

Goodmans^{LLP} Update

International Comparative Legal Guide - Outsourcing 2020 Canada Chapter

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1. Regulatory Framework

1.1 Are there any national laws or regulations that specifically regulate outsourcing transactions, either generally or in relation to particular types of outsourcing transactions (e.g. business process outsourcings, IT outsourcings, telecommunications outsourcings)?

There are no federal or provincial Canadian laws that specifically regulate outsourcing transactions. However, certain aspects of an outsourcing transaction may be subject to industry or sector-specific regulations and/or guidelines. For example, the Office of the Superintendent of Financial Institutions (Canada) (OSFI) provides guidelines for certain federally regulated entities (e.g., banks, credit unions) entering into outsourcing agreements. Additionally, the structure of an outsourcing transaction may be viewed by applicable regulatory bodies as mergers or acquisitions, which could subject the transaction to notification and/or review under the *Competition Act* and/or the *Investment Canada Act*.

1.2 Are there any additional legal or regulatory requirements for outsourcing transactions undertaken by government or public sector bodies?

Public sector bodies at the federal, provincial and, in some cases, municipal levels must comply with applicable public procurement requirements. The Canadian Free Trade Agreement, and the growing list of international trade agreements that Canada is party to, impose principles of fairness, transparency and non-discrimination on an increasingly broad spectrum of public procurements. Further, if the outsourcing arrangement involves the collection, use, retention or disclosure of personal information collected by or for, or in the possession of, a public sector body, federal and/or provincial privacy regulations may apply.

1.3 Are there any additional legal or regulatory requirements for outsourcing transactions undertaken in particular industry sectors, such as for example the financial services sector?

Outsourcing transactions may be subject to various regulatory requirements depending on the particular industry sector. For example, federally regulated financial entities (FREs) are subject to OFSI guideline B-10, which imposes overall accountability and control requirements on FREs. Specifically, the guideline requires materiality assessments and risk management implementation for FREs entering into outsourcing transactions. In addition to the financial sector, the following is a non-exhaustive list of industry sectors that are subject to regulation in Canada, each of which may subject certain types of outsourcing transactions to additional regulatory requirements: telecommunications; broadcasting; education; energy; gambling/lottery; healthcare; transportation; and environment. In each case, the applicable requirements are industry-specific.

1.4 Is there a requirement for an outsourcing transaction to be governed by local law? If it is not to be local law, is there any generally accepted norm relating to the choice of governing law?

There is no requirement for an outsourcing transaction to be governed by local law. However, it is common for outsourcing agreements to be governed by the laws of the Canadian province or territory in which the customer is receiving the services. Ontario law is most frequently used for outsourcing contracts under which services are provided on a national basis or in Ontario together with other provinces and/or territories.

2. Legal Structure

2.1 What are the most common types of legal structure used for an outsourcing transaction?

The most common and straightforward legal structure is a direct outsourcing agreement under which the customer contracts directly with the supplier. The agreement is typically entered into by the customer's operating company and the supplier (or the supplier's local affiliate). This structure consists of one or more agreements that prescribe the services provided, the payment terms, key personnel and assets, and the supplier's performance obligations and the consequences of failing to meet those obligations. A provision may be included to permit affiliates of the customer to have work performed under the main agreement or to enter into separate agreements or statements of work that incorporate the terms of the main agreement.

In some cases, outsourcing agreements may be entered into as part of or in connection with mergers and acquisitions, joint venture arrangements or other corporate or commercial arrangements.

3. Procurement Process

3.1 What is the most common type of procurement process that is used to select a supplier?

The type of procurement process depends on whether the customer operates in the private or public sector. Private sector customers are generally unconstrained by law as to their choice of procurement process. That said, requests for proposals are commonly used for complex outsourcings to ensure the customer is obtaining a competitive solution.

For public sector entities, federal and provincial procurement rules typically require that outsourcings go through a competitive procurement process. In addition, multilateral trade agreements such as the North American Free Trade Agreement, the Canadian Free Trade Agreement and others generally require public sector procurements be transparent and implement safeguards to ensure a fair and non-discriminatory process.

4. Term of an Outsourcing Agreement

4.1 Does national or local law impose any maximum or minimum term for an outsourcing contract?

No minimum or maximum terms are imposed by Canadian law.

4.2 Does national or local law regulate the length of the notice period that is required to terminate an outsourcing contract?

Canadian law does not. However, in exceptional circumstances equitable principles could apply to require a reasonable notice period (e.g., if an outsourcing arrangement were to involve a significant imbalance of power and a high level of dependency of one party on the other).

5. Charging

5.1 What are the most common charging methods used in outsourcing transactions?

The specific charging methods used in Canadian outsourcing agreements depend on the nature of the services provided. While some services or projects are performed on a fixed-price basis, it is more common that the price of the service scale with the volume of the service (such as hours of labour, number of transactions, number of customers serviced, number of computers maintained, etc.). Pricing can also reflect gain-sharing, sharing of benefits and other incentive arrangements.

5.2 What other key terms are used in relation to costs in outsourcing transactions?

Other key pricing terms include rate cards setting out the agreed hourly rates for additional labour, price performance provisions (providing for automatic, year over year savings), price adjustment provisions (dealing with inflation and/or changes to exchange rates), change process (mandating a process for settling the price of changes), gain sharing, and benchmarking (to test competitiveness).

