.²

5. The CRA filed its brief on April 18, 2012, submitting that no compensation should be awarded to FreeBalance.³

6. FreeBalance filed a reply brief on April 25, 2012.

7. On April 30, 2012, on the Tribunal's direction, the CRA disclosed additional information about the contract. FreeBalance filed comments on this new information on May 15, 2012, including a revised estimate of compensation in the amount of \$3,384,411,⁴ and further submitted that it should be compensated in full for its costs due to the CRA's attempt to re-litigate issues with which the Tribunal had already dealt in its decision on the merits of the complaint.⁵

8. On May 22, 2012, the CRA filed a reply to FreeBalance's comments. At the same time, with the Tribunal's consent, the CRA introduced evidence with respect to interfacing and filed information concerning Treasury Board's new "Standard on Enterprise Resource Planning Systems" (the Treasury Board Policy).⁶ FreeBalance commented on this new information on June 1, 2012.

9. Among the submissions are two affidavits. The first is sworn by Mr. Donald D. Gibbons, Chief Financial Officer, FreeBalance.⁷ The second affidavit is sworn by Mr. Michael Komery, Director, Contracting and Material Management Division, Canada Border Services Agency (CBSA).⁸ Mr. Komery's affidavit includes a letter from Mr. Marc Lefebvre, Director, Corporate Systems Division, CBSA.

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

2. FreeBalance's submission dated April 5, 2012, at para. 8, Exhibit E, Administrative Record, Vol. 3.

3. CRA's submission dated April 18, 2012, at para. 21, Administrative Record, Vol. 3.

4. FreeBalance's submission dated May 15, 2012, tab 1A, Administrative Record, Vol. 3.

5. *Ibid.* at paras. 16-17, Administrative Record, Vol. 3; FreeBalance's submission dated June 1, 2012, at para. 9, Administrative Record, Vol. 3.

6. CRA's submission dated May 22, 2012, Administrative Record, Vol. 3.

7. FreeBalance's submission dated April 5, 2012, Administrative Record, Vol. 3.

8. CRA's submission dated May 22, 2012, Administrative Record, Vol. 3.

COMPENSATION FOR LOST PROFIT

10. The *CITT Act* and *Canadian International Trade Tribunal Procurement Inquiry Regulations*⁹ provide little or no guidance on how to quantify compensation.¹⁰ The Tribunal's *Procurement Compensation Guidelines*, revised in June 2001, provide as follows:

2.2 Compensation awards will not be based on speculation or conjecture. The Tribunal recognizes that inherent in certain compensation recommendations will be the requirement to project into the future. However, in all circumstances, claims for compensation must be accompanied by credible economic, financial or other evidence.

...

3.1.2 In determining the amount of compensation to recommend, the Tribunal will attempt, insofar as is appropriate in the circumstances and bearing in mind any other relief that it recommended, to place the complainant in the position in which it would have been, but for the government's breach or breaches.

...

3.1.4 Compensation will be awarded for lost opportunity in situations where it is uncertain whether the complainant or other bidders would have won the contract, but for the government's breach or breaches. Where the Tribunal is unable to conclude that the complainant would have been awarded the designated contract, but concludes that the complainant lost the opportunity to participate actively or meaningfully in the procurement process as a result of the government's breach or breaches, the Tribunal may recommend that compensation be awarded for the lost opportunity. Subject to 3.1.5 below, compensation for lost opportunity may also be awarded with relation to the terms of any option periods contained in the contract.

3.1.5 In assessing the value of a lost opportunity, the Tribunal may take into account any factor it considers relevant, including:

- the number of bidders in respect of the designated contract;
- the number of bidders whose bids were determined to be compliant by the government, if that information is available; and
- the likelihood that, but for the government's breach or breaches, the complainant would have been awarded the designated contract.

...

3.2.1 Compensation awards for lost profit and lost opportunity may be reduced in accordance with the principles outlined herein.

...

4.1 The complainant bears the onus of proof in establishing a compensation claim.¹¹

9. S.O.R./93-602.

10. Subsection 30.15(2) of the *CITT Act* simply provides that, where the Tribunal determines that a procurement complaint is valid, it may recommend any remedy that it considers appropriate, including payment of compensation to the complainant in an amount specified by the Tribunal.

11. In its order in *Re Complaint Filed by Spacesaver Corporation* (27 April 1999), PR-98-028 (CITT) [*Spacesaver*], the Tribunal stated that the burden on the complainant is to prove the loss of profit for which compensation is claimed "... on a reasonable preponderance of evidence."

11. The Tribunal calculates compensation for lost opportunity by taking the profits that a complainant would have earned on a contract and dividing it by the number of potential bidders.¹² The resulting recommendation should reflect the actual loss suffered as a result of the government's breach, as opposed to a windfall.¹³

12. FreeBalance submitted that it ought to be awarded compensation for damages to the integrity of the procurement regime.¹⁴ This was a factor considered by the Tribunal, pursuant to paragraph 30.15(3) of the *CITT Act*, in recommending compensation for lost opportunity as the appropriate remedy in its determination of January 24, 2012.¹⁵ The Tribunal did not however recommend additional compensation for prejudice to the integrity of the procurement system. In previous cases, the Tribunal has only recommended such compensation in "very exceptional circumstances" to account for the seriousness of the prejudice to the integrity of the procurement system and the lack of good faith shown in conducting the procurement.¹⁶ Since no additional compensation has been recommended in this case, the Tribunal is not required to consider this factor in determining the amount of compensation for lost opportunity.

13. In terms of calculating compensation for lost opportunity, much of the information presented by the parties was highly speculative and unsubstantiated. Although unsubstantiated claims were a major problem on both sides, it was particularly problematic for FreeBalance, given that the onus of proof in establishing a compensation claim is on the complainant.

REMEDY

14. The parties are in agreement that, excluding HST,¹⁷ the amount of the contract that the CRA awarded to SAP is [REDACTED], which consists of [REDACTED] for software licences and [REDACTED] for software maintenance and support (SMS), both for an initial one-year period.¹⁸ The CRA has the option to renew the contract for up to five one-year periods.¹⁹ In addition, the [REDACTED]

20

12. See, for example, *Re Complaint Filed by Douglas Barlett Associates Inc.* (7 June 1999), PR-98-050 (CITT) [*Douglas Barlett*]; see order in *Re Complaint Filed by Cognos Incorporated* (21 July 2004), PR-2002-017 (CITT) [*Cognos*].

13. See order in *Re Complaint Filed by Douglas Barlett Associates Inc.* (7 January 2000), PR-98-050 (CITT).

14. See FreeBalance's submission dated April 5, 2012, at para. 44, Administrative Record, Vol. 3.

15. *Re Complaint Filed by FreeBalance Inc.* (24 January 2012), PR-2011-041 (CITT) [*FreeBalance*] at para. 58.

16. *Re Complaint Filed by Dr. John C. Luik* (28 March 2000), PR-99-035 (CITT); *Re Complaint Filed by Papp Plastics & Distributing Limited* (31 January 2002), PR-2001-038 (CITT) [*Papp Plastics*].

17. Compensation awards are based on the value of the actual contract award excluding GST/HST. See, for example, *Re Complaint Filed by Wescam Inc.* (19 April 1999), PR-98-039 (CITT) [*Wescam*]; see order in *Re Complaint Filed by PTI Services* (17 September 2002), PR-2001-027 (CITT) [*PTI*].

18. CRA's submission dated April 18, 2012, at para. 3, Administrative Record, Vol. 3; FreeBalance's submission dated April 25, 2012, at para. 16, Appendix 1, Administrative Record, Vol. 3.

19. CRA's submission dated April 18, 2012, at para. 3, Administrative Record, Vol. 3; FreeBalance's submission dated April 25, 2012, at para. 16, Appendix 1, Administrative Record, Vol. 3.

20. CRA's submission dated April 30, 2012, at 2, Administrative Record, Vol. 3.

15. Accordingly, FreeBalance breaks down its compensation claim into the following five “elements”:²¹

- (1) the software licences procured for the initial one-year period;
- (2) SMS on those software licences;
- (3) SMS on the renewal of those software licences;
- (4) additional software licences procured during the renewal period; and
- (5) SMS on the additional software licences.

16. The CRA does not dispute that the contract, including the options, consists of these five elements. However, it takes the position that no compensation should be awarded for any of them because the Treasury Board Policy designates SAP software as the “Finance/Materiel software of choice” and, as such, is “. . . determinative of the debate”²² The CRA argues that FreeBalance would not have been in a position to participate in any RFP process in relation to the sole-source procurement at issue because it is unable to supply the “software of choice” designated by the Treasury Board Policy,²³ which applies to all new investments and upgrades and which took effect on May 1, 2012.²⁴

17. For the following reasons, however, the Tribunal finds that compensation should be awarded in relation to elements 1 and 2.

18. The CRA’s interpretation of the Treasury Board Policy is speculative. As noted by FreeBalance, the Treasury Board Policy does not clearly state that SAP software is the software of choice, but rather that senior officials are responsible for ensuring that new investments “. . . result in the implementation of the product configuration (SAP).”²⁵ The CRA clearly believes that this requirement implies that all new investments and upgrades must result in the implementation of SAP products. However, the reference to SAP is vague and does not expressly state that only SAP products may be purchased in the future. Nevertheless, even if the Treasury Board Policy does apply, the Tribunal is satisfied that a competitive process probably would have been completed before it took effect. The CRA rejected FreeBalance’s statement of capabilities in response to the ACAN on September 28, 2011, and the policy took effect on May 1, 2012—a little more than six months later. Given that the CRA had considered the procurement to be urgent,²⁶ it seems unlikely that the CRA would have taken more than six months to issue an RFP and award a contract. Therefore, at least in relation to elements 1 and 2, the Tribunal is satisfied that the Treasury Board Policy is not an impediment to awarding compensation to FreeBalance.

19. Whether the Treasury Board Policy now precludes the CRA from being able to renew any of the licences that it has already procured or from exercising the options to procure additional licences and SMS, the Tribunal is not persuaded that, on a balance of probabilities, the CRA will renew the licences or exercise the options to acquire additional licences and SMS for them.

21. FreeBalance’s submission dated April 5, 2012, at para. 7, Administrative Record, Vol. 3.

22. CRA’s submission dated May 22, 2012, at para. 10, Administrative Record, Vol. 3.

23. *Ibid.*

24. Treasury Board Policy at para. 1.1.

25. FreeBalance’s submission dated June 1, 2012, at para. 29, Administrative Record, Vol. 3; see also Treasury Board Policy at para. 6.1.

26. *FreeBalance* at paras. 4, 55.

20. It has been the Tribunal's practice not to recommend a compensation award on the basis of speculative renewals and options, as exemplified in the following cases:

- In File No. PR-2003-070,²⁷ the Tribunal stated the following: "The right to exercise the option rests with the Crown; it is pure speculation for CSI to argue that, if it had been awarded the contract, the Crown would have proceeded with the option periods."²⁸
- In *Cognos*, where the complainant claimed the actual contract amount, which included software licences and SMS for one year, plus lost profit for two additional years of SMS, the Tribunal declined to recommend compensation for the two additional years because they were "optional".
- In File No. PR-99-020,²⁹ in response to the complainant's claim that the contract would likely have been extended for up to three years, the Tribunal was "...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."³⁰

21. Similarly, the courts do not award compensation for lost opportunity in respect of the prospective renewal of a contract or exercise of an option if, on a balance of probabilities, there is no reasonable probability of a profitable renewal or "... an advantage of some real substantial monetary value."³¹

22. With respect to element 3, FreeBalance argues that it should be assumed that the CRA will renew the SMS on the existing licences for each of the five option years and that, accordingly, all the SMS will be renewed. Mr. Gibbons's affidavit evidence is that the renewal rate is typically 95 percent in the industry.³² The CRA's initial position was consistent with this evidence, stating that a discount factor of 5 percent per year should be applied to each option year to account for contingencies and the possibility that all five options will not be exercised,³³ but the CRA seems to have backed away from that position since the Treasury Board Policy took effect. In addition, the CRA filed evidence that casts serious doubts on the likelihood that it will be able to renew the licences, let alone acquire additional licences and SMS. In particular, the CRA faces \$143 million in cuts to its budget, and the Government is moving towards a "shared services" model for software applications.³⁴ FreeBalance expressed doubt that these cutbacks would impact upon revenue-generating systems, but Mr. Komery states categorically in his affidavit that "... it is a certainty that there will be no future demand for more SAP licenses in the next three years."³⁵ In these circumstances, the CRA submits that FreeBalance's suggestion that there will be demand for the licences in the future is mere speculation and conjecture, and the Tribunal agrees.³⁶

27. See order in *Re Complaint Filed by CSI Consulting Inc.* (22 March 2006) (CITT) [*CSI Consulting*].

28. *CSI Consulting* at v.

29. See order in *Re Complaint Filed by IBM Canada Ltd.* (7 September 2000) (CITT) [*IBM*].

30. *IBM* at 4-5.

31. See, for example, *Sharab Developments Ltd. v. Zellers Inc.*, 1999 BCCA 39 (CanLII) at para. 36; *Eastwalsh Homes Ltd. v. Anatal Developments Ltd.*, 1993 CanLII 3431 (ON CA); *Kinkel v. Hyman*, 1939 CanLII 7 (SCC) at 376, 383.

32. Mr. Gibbons's affidavit at paras. 24-26, FreeBalance's submission dated April 5, 2012, Administrative Record, Vol. 3.

33. CRA's submission dated April 18, 2012, at para. 4, Administrative Record, Vol. 3.

34. *Ibid.*

35. Mr. Komery's affidavit at para. 4, CRA's submission dated May 22, 2012, Administrative Record, Vol. 3.

36. CRA's submission dated May 22, 2012, at para. 9, Administrative Record, Vol. 3.

23. In typical circumstances, Mr. Gibbons's evidence with respect to the industry standard renewal rate would perhaps be persuasive in relation to element 3. However, the circumstances are atypical, given Mr. Komery's evidence and the current fiscal environment. Moreover, the Treasury Board Policy, if nothing else, confirms that the Government is trying to standardize its finance, materiel and human resources management systems and suppliers insofar as the Treasury Board's policy stated objectives are to ensure that investments in Enterprise Resource Planning systems drive the adoption of standardized product configurations, maximize the benefits of these investments by rationalizing the number and diversity of record-keeping systems in use through increased standardization and economies of scale, and facilitate the migration from individual, department-specific information technology (IT) systems to shared services.³⁷

24. Given the significant degree of uncertainty in the current fiscal and policy context, the Tribunal concludes that no compensation should be awarded for elements 3 to 5.

Profit Formula

25. Having determined that compensation should be awarded for elements 1 and 2 only, the Tribunal must now quantify such compensation.

26. The formula that the Tribunal applies when calculating compensation for lost opportunity is the profit that the complainant would have earned on the contract, divided by the total number of potential suppliers.³⁸ The amount of profit is based on the contract value less one dollar because it is assumed that the complainant would have bid lower than the actual contract recipient.

27. As discussed, the CRA has contracted to pay [REDACTED] for the software licences and [REDACTED] for the associated SMS.

28. FreeBalance submitted that its earnings, had it been awarded the contract, can be determined by applying the following profit margins: 87 percent for software licences and 57 percent for SMS. Thus, FreeBalance would apply the following formulas: $[REDACTED] - \$1 \times 87 \text{ percent} = [REDACTED]$ + $[REDACTED] \times 57 \text{ percent} = [REDACTED]$) = \$1,741,949.³⁹ FreeBalance would divide this subtotal in half on the basis that there were only two potential suppliers: itself and SAP.⁴⁰

29. The CRA submitted that substantially lower profit margins should apply (i.e. no more than 3.54 percent for the software licences and no more than 23.53 percent for SMS),⁴¹ that an additional amount should be deducted to take into the account the cost that FreeBalance would have had to incur to develop, implement and maintain an interface⁴² and that the bottom denominator should be 18, not 2, because that is the number of OEM and major software solution providers that could have bid on the contract.⁴³

37. Treasury Board Policy at para. 5.1.

38. *Douglas Barlett; Cognos*.

39. FreeBalance's submission dated April 5, 2012, at paras. 31, 39-40, 58, Administrative Record, Vol. 3.

40. FreeBalance's submission dated April 25, 2012, at paras. 42, 49, Administrative Record, Vol. 3.

41. CRA's submission dated April 18, 2012, at paras. 9-13, Administrative Record, Vol. 3.

42. *Ibid.*, at para. 18, Administrative Record, Vol. 3.

43. *Ibid.*, at para. 17, Administrative Record, Vol. 3.

30. The Tribunal recalls that the onus of establishing a compensation claim is on the complainant. Where a complainant relies upon a profit formula to establish its compensation claim, it can demonstrate its profit margins by submitting, *inter alia*, its financial statements, contracts of similar size to that in issue or an industry standard.⁴⁴ Affidavit evidence could also be helpful, particularly from a third party (e.g. an external accountant).⁴⁵

31. FreeBalance has filed its financial statements for 2008, 2009 and 2010, as well as an affidavit, not from an independent third party, but from its chief financial officer, Mr. Gibbons. It is Mr. Gibbons's evidence that the profit margins of 87 percent and 57 percent are based on FreeBalance's actual profit margins from other contracts.⁴⁶ However, there is no evidence on the record to substantiate this assertion. FreeBalance has not submitted any specific evidence relating to other contracts, and Mr. Gibbons has not revealed how these profit margins were calculated, except to identify the costs that were applied (e.g. salaries, benefits, travel expenses), without providing a breakdown for each.⁴⁷ Thus, the Tribunal has no way of verifying the profit margins that FreeBalance is claiming.

32. Further, the Tribunal notes that FreeBalance is not taking into account some costs. Notably, FreeBalance has not allocated any sales and marketing or selling, general and administrative (SG&A) expenses, any depreciation expenses and any research and development (R&D) expenses.

33. FreeBalance argued that its SG&A expenses are fixed and would not have increased had it bid on and performed the contract.⁴⁸ FreeBalance stated that the bulk of its sales and marketing expenses relate to building new markets and opportunities outside Canada and that the proximity between its Ottawa, Ontario, headquarters and the CBSA and the fact that it already had existing marketing material to leverage mean that it would have incurred little in the way of sales and marketing expenses.⁴⁹ FreeBalance stated that SG&A expenses are spread over its entire client base in 19 countries.⁵⁰

34. In general, the Tribunal will not deduct fixed costs which would have been incurred regardless of whether a complainant had been awarded a contract.⁵¹ However, where a contract would have seen a large increase in revenue, overhead costs would inevitably rise, at least incrementally, and therefore should be deducted accordingly.⁵² In the present case, a comparison of the contract price with the financial statements reveals that this contract would have significantly boosted FreeBalance's revenues. Consequently, it would have been appropriate to account for an incremental increase in SG&A expenses.

44. See order in *Re Complaint Filed by ACE/ClearDefense Inc.* (17 April 2002), PR-99-051 (CITT) [ACE].

45. *Re Complaint Filed by Ready John Inc.* (20 July 2004), PR-2003-005R (CITT) [Ready John]; *Cognos*.

46. Mr. Gibbons's affidavit at para. 42, FreeBalance's submission dated April 5, 2012, Administrative Record, Vol. 3.

47. FreeBalance's submission dated April 5, 2012, at paras. 38-40, Administrative Record, Vol. 3.

48. FreeBalance's submission dated April 25, 2012, at para. 33, Administrative Record, Vol. 3.

49. *Ibid.*, at para. 35, Administrative Record, Vol. 3.

50. *Ibid.*

51. See order in *Re Complaint Filed by Immeubles Yvan Dumais Inc.* (7 June 2010), PR-2007-079 (CITT) [Immeubles Yvan Dumais] at para. 70; *Ready John*.

52. See order in *Re Complaint Filed by Les Systèmes Equinox Inc.* (1 June 2011), PR-2006-045R (CITT); see order in *Re Complaint Filed by Antian Professional Services Inc.* (15 August 2007), PR-2006-024 (CITT); see order in *Re Complaint Filed by Conair Aviation, A Division of Conair Aviation Ltd.* (30 January 1997), PR-95-039 (CITT) [Conair]; see order in *Re Complaint Filed by Douglas Barlett Associates Inc.* (7 January 2000), PR-98-050 (CITT).

35. It may also be appropriate to deduct some depreciation expenses.⁵³ In the past, the Tribunal has indicated that it was appropriate to consider equipment depreciation costs, as long as they were not costs that *would have been incurred regardless of the complainant having been awarded the contract*.⁵⁴ Despite the CRA's submission that depreciation expenses ought to be taken into account in calculating the profit margins for the software licences and SMS, FreeBalance has not clearly explained why some property and equipment costs should not be depreciated over the life of the products in this case.⁵⁵

36. More importantly, it appears that FreeBalance is not taking into account the possibility that it would have had to incur R&D expenses, as well as additional operating expenses (e.g. salaries, supplies, equipment acquisition and related amortization) to develop, implement and maintain an interface.

37. FreeBalance submitted that there is no basis for assuming that it would have had to develop an interface. FreeBalance relied in part on the Tribunal's finding in its reasons on the merits of the complaint that FreeBalance "... clearly believes that its solution would ensure compatibility ..." and had asserted that it already had a functioning interface with SAP software at the CBSA.⁵⁶ FreeBalance insists that the product that it would have proposed is interoperable with SAP software and includes off-the-shelf interfaces.⁵⁷ However, the Tribunal is satisfied that, on a balance of probabilities, an interface would have been needed and that the related R&D expenses and additional operating expenses would have the effect of reducing the profit margin.

38. While it is true that the Tribunal found that the CRA should have opened the procurement to a competitive process to test FreeBalance's claim to have a compatible solution, the Tribunal did not make a finding on whether FreeBalance's solution was interoperable or could have been integrated with existing applications with or without an interface.

39. In this phase of the proceedings, in the face of FreeBalance's assertions to the contrary, there is Mr. Komery's affidavit, which states that FreeBalance's product on the CBSA's network does not interoperate seamlessly with the existing SAP application.⁵⁸ This evidence is supported by a letter from Mr. Lefebvre, which states that the CRA has to manually extract a file from the SAP application and that the CBSA then imports it into the FreeBalance system.⁵⁹ FreeBalance took exception to this evidence in argument,⁶⁰ but it did not file any affidavit evidence to rebut it, either from one of its software engineers or from someone else. In fact, FreeBalance *admitted* that it could not have known whether an interface would have been required because the CRA did not detail its technical requirements in an RFP.⁶¹ The persons in the know, namely, Mr. Komery and Mr. Lefebvre, have expressed the view that an interface would have been required, and the Tribunal accepts this evidence as truthful.

40. Accordingly, the Tribunal is satisfied that, on a balance of probabilities, an interface would have been needed and that the related R&D expenses and additional operating expenses would have the effect of reducing the profit margin.

53. See order in *Re Complaint Filed by Bluedrop Performance Learning Inc.* (19 February 2009), PR-2008-017 (CITT).

54. *Immeubles Yvan Dumais; Ready John*.

55. CRA's submission dated April 18, 2012, at para. 10, Administrative Record, Vol. 3.

56. FreeBalance's submission dated April 25, 2012, at paras. 52-53, Administrative Record, Vol. 3.

57. FreeBalance's submission dated June 1, 2012, at paras. 5-7, Administrative Record, Vol. 3.

58. Mr. Komery's affidavit at paras. 2-3, CRA's submission dated May 22, 2012, Administrative Record, Vol. 3.

59. *Ibid.* at para. 2, CRA's submission dated May 22, 2012, Administrative Record, Vol. 3.

60. FreeBalance's submission dated June 1, 2012, at paras. 12-16, Administrative Record, Vol. 3.

61. *Ibid.*, at para. 22, Administrative Record, Vol. 3.

41. In summary, the Tribunal finds that FreeBalance has not substantiated its profit margins.
42. In previous cases where a complainant failed to substantiate its profit margins, the Tribunal applied a 10 percent profit margin.⁶² In other cases, it applied a rate of 15 percent.⁶³ There is no “rule of thumb”, however, and another amount might be appropriate in a given case.⁶⁴
43. For the following reasons, the Tribunal finds that a higher rate for both the software licences and SMS would be appropriate.
44. The CRA offered two alternatives for calculating FreeBalance’s profit margins, one being the average of FreeBalance’s overall profit margins for 2009 and 2010, as indicated in the financial statements for those years.⁶⁵ That would mean a blended profit margin of ----- . The problem with this approach is the overall profit margins do not distinguish between FreeBalance’s three revenue streams: software licences, SMS and consulting services. The CRA itself describes this methodology as “crude”.⁶⁶
45. The CRA’s other suggestion, which is to allocate expenses to each line of business, goes in the right direction.
46. The 2010 financial statements disclose that FreeBalance earned ----- . Of that amount, -----, or -----, came from the sale of software licences and -----, or -----, came from “Product Support Services” (i.e. SMS). From these amounts, the CRA would deduct a prorated amount for operating expenses.⁶⁷
47. The 2010 financial statement lumps the cost of product support and consulting services on the same line. The CRA would apportion ----- of this cost to SMS and the balance to consulting services, which is the ratio of product support services revenue to consulting services revenue.⁶⁸ The CRA would then deduct ----- of the overall SG&A and depreciation expenses.⁶⁹ That would leave total expenses for product support in the amount of -----, for a profit margin of -----.
48. For the software licences, the CRA would deduct the cost of software licences, plus ----- of the overall SG&A and depreciation expenses and the total R&D expenses.⁷⁰
49. For the reasons previously discussed, this approach may somewhat overstate the SG&A and depreciation expenses. However, among the options submitted by the parties, this approach is the most reasonable and concrete valuation of the profit margin for SMS because it is based upon the most recent financial statement. In addition, any potential overstatement of the SG&A and depreciation expenses is outweighed by a contingency factor that the Tribunal might otherwise apply to account for the absence of risks normally associated with the performance of a contract.⁷¹

62. *Spacesaver; ACE; Wescam; PTI; IBM; Papp Plastics.*

63. *Re Complaint Filed by IHS Solutions Limited* (8 March 2004), PR-2003-067 (CITT); *Re Complaint Filed by AppDepot Web Services Inc.* (8 March 2004), PR-2003-069 (CITT).

64. See order in *Re Complaint Filed by Huron Consulting* (18 June 2003), PR-2002-037 (CITT).

65. CRA’s submission dated April 18, 2012, at para. 12, Administrative Record, Vol. 3.

66. *Ibid.*, at para. 14, Administrative Record, Vol. 3.

67. *Ibid.*, at para. 10, Administrative Record, Vol. 3.

68. *Ibid.*

69. *Ibid.*

70. *Ibid.*

71. In *Conair*, the Tribunal deducted a 10 percent contingency to reflect the absence of risks normally associated with the performance of a contract.

50. Having said that, an adjustment is necessary in respect of the software licences. In particular, the Tribunal would remove the R&D expenses. Otherwise, the expenses would total _____, which is well in excess of the revenues from the sale of software licences, and the Tribunal does not accept that FreeBalance would have irrationally entered into a contract knowing that it would lose money from it. Rather, it would be more reasonable to remove the R&D expenses from the equation on the understanding that much of these expenses have already been incurred to develop the existing solution that FreeBalance would have proposed.

51. Similarly, even though the Tribunal has concluded that FreeBalance would likely have needed to develop, implement and maintain an interface for the CBSA network, according to the CRA, the costs for doing so would more than wipe out FreeBalance's revenues and, therefore, would again require the Tribunal to assume that FreeBalance would have irrationally entered into a contract knowing that it would lose money.⁷²

52. The Tribunal prefers instead to follow the approach that it took in *Cognos*, where it found that the complainant had underestimated the work that needed to be done, including some interfacing, in respect of a contract for the supply of software licences and SMS. To offset that discrepancy, the Tribunal applied a 50 percent contingency factor.

53. A 50 percent contingency factor applied to the software profits in this case, which is _____ without the R&D expenses, amounts to _____. When that amount is divided by gross revenues of _____, the result is a profit margin of 17.06 percent for the software licences.

54. Therefore, the Tribunal considers it appropriate to apply a profit margin of _____ for SMS and 17.06 percent for the software licences.

55. As for the number of potential bidders, the Tribunal agrees with FreeBalance that the correct number is two. Where, as in this case, an ACAN is concerned, the potential suppliers are the successful bidder and the firm or firms that have challenged the ACAN.⁷³ In the present case, the record indicates that SAP is the contract awardee and that only FreeBalance responded to or challenged the ACAN.

56. Accordingly, the formula that ought to apply in this case is as follows:

$$\frac{(\text{-----} - \$1 \times 17.06\%) + (\text{-----} \times \text{-----})}{2}$$

57. Applying this formula, the Tribunal determines that compensation should be awarded in the amount of \$194,570.

72. FreeBalance did not offer any evidence about how much an interface would cost. The CRA submitted that, according to its IT division, the cost to develop and implement an interface would have been \$2,369,367 and maintenance would have cost a further \$818,604 per year. CRA submission dated 18 April 2012, at para. 19, Administrative Record, Vol. 3.

73. Specifically, in *Cognos* and in *Re Complaint Filed by InBusiness Systems Inc.* (29 November 2002), PR-2002-020 (CITT), which involved two separate complaints about the same ACAN, the Tribunal recommended that each complainant be awarded one third of the profit that it would have earned if it had submitted a bid that was one dollar lower than the estimated value of the contract.

COSTS

58. In its decision of January 24, 2012, the Tribunal, pursuant to section 30.16 of the *CITT Act*, awarded FreeBalance its reasonable costs incurred in preparing and proceeding with the complaint. In accordance with the *Guideline for Fixing Costs in Procurement Complaint Proceedings* (the *Guideline*), the Tribunal's preliminary indication of the level of complexity for the complaint case was Level 2, and its preliminary indication of the amount of the cost award was \$2,400. The Tribunal reserved jurisdiction to establish the final amount of the cost award.

59. The Tribunal's preliminary cost assessment was made before it had become apparent that these compensation proceedings would be necessary.

60. FreeBalance submitted that it ought to be compensated in full for its costs on the grounds that the CRA was attempting to re-litigate its allegation that FreeBalance would not have been capable of supplying the CBSA's interoperability requirement without encountering interfacing issues.⁷⁴

61. The CRA did not make submissions regarding the Tribunal's preliminary indications of the cost award.

62. Further costs and complexity were generated by these proceedings. The parties made several additional submissions on the issue of compensation, in large part due to the CRA's initial refusal to be forthcoming with certain information, particularly about the contract options. The Tribunal is of the view that the complexity of the compensation issue has added sufficiently to the complexity of the proceedings.

63. Accordingly, the Tribunal hereby revises its preliminary assessment of the level of complexity for this complaint case to Level 3, and its preliminary indication of the amount of the cost award is now \$4,100. The parties are invited to file further submissions on costs, as contemplated in article 4.2 of the *Guideline*, before the Tribunal finalizes the amount of the award.

CONCLUSION

64. The Tribunal hereby recommends that the CRA compensate FreeBalance in the amount of \$194,570, which represents one half of the profit that it lost in not being awarded the contract in question.

65. Further to the Tribunal's award of costs to FreeBalance on January 24, 2012, the Tribunal's revised preliminary indication of the level of complexity for this complaint case is Level 3, and its revised preliminary indication of the amount of the cost award is \$4,100. If any party disagrees with the revised preliminary indication of the level of complexity or the revised preliminary indication of the amount of the cost award, it may make submissions to the Tribunal, as contemplated in article 4.2 of the *Guideline*. The Tribunal reserves jurisdiction to establish the final amount of the award.

Stephen A. Leach
Stephen A. Leach
Presiding Member

74. FreeBalance's submission dated May 15, 2012, at paras. 16-17, Administrative Record, Vol. 3.