

Outsourcing: Canada Overview

Resource type: **Practice Note: Overview** Status: **Maintained** Jurisdiction: **Canada**

This practice note gives a high level overview of outsourcing in Canada, including the following topics: legal and regulatory requirements with respect to different types of outsourcing, commonly used legal structures, procurement processes, formalities required for transferring assets and employees, data protection and privacy considerations, customer remedies and protections, dispute resolution, and tax considerations.

Wesley Ng and Michael Decicco of Stikeman Elliott LLP with Practical Law Canada Commercial Transactions

Contents

Introduction

General Regulations and Requirements

- Financial Services Regulations

- Business Process Regulations

- IT Regulations

- Telecommunications Regulations

- Public Sector

- Additional Industry Sectors with Specific Regulatory Requirements Relating to Outsourcing

Legal Structures Used in Outsourcing

- Direct Outsourcing

- Multi-Sourcing

- Indirect Outsourcing

- Joint Venture or Partnership

- Captive Entity

- Build Operate Transfer

- Cloud Computing

Procurement Processes Used to Select a Supplier of Outsourced Services

- Request for Proposal (RFP)

- Invitation to Tender

- Due Diligence

- Negotiation

Transferring or Leasing Assets

Immovable Property
IP Rights and Licences
Movable Property
Key Contracts

Formalities for Leasing or Licensing

Immovable Property
IP rights and Licences
Movable Property
Key Contracts

Transferring Employees

Initial Outsourcing
Change of Supplier
Termination

Legal Requirements Concerning Data Protection and Privacy

Banking Secrecy
Confidentiality of Customer Data

Service Specification and Levels

Service Levels and Service Credit Schemes in Contract Documentation

Flexibility in Volumes Purchased

Charging Methods and Key Terms

Cost Plus
Fixed Price
Time and Materials
Resource-Based Charges
Key Terms in Relation to Costs

Customer Remedies and Protections

Warranties and Indemnities

Warranties
Indemnities

Insurance

Term and Notice Period

Termination and Termination Consequences

Insolvency Events
Additional Termination Rights

Remedies

IP Rights and Know-How Post-Termination

Liability, Exclusions and Caps

Dispute Resolution

Tax

Transfers of Assets to the Supplier

Transfers of Employees to the Supplier

Value Added Tax or Sales Tax

Other Tax Issues

Online Resources

Introduction

Outsourcing involves a transaction in which an organization that previously provided services using its own internal resources contracts with a third party to provide all or some of those services. Outsourcing may involve transferring employees and/or assets from one business to another.

Outsourcing a business function has become common practice among Canadian businesses. This practice note provides counsel for a Canadian-based business with general guidance about key business and legal issues to consider when entering into an arrangement for outsourcing a business function.

General Regulations and Requirements

In Canada, no federal (or provincial) laws generally regulate outsourcing transactions. However, depending on the industry sector and/or the specific details of the outsourcing transaction (transfer of employees, movement of technology, licenses and so on), different aspects of the transaction may be subject to specific regulations.

The regulation of outsourcing transactions under federal and provincial law in Canada depends less on the nature of the outsourced service (for example, information technology (IT) or business process outsourcing (BPO) and more on the sector in which the outsourcing takes place (for example, financial services or telecommunications) or the specific details of the outsourcing (for example, cross-border transfer of technology or transfer of employees).

Financial Services Regulations

Guideline B-10 of the Office of the Superintendent of Financial Institutions (Canada) (OSFI) governs outsourcing arrangements entered into by federally regulated entities (FREs), which include Canadian:

- Banks.
- Insurance companies.

- Trust and loan companies.
- Credit unions.
- Branches of foreign banks and insurance companies.

Guideline B-10 broadly interprets outsourcing arrangements as any arrangement between an FRE and a service provider in which the service provider performs a business activity, function or process that is, or could be, undertaken by the FRE itself.

This guideline imposes overall accountability and control requirements on FREs. It requires an assessment of the materiality of an outsourcing arrangement and the implementation of a risk management program (the scope and nature of which will vary depending on the materiality of the particular outsourcing arrangement).

OSFI's specific expectations can vary depending on the nature of the outsourcing arrangement being contemplated and the relationship between the FRE and the service provider.

As part of a FRE's risk management program in respect of any outsourcing, OSFI expects that a FRE will:

- Conduct due diligence to fully assess the risks associated with the outsourcing arrangement.
- Document the outsourcing arrangement by a written contract that addresses all elements of the arrangement, including (if applicable):
 - the nature and scope of the services to be provided;
 - performance measures;
 - reporting requirements;
 - dispute resolution procedures;
 - termination rights;
 - ownership of, and access to, assets;
 - contingency planning;
 - audit rights;
 - subcontracting;
 - confidentiality, security and separation of property; and
 - pricing and insurance.
- Comply with all applicable record retention requirements.
- Ensure adequate business continuity measures are in place.
- Develop, implement and oversee procedures that actively monitor and supervise the outsourcing arrangement.

An FRE that outsources, or contemplates the outsourcing of, one or more business activities must ensure that the key stakeholders within the FRE receive sufficient information to enable the FRE to discharge its duties and

obligations under OSFI's Guideline B-10.

Business Process Regulations

There are no regulations specific to BPO. BPOs can cover many different types of services, and there may be industry-specific rules or regulations that are applicable to a particular BPO.

IT Regulations

There are no regulations specific to outsourcings in the information technology industry.

Telecommunications Regulations

There are no telecommunications regulations specific to outsourcing. However, when structuring any outsourcing in the telecommunications sector, the parties must comply with the general telecommunications regulatory requirements. Telecommunications providers are regulated by the Canadian Radio and Telecommunications Commission (CRTC). Specific restrictions contained in the terms of any applicable CRTC licences held by the telecommunications provider and any facilities licences issued by Industry Canada can prevent or restrict all or certain aspects of an outsourcing transaction. In addition, Canadian ownership requirements contained in the *Telecommunications Act*, S.C. 1993, c.38, can restrict non-Canadian controlled entities from performing certain services for Canadian controlled entities.

In the telecommunications sector, notification and/or approval requirements may be found in the terms of any applicable licenses issued by the CRTC or Industry Canada. The potential consequences of failing to comply with any notification or approval requirements may be specified in the applicable licences.

Public Sector

When a provincial or federal body enters into an outsourcing, it must comply with the applicable public procurement rules and its authority to outsource the particular activity must be considered. Privacy regulations must also be considered in relation to outsourcings by public sector bodies. See [Procurement Processes used to Select a Supplier of Outsourced Services](#).

Additional Industry Sectors with Specific Regulatory Requirements Relating to Outsourcing

Outsourcings in any sector can be subject to sector-specific regulations. The following non-exhaustive list provides examples of sectors that are subject to sector-specific regulation (the primary regulator of each sector is provided in brackets):

- Aviation (Transport Canada).
- Consumer credit (Financial Consumer Agency of Canada and the Office of the Superintendent of Financial Institutions (Canada)).
- Education and childcare (various provincial bodies).
- Energy (National Energy Board and various provincial bodies).

- Food (Canadian Food Inspection Agency).
- Gambling (various provincial bodies).
- Healthcare (various provincial bodies).
- Pensions (Office of the Superintendent of Financial Institutions (Canada) and various provincial bodies).
- Rail (Transport Canada).
- Road transport (Transport Canada and various provincial bodies).
- Water and sewage (Environment Canada).

Legal Structures Used in Outsourcing

Direct Outsourcing

The simplest outsourcing structure is a direct outsourcing, which involves a customer directly contracting with a supplier, and is typically comprised of one or more separate contracts dealing with core issues and detailed schedules that set out:

- The services provided.
- Payment terms.
- Key personnel and assets.
- Performance obligations of the supplier and the consequences of failing to meet those obligations.

The structure is more complex if the customer procures services on behalf of itself and its group companies. Typically, a customer either enters into an outsourcing contract as agent on behalf of its group companies, or includes a third party rights clause to ensure its group companies have directly enforceable rights under the agreement.

In this case, a supplier will typically request specific contractual provisions that control multiple actions by the customer and its group companies, and ensure that any clauses limiting and/or excluding the supplier's liability apply to each of the customer and its group companies.

Depending on a particular supplier's reputation and financial position, a customer may require performance guarantees by the supplier's corporate parent. In addition, if a supplier intends to use subcontractors, the customer may require:

- That the supplier notify the customer of its choice of subcontractor.
- That the supplier remain liable for its subcontractors' acts and omissions.
- A right to veto particular subcontractors.

In order to preserve flexibility and mitigate risk, a customer will typically request some degree of termination transition service assistance. The duration and extent of such assistance will depend on the materiality and

complexity of the particular outsourced services.

Direct outsourcing arrangements allow a customer to streamline its operations and take advantage of economies of scale achieved by a large supplier. By retaining a third party to perform noncore operations, a customer is better able to focus on the core areas of its business. The potential issues associated with an outsourcing depend on the sector in which the customer operates. For example, in highly regulated sectors such as financial services, a customer needs to carefully consider that all requirements applicable to the outsourcing are fulfilled.

Multi-Sourcing

The customer enters into contracts with different suppliers for specific services. The issues are generally similar to those in a direct outsourcing (see above, [Direct Outsourcing](#)) but, in addition, the customer must ensure that interfaces between the different suppliers are carefully managed to ensure the seamless provision of the overall service. The customer may also wish to impose contractual obligations in suppliers to co-operate with each other.

In addition to the advantages and disadvantages described for a direct outsourcing (see above, [Direct Outsourcing](#)), the difficulty of managing multiple suppliers to perform ongoing related services that interface with each other is likely to add layers of cost, complexity and risk.

Indirect Outsourcing

The structure of an indirect outsourcing is similar to a direct outsourcing (see above, [Direct Outsourcing](#)), except that the customer appoints a supplier that immediately subcontracts to another supplier.

The structure shares similar advantages and disadvantages to direct outsourcing (see above, [Direct Outsourcing](#)), except that it is often more difficult for the customer to manage the activities of, and enforce its rights upon, the supplier's subcontractor.

Joint Venture or Partnership

The customer and the supplier set up a joint venture company, partnership or contractual joint venture. Each party contributes certain assets, technology and capital to the entity performing the services for the customer.

Advantages of this structure include:

- The customer having a greater degree of control than in the other structures.
- The customer benefiting from the supplier's knowledge and expertise.
- The customer sharing in the profits generated by any third party business the joint venture may conduct.
- Smoother repatriation of the services or transition to a new supplier.

However, in addition to the detailed agreements required to document the outsourcing arrangement, the joint venture or partnership arrangement requires complex and comprehensive agreements that address the formation, decision-making, profit sharing and dissolution of the entity.

For comprehensive information on structuring and negotiating joint venture and partnership arrangement,

including sample agreements and clauses, see:

- [General Partnership and LLP Toolkit](#)
- [Joint Venture Toolkit](#)
- [Limited Partnership Toolkit](#)

Captive Entity

The customer outsources its processes to a wholly-owned subsidiary. This provides the customer with a great degree of control, allowing the services to remain within the governance and control of the customer. These arrangements may provide the customer with tax benefits. Considerations with respect to this structure include:

- Potentially significant upfront cost, depending on whether the customer already has sufficient assets for the subsidiary.
- The risk may not pass sufficiently to an unaffiliated third-party supplier.
- The supplier may not have any greater experience in providing the service.
- Any cost reduction through economies of scale is unlikely.

Build Operate Transfer

The customer contracts with a supplier to build and operate a facility. The supplier subsequently transfers the facility to the customer. This is a relatively low-risk model but involves significant costs.

Cloud Computing

The customer acquires remote, shared information technology infrastructure and/or services on an as-needed basis.

This model offers significant cost savings since the customer is not required to acquire and maintain its own localised infrastructure to support the services. In addition, because cloud computing services are available to multiple users leveraging the same infrastructure, the cloud service supplier is typically able to achieve significant economies of scale, producing additional savings for the customer. However, customers may have little control over the services, and the virtual, shared nature of the services may present issues in highly regulated sectors.

Procurement Processes Used to Select a Supplier of Outsourced Services

Request for Proposal (RFP)

In a request for proposal (RFP) process, the customer develops a business plan for the particular service to be outsourced, which includes specific objectives, milestones and performance measures. Depending on the nature of the services, the customer may issue a request for information (RFI), quotation (RFQ) or proposal (RFP). The customer should include the following in the procurement documents:

- All information the supplier will require to make a bid.
- A description of the procurement selection process and rules, including the contractual terms of the

prospective bid.

- A detailed description of the service requirements.
- A draft services agreement.

A competitive procurement process creates two contracts:

- The bidding contract, which sets out the rules that apply up until the completion of the competitive procurement process.
- The substantive contract, entered into between the procuring authority and the successful bidders.

In the public sector, layered on top of this framework is a collection of trade agreements and government guidelines that regulate the procurement practices of government and quasi-government entities.

Invitation to Tender

An invitation to tender can be used in addition to, or as an alternative to, the RFP process and to invite responses.

Due Diligence

The customer assesses the responses and selects a number of possible suppliers. Each supplier's capacity and ability are likely to be assessed at this stage. Potential suppliers can carry out due diligence of the customer's business as part of the RFP process.

Negotiation

The customer will select one or more suppliers to progress past the initial RFP stage and enter into direct negotiations (or request additional bids). In certain circumstances, a customer will engage in parallel business or contractual negotiations with two or more bidders to select the successful proponent.

Transferring or Leasing Assets

Certain formalities are required to transfer assets on an outsourcing.

Immovable Property

Transfer of title to immovable property must be in writing and requires registration in the appropriate land registry office. Each province may have additional requirements for transferring immovable property.

IP Rights and Licences

To transfer ownership rights in a patent or copyright (including computer programs), the transfer must be in writing.

Any transfer of rights in a patent must be registered with the Patent Office of Canada and may be required to meet specific formalities provided under the *Bills of Exchange Act*, R.S.C. 1985, c. B-4.

Moral rights (an author's rights in a copyrighted work, including rights of attribution, anonymity and integrity) can only be waived and cannot be assigned (see section 14.1(2) of the *Copyright Act*, R.S.C. 1985, c. C-42).

Other than the requirements above, there are no prohibitions on the transfer of intellectual property in an outsourcing. However, assignments of patent or copyright licences (such as a licence to use software) may be prohibited or may require consent under the terms of the commercial agreement governing the licence. The parties to an outsourcing that involves a transfer or licence of intellectual property rights should conduct adequate due diligence in advance of the transaction in order to obtain any appropriate consents and/or additional rights.

Movable Property

A transfer in the ownership of chattels can generally be effected by exchanging consideration for possession. A bill of sale can be used to evidence the transfer of title. In order to ensure that title is free and clear of any liens and is properly transferred, the parties typically arrange for national and provincial lien searches to be conducted.

Each province can also have additional requirements. For example, in Ontario, the *Bulk Sales Act*, R.S.O. 1990, c. B.14 (the "Bulk Sales Act"), applies to a sale of goods or inventory (referred to as stock in the legislation) in bulk outside the usual course of the seller's business or trade, and a failure to comply with the Bulk Sales Act can invalidate the sale. At the time of this publication, a bill which would repeal the Bulk Sales Act has passed first reading in the Ontario legislature.

Key Contracts

Any contract to be transferred should be identified at an early stage and its terms reviewed to identify whether assignment is possible without notice to the counterparty or its express consent. As with the transfer of any contract or licence, consideration should be given as to whether the burden of the contract should also transfer to the supplier, either by novation or express indemnity.

Formalities for Leasing or Licensing

Certain formalities are required to lease or license assets on an outsourcing.

Immovable Property

Leases or licences of immovable property must be in writing and must be signed by both parties. It is prudent, and may also be necessary in some cases, to register leases and licences in the appropriate land registry office.

IP rights and Licences

Intellectual property licences should be in written form, as a matter of good practice. Licences of registered intellectual property should be recorded on the appropriate register to avoid enforcement issues. Trade-mark licences must comply with the licensing provisions of the *Trade-marks Act*, R.S.C. 1985, c. T-13.

Movable Property

There are no strict formalities required when licensing or leasing movable property. To avoid potential ambiguity and ensure that the parties are aligned on the terms of the licence or lease, it is prudent to document the terms in writing and have each party indicate their agreement to such terms through execution.

Key Contracts

The formalities for leasing or licensing under key contracts are the same as those applicable to the transfer of key contracts (see [Transferring or Leasing Assets, Key Contracts](#)).

Transferring Employees

There are certain circumstances under which employees may be transferred by operation of law. To properly assess any issues that may arise in an outsourcing scenario, it is important to establish whether the relevant customer and supplier are federally or provincially regulated and if provincially regulated, the province in which the outsourcing will take place. Such inquiry will determine the legislation and other laws that must be examined for the purposes of assessing labour and employment issues arising from the outsourcing.

Initial Outsourcing

A customer's non-unionised employees will not transfer to the supplier by operation of law as a result of an outsourcing and the employment of those individuals will remain with the customer.

Generally, the employment of unionised employees will also not transfer to the supplier by operation of law as a result of an outsourcing. However, if an outsourcing transaction constitutes a "sale of business" under applicable labour relations legislation, a union's collective bargaining rights could extend to the supplier. In this case, applicable labour legislation and the terms of the customer's collective agreement will dictate whether the customer's employees are automatically transferred to the supplier or whether they may exercise individual rights to remain with the customer.

For a more detailed discussion of employment and labour law considerations in the context of a "sale of a business", see [Practice Note, Employment Issues in Sale of Business Transactions](#).

In Québec, an outsourcing agreement which is accompanied by the transfer of the essential elements of the business may entail a transfer of unionised employees to the sub-contractor. However, the transfer of duties which is not accompanied by a transfer of the elements which characterise the business will not result in the transfer of the employees to the sub-contractor.

Change of Supplier

If there was a change of supplier only, this will not result in the transfer of employees.

Termination

There is no automatic transfer by operation of law resulting from the termination of outsourcing arrangements. In

Québec, if the subcontract consisted of work only, then there will be no other transfer of employees of the supplier to the customer. However, if the transfer was accompanied by the transfer of the essential elements of the business, the termination of the outsourcing agreement (and the return to the client of the essential elements of his business) may entail the return of unionised employees to the client.

Legal Requirements Concerning Data Protection and Privacy

Canada's data protection legislation is comprised of a patchwork of various federal and provincial laws and specific industry regulations that can broadly be separated into two categories:

- **Public sector.** Federal, provincial and municipal governmental bodies or other public sector entities (generally government ministries and agencies; boards and commissions; schools, colleges and universities; libraries; hospitals and other health integration networks) are subject to specific public sector privacy legislation and regulations. The Office of the Privacy Commissioner of Canada and many of its provincial counterparts have issued guidance on compliance with the public sector legislation, including for data protection and security and responding to freedom of information requests. In addition, personal health information that originates from a health information custodian (defined as entities such as doctors, hospitals and certain quasi-private public operations such as pharmacies and assisted living facilities) can be subject to additional legislation.
- **Private sector.** Generally, Canada's federal *Personal Information Protection and Electronic Documents Act*, S.C. 2000, c. 5 (PIPEDA) and its provincial counterparts in the provinces of British Columbia, Alberta and Québec provide the regulatory framework applicable to data protection and security in the private sector. Private sector service providers may be subject to public sector requirements, depending on their customers and the nature of the services being provided.

The contract between a customer and supplier typically contains provisions addressing the applicable legal requirements. Specific rights and obligations are often specified in the contract to enable the customer and supplier to comply with their regulatory requirements. A general undertaking by the parties to comply with all applicable privacy laws and general obligations of confidentiality is usually included.

The relevant regulations do not require compliance with any particular international standard. However, the principles underlying Canada's federal and provincial privacy legislation are generally consistent with Directive 95/46/EC on data protection. The European Commission has recognised that PIPEDA provides adequate protection for personal data transferred from the European Union to Canada without the need for additional safeguards, provided the data is subject to PIPEDA.

Complaints can be made to the applicable office of the privacy commissioner (each province and territory maintains an office analogous to the Office of the Privacy Commissioner of Canada) in connection with any breach of an organisation's privacy obligations, and the organisation can be subject to investigation by the applicable office. In British Columbia and Alberta, privacy commissioners have order-making power. In addition, an individual suffering damages as a result of an entity's breach of applicable privacy legislation can seek recourse in the courts.

Recent amendments to PIPEDA require private sector organizations subject to PIPEDA to notify the Office of the Privacy Commissioner of Canada and any affected individuals in the event of a breach of the organizations

security safeguards that creates a real risk of significant harm to the affected individual(s). At the time of this publication, these new breach notification provisions of PIPEDA were not yet in effect.

Banking Secrecy

In addition to privacy laws, banking secrecy laws can also apply in the context of an outsourcing. However, a bank's common law duty of confidentiality to its customers is not absolute, and is subject to exceptions where:

- The bank is compelled by law to disclose.
- It is in the interests of the bank to disclose.
- The customer consents.
- There is a duty to the public to disclose.

Confidentiality of Customer Data

Confidentiality obligations regarding customer data can arise through privacy laws and the terms of the commercial agreements with the customers.

For a more detailed discussion of the use of confidentiality agreements to protect customer data in the commercial context, see [Practice Note, Confidentiality and Non-disclosure Agreements](#).

Service Specification and Levels

The responsibility for preparing the service specifications will vary by transaction and sector. To the extent possible, a customer should describe the services in detail as part of the request for proposal (RFP) process in order to obtain realistic and comparable bids.

However, it is common for an RFP to only contain a high-level description of the services. This is typically the case where the customer is performing or obtaining the service for the first time. In complex outsourcings, a customer may engage one or more specialised third parties to assist with developing the service specifications.

Drafting complex service specifications is often an iterative and interactive process between the customer and supplier that evolves as the customer better understands its own requirements and the supplier gains additional insight into the customer's business. For simpler and more standard outsourcings, the service specifications can follow an industry standard model. There is no one-stop shop for models, as even standard or simple outsourcings will be specific to the services to be provided.

Service Levels and Service Credit Schemes in Contract Documentation

Service levels and service credit schemes can vary considerably depending on the industry, the level of customisation of the service and how important the services are to the customer's business.

Often, specific service levels in respect of a supplier's performance of objectively measurable services (for example, time to respond, time to notify or resolution time) are set out in detail in the agreement. For services that

are not objectively measurable, more general service warranties can be included, but these can be more difficult to enforce.

In long-term outsourcings, a customer may require a supplier to improve its service levels based on the supplier's increased effectiveness and efficiency over time. The parties can also agree to assemble governance committees that will meet regularly to assess the supplier's performance against the service levels.

Service level credits are a mechanism that ensures that the service provider is incentivised to meet the customer's internal service level requirements or other expectations. While service level credits are often viewed as compensation for poor service, they are sometimes not sufficient to offset the full impact of missed service levels. Service level credits can be calculated in a number of ways, including:

- A percentage of fees or fixed dollar amount for any service level failure.
- Different dollar amounts or percentages depending on the criticality of the service level and/or the length of the service level breach.
- Scorecard mechanisms.
- Earnbacks (where a supplier can "earn back" a service level credit by achieving or surpassing service level requirements in subsequent measurement periods).

For a sample service level agreement which includes credit provisions in the IT context, see [Standard Document, Software/SaaS Support Service Level Agreement \(Pro-customer\)](#).

Flexibility in Volumes Purchased

A customer's request for an increase or decrease in the volume of services provided by the supplier will typically be addressed using the agreement's change control provisions.

In cases where a customer anticipates increased volumes, it should negotiate a commitment from the supplier to meet those increased volumes automatically. Often, prices are fixed within a given volume band and pricing can only be adjusted when volumes rise or fall outside of the pre-determined volume band.

In cases where a customer anticipates decreased volumes and a supplier has agreed to provide the services on the basis of a minimum amount of volume, the supplier is likely to resist attempts by the customer to reduce fees payable by the customer based on those decreased volumes. As noted above, volume fluctuations (including both increases and decreases of services) are often addressed by the parties through a pre-determined volume band.

Charging Methods and Key Terms

The parties to an outsourcing can adopt different charging methods depending on:

- The nature of the services being provided.
- Whether the relationship is exclusive.

- The risk allocation between the parties.

One or more of the following charging methods can be used for an outsourcing transaction:

- Cost plus.
- Fixed price.
- Time and materials.
- Resource-based charges.

Cost Plus

The customer pays the supplier the actual cost of providing the services and an agreed on profit margin. Typically, provisions are included to ensure that costs are assessed on a transparent basis, and indirect costs (for example, overheads or additional investment in new assets) are included in the actual costs (often on an amortised basis).

Fixed Price

A fixed price method is typically used in outsourcings with regular and predictable volumes and services, and where the customer desires cost certainty.

Time and Materials

The customer pays an agreed on unit price for specific items of service (such as volumes of data processed or deliveries made). The supplier may want to stipulate a minimum fee. This arrangement is often used in situations where the level and volume of services are not predictable.

Resource-Based Charges

The customer pays a fixed recurring charge based on an assumed service volume. A resource-based charging mechanism is used to adjust the fixed charge depending on the actual volume of resources used.

In complex outsourcings, different portions of the outsourcing can be subject to different charging methods. In many instances, all of the charging methods above may be used to cost different elements of an outsourcing transaction.

Key Terms in Relation to Costs

For complex outsourcings with an extended duration, the parties may wish to include in their agreement defined mechanisms to vary fees in order to maintain price competitiveness over the term. These mechanisms can include:

- Index-linked increases to cover general increases in the cost of doing business
- Sharing cost savings that result from outsourcing the services.

- Benchmarking the supplier's charges for the services against other suppliers or contracts in the market.

The customer will typically request the inclusion of a disputed fee mechanism under which the customer's payment obligations with respect to a disputed charge are suspended while the parties work together to resolve the dispute.

Customer Remedies and Protections

When the supplier fails to perform its obligations, the remedies available to a customer can include:

- Damages.
- An order for specific performance or an injunction.
- Termination of the contract.
- The amount of damages that can be recovered is often limited by the terms of the contract.

Outsourcing contracts often afford a variety of other protections to the customer. Typical protections include:

- Comprehensive governance structures, which can include regular reporting, meetings and/or periodic reviews.
- Rights for the customer to audit the supplier.
- Service level and service level credit regimes.
- Developing and implementing remedial plans applicable in situations where services are inadequate.
- Rights for the customer or a third party to step in and perform the services.
- Rights for the customer to terminate some or all of the services, and obligations on the supplier to perform post-termination assistance.
- Warranties and indemnities from the supplier.
- Obligations on the supplier to hold insurance.
- Using a scorecard that balances bonuses for exceptional performance against credits for poor performance.
- Disaster recovery and business continuity measures.
- Benchmarking performance against industry standards.
- Other financial consequences, such as loss of exclusivity or a reduction in the minimum price payable by the supplier.
- Guarantees from the parent company of the supplier.

Warranties and Indemnities

Warranties

The warranties included in an outsourcing agreement depend on the nature of the transaction and negotiations

between the parties. Typically, a supplier warrants that:

- It is entitled to enter into the contract and perform its obligations.
- It will perform the services with reasonable skill and care in accordance with good industry practice, in a timely and professional manner and in accordance with all applicable laws and regulations.
- Any material information provided in the pre-tender and tender stages was and remains complete and accurate.

Suppliers may sometimes warrant that the services and deliverables do not infringe or violate the intellectual property rights of third parties and that the supplier has all rights necessary to provide the services. Suppliers can sometimes be reluctant to provide this warranty, as the customer is often protected through the indemnity described below.

Depending on the nature of the services, a customer may request that a supplier give additional warranties specifically related to the services. For example, a customer can request that the supplier warrant that it has particular accreditations or operates in accordance with a particular quality assurance system.

The sale of goods and consumer protection legislation in each province and territory imply certain conditions and warranties (see, for example, sections 13 and 15 of the *Sale of Goods Act*, R.S.O. 1990, c. S.1). Warranties relating to services can be implied, but only where the beneficiaries of these services are consumers (that is, individuals acting for personal reasons).

The warranties and conditions implied by law can be expressly excluded by contract.

Parties should also consider the application of international treaties to which Canada is a signatory such as the United Nations Convention on Contracts for the International Sale of Goods (CISG) that may impact their sale of goods transaction. As a ratified, self-executing, international treaty, the CISG pre-empts Canadian provincial and territorial law (other than in Québec). This means that parties must specifically exclude the applicability of the CISG if the parties wish:

- To select specified Canadian provincial or territorial law as the governing law of an international sales contract.
- The particular terms of their agreement to take precedence and govern the sale of goods transaction.

Indemnities

Each party usually indemnifies the other party for property damage caused by the indemnifying party and damages arising from its wilful misconduct or gross negligence of the indemnifying party. The supplier usually also indemnifies the customer for damages or losses relating to:

- Third-party claims of intellectual property infringement.
- Claims from the supplier's employees for employment related matters, such as worker's compensation payments.
- The supplier's breach of applicable law.

- The supplier's breach of its confidentiality, personal information and/or security obligations.

For more detailed information about indemnities in the commercial context, see:

- [Standard Clause, General Contract Clauses: Indemnification](#)
- [Practice Note, Indemnification Clauses in Commercial Contracts](#)
- [Checklist, Drafting and Negotiating an Indemnification Clause Checklist](#)

Insurance

There are several types of insurance concerning outsourcing. The types of insurance that a customer may require a supplier to obtain and maintain during the duration of an outsourcing can include:

- Employer's liability.
- Workers' compensation coverage.
- General commercial liability.
- Automotive liability.
- Property (land and buildings).
- Directors and officers.
- Fidelity insurance.

Term and Notice Period

Neither national nor provincial laws impose a maximum or minimum term on outsourcing agreements, so the parties can negotiate term limits specific to their arrangement. The term of an outsourcing will typically be informed by the amortisation term of the upfront investments and the complexity of the arrangement, and generally ranges from three to ten years. The arrangement can include provisions for automatic renewal on a rolling annual basis if a party does not give notice of termination, and a mechanism for reviewing charges prior to each renewal.

There are similarly no laws which regulate the notice period required to terminate an outsourcing arrangement. The parties can agree on termination rights and notice periods. Notice periods can vary depending on the grounds giving rise to a particular termination right. In the context of egregious breaches and where technically and practically possible, termination can occur without any advance notice.

Generally, a customer will require an extended notice period in order to repatriate the services or transition them to another supplier. In these cases, the contract typically contains transition assistance obligations on the supplier that continue after the termination of the agreement to ensure a smooth transition.

Termination and Termination Consequences

A contract can be terminated without giving rise to a claim in damages against the terminating party where:

- The parties to the contract agree to terminate the contract at a particular time.
- Either party has a right to terminate for convenience provided all termination for convenience requirements (such as notice or payment obligations) are adhered to (typically only the customer will have this right).
- The contract has been frustrated (such that it has become incapable of being performed without default of the parties due to an unanticipated event).
- The contract is void and of no force and effect due to mistake.

Insolvency Events

Canadian insolvency legislation does not enable a party to an agreement to terminate an agreement on the grounds of insolvency (see, for example, section 65.1(5) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 and section 34(5) of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36. However, parties to an outsourcing agreement often agree that either party will have a right to terminate on the insolvency of the other party.

For more information on drafting and negotiating a contractual termination provision triggered by the insolvency of a party, see [Standard Clause, Termination for Bankruptcy, Insolvency or Financial Condition \(Ipso Facto Clause\)](#).

Federally regulated entities obtaining services that are subject to regulation by the Office of the Superintendent of Financial Institutions (Canada) (OSFI) Guideline B-10 are prohibited from permitting a supplier to terminate on either:

- The insolvency of that regulated entity.
- OSFI otherwise assuming control of that entity.

Additional Termination Rights

Commercial entities are generally free to agree to any additional termination rights (provided those rights are consistent with public policy) appropriate for their relationship. Typical termination rights include a right for either party to terminate:

- For a material breach of the contract on notice to the other party where the breach is not remedied during a pre-determined cure period.
- For minor but consistent breaches (with the type of breach and number of breaches needed to trigger the termination right defined in the contract).
- For insolvency, as that term is defined in the contract.
- On a change of control of the supplier.
- For convenience on prior notice.
- For more information on drafting and negotiating a termination clause, see [Standard Clause, General Contract Clauses: Term and Termination](#).

Remedies

The main remedies available to the parties in the event of a contractual breach are damages, termination and specific performance or injunction. However, parties often agree to modify and/or supplement these remedies with the following:

- Liquidated damages.
- Indemnities in respect of specific types of loss.
- The ability for the customer to terminate certain aspects of the services.
- If the services have not been performed in accordance with the contract, a right for the customer to require the supplier to re-perform the services.
- Step-in rights for the customer or a third party to take over the services.

For a sample liquidated damages provision, see [Standard Clause, General Contract Clauses: Liquidated Damages](#).

For more detailed information about indemnities in the commercial context, see:

- [Standard Clause, General Contract Clauses: Indemnification](#)
- [Practice Note, Indemnification Clauses in Commercial Contracts](#)
- [Checklist, Drafting and Negotiating an Indemnification Clause Checklist](#)

IP Rights and Know-How Post-Termination

The licensing of IP rights both during and following the termination of an outsourcing agreement is a matter of contract. There are no implied rights to continue using licensed IP rights post-termination, although it can be argued that such an implied right exists where necessary to benefit from express rights that survive termination. For example, if there is a limited right to retain information post-termination for audit purposes, there arguably is a limited implied licence to use any licensed IP necessary to exercise that right.

Generally, know-how is protected as a form of trade secret or confidential information rather than a form of IP. Therefore, it is usually protected by contractual agreement between the parties. Typically, a customer will agree to maintain know-how in confidence and use it only in connection with the agreement. If a supplier's know-how is retained by employees of the customer, it can be used post-termination, but that use may be subject to any confidentiality obligations of the customer contained in the agreement and any IP protection that exists in respect of documented know-how.

Liability, Exclusions and Caps

The parties are generally free to exclude most forms of liability, subject to the following:

- An exclusion of liability can be interpreted as unconscionable or in violation of public policy (for example, excluding liability for fraud).
- Explicit wording is usually required if exclusions or limitations are intended to apply to liability arising from a party's negligence or deliberate breach.

Typically, a supplier will aim to limit or exclude its liability for indirect, consequential, incidental and special damages as well as for loss of business, profit or revenue, where they constitute a direct loss. In contrast, a customer typically aims to ensure that it is able to recover all of its direct losses. In arrangements where a supplier will or may gain access to a customer's confidential information, a customer typically tries to ensure that the supplier remains liable for all damages arising from any breach of the supplier's confidentiality obligations, whether those damages are direct, indirect, consequential or incidental.

The parties are free to agree on a liability cap subject to the limitations described above. Factors considered by the parties when setting a cap on liability will depend on each party's assessment of the applicable risks and its options for mitigating those risks. The factors can include:

- The term of the agreement.
- The profit margin of the supplier.
- The fee structure.
- The existence of unique risks that cannot be mitigated.

For a more detailed discussion on drafting and negotiating limitation of liability provisions, see [Standard Clause, General Contract Clauses: Limitation of Liability](#).

Dispute Resolution

Generally, parties agree to a staged dispute resolution approach, which begins with escalating communications to the senior management of both parties. If necessary and desired by the parties, this can be followed with non-binding efforts to mediate the dispute, and binding or nonbinding arbitration. Otherwise, parties will have recourse to the courts. For sample staged alternative dispute resolution clauses, see [Standard Clauses, General Contract Clauses: Alternative Dispute Resolution \(Multi-tiered\)](#).

Where the parties agree to binding arbitration, disputes arising from IP infringement are often carved out from the arbitration process in order to enable the injured party to seek injunctive relief from the courts. For a sample arbitration clause, see [Standard Clauses, General Contract Clauses: Arbitration](#).

Tax

Transfers of Assets to the Supplier

The transfer of assets to a supplier can give rise to federal and provincial taxes based on the proceeds of disposition of the assets, the nature of the assets and the cost of the transferred assets.

Transfers of Employees to the Supplier

If employees are transferred to a supplier, the supplier is generally responsible for withholding and paying certain payroll taxes from the compensation paid to the employees.

Value Added Tax or Sales Tax

Sales tax (which can be provincial (PST), federal (GST) and/or harmonised (HST)) can apply depending on the types of goods and services being supplied. Sales taxes vary by province as follows:

- In Ontario, Prince Edward Island, Nova Scotia, New Brunswick and Newfoundland and Labrador, HST of 13% applies.
- In British Columbia, Manitoba, Québec and Saskatchewan, GST of 5% and PST (which varies by province) applies.
- In Alberta, the Northwest Territories, Nunavut and the Yukon, GST of 5% applies and PST does not apply.

The transfer of assets can also give rise to provincial, federal and/or harmonised sales taxes depending on the location and the nature of the assets being transferred.

For a more detailed discussion on various indirect taxes applicable in Canada including GST, HST, PST, First Nations Goods and Service Tax (FNGST), Excise Tax, Excise Duty, and Customs Duty, see [Standard Clauses, General Contract Clauses: Indirect Taxes](#).

Other Tax Issues

Withholding tax can arise on payments to non-residents in respect of services performed in Canada and non-resident suppliers can be subject to tax if they carry on business in Canada. Tax treaties between Canada and other countries may limit applicable taxes in certain circumstances.

Online Resources

Official website of the [Office of the Privacy Commissioner of Canada](#), containing federal privacy law information and applicable legislation.

Official website of the [Office of the Superintendent of Financial Institutions \(Canada\)](#), containing information regarding outsourcing arrangements for financial institutions and Guideline B10.

Related content

Topics

[E-Commerce and Technology](#)

Call us toll free 1-844-717-4488 (in Toronto 416-649-9318)

Email us PLorders.legaltaxcanada@tr.com

Monday to Friday 8:30 a.m. to 4:30 p.m. ET

You can also **send us feedback** with any questions or comments on the site. For more options to contact us **click here**.

Use and Privacy Policy. Practical Law Company® services are now a Thomson Reuters Legal Solution.