6. Transfer of Assets

6.1 What formalities are required to transfer, lease or license assets on an outsourcing transaction?

The required formalities differ based on the nature of the assets themselves. In instances where intellectual property (IP) is being transferred, transfers must be in writing and in some cases should be registered with the Canadian Intellectual Property Office.

Personal property is typically transferred through a bill of sale. There are no strict formalities regarding the leasing and licensing of personal property, however, documenting transfers in writing is recommended.

The transfer, lease and license provisions of key contracts should be reviewed early to assess potential restrictions on assignment. Contracts may require express consent from the counterparty to the assignment.

6.2 What are the formalities for the transfer of land?

To transfer land, the transfer of title must be in writing and must be registered in the applicable land registry office. Provinces may have further requirements that should be assessed on a case-by-case basis.

6.3 What post-completion matters must be attended to?

Generally, assignments of assets are complete at the time and date listed in the outsourcing agreement. Additional post-completion matters frequently include the provision of transition services.

6.4 How is the transfer registered?

Personal property is typically unregistered in Canada. However, it is possible for security interests to be taken in personal property. If this is the case, such interests may require registration in applicable personal property security act registries to claim a priority interest.

Land transfers must be registered in the relevant land registry office.

7. Employment Law

7.1 When are employees transferred by operation of law?

Whether employees are transferred by operation of law depends on a number of factors. The jurisdiction, the structure of the transaction and the employees' union status are all relevant to consider. For example, if an outsourcing transaction is structured as a transfer of shares, Canadian employment law does not recognise any change in employer. All employees, including any associated liabilities would be carried through to the service provider, uninterrupted. This is true regardless of union status or jurisdiction. However, in an asset purchase, whether such a transfer occurs will highly depend on the applicable jurisdiction. In most Canadian jurisdictions, non-unionised employees are not transferred by operation of law. Unionised employees may be transferred by operation of law if the transaction constitutes a "sale of business" under applicable labour legislation. In such instances, the union's collective bargaining rights could extend to the service provider. Even then, whether such employees are transferred to the service provider will depend on the specific terms of the applicable collective bargaining agreement (CBA).

7.2 On what terms would a transfer by operation of law take place?

If employees are transferred by operation of law, the terms of employment would remain as is, unless otherwise negotiated and agreed to as part of the outsourcing transaction.

7.3 What employee information should the parties provide to each other?

As part of the due diligence phase, parties typically share basic employment information such as the number of employees and the material terms of the employment. They may also share employee information needed for benefit plan enrolment. Canadian privacy legislation may limit the sharing of certain personal information.

7.4 Is a customer/supplier allowed to dismiss an employee for a reason connected to the outsourcing?

In a non-unionised setting, it is not unusual, in connection with an outsourcing transaction, that employees may be terminated (in accordance with applicable Canadian employment law). Unionised employees are subject to the terms of the applicable CBA. CBAs often protect unionised employees from termination, barring misconduct. However, CBAs may also explicitly contemplate a "changed business" environment and allow terminations in such instances.

7.5 Is a supplier allowed to harmonise the employment terms of a transferring employee with those of its existing workforce?

For non-unionised employees, yes. Such harmonised terms would be made clear in the offer to the employees. If material changes were made without the employees' consent, a constructive dismissal or breach of contract could result, on which employees could base a claim for damages. Any changes to the terms of unionised employees' employment require union agreement.

7.6 Are there any pensions considerations?

Yes. The considerations will be driven by the nature of the benefits provided to the employees by the service provider and the jurisdiction of the plan. Pension benefits are regulated under federal tax legislation and the applicable pension benefits legislation. The applicable legislation is based on the province of registration of the pension plan, and the location of the affected employees. Consideration must be given to the fiduciary responsibilities of the employer to the plan and its members, and to any collectively bargained benefits. Further, expert advice is often required concerning dispositions and transfers of pension assets held in registered retirement plans. Considerations on portability, accrual of benefits and other pension administration will depend on the jurisdiction and the type of pension provided, such as a defined benefit or defined contribution pension plan, or other type of retirement benefit plan.

7.7 Are there any offshore outsourcing considerations?

Privacy law is a key consideration for offshore outsourcing transactions. In Canada, the *Personal Information Protection and Electronic Documents Act* (PIPEDA) governs the international collection, use and disclosure of personal information. Pursuant to PIPEDA, customers and service providers will be responsible for any personal information in their custody or control (as defined in PIPEDA). This is of particular importance in outsourcing transactions as personal information is often stored, or passes through a third-party intermediary for processing at some stage of the transaction. If such personal information is to be accessed, processed and/or stored outside of Canada (whether physically or virtually), it is critical for the parties to ensure that appropriate notices and/or consents have been given and obtained and that the outsourcing agreement contemplates this and provides for an appropriate level of protection of the data as would be received under Canadian privacy law.

The public sector has stricter requirements and in some provinces, provincial public sector laws restrict government bodies from storing information outside of Canada.

8. Data Protection Issues and Information Security

8.1 What are the most material legal or regulatory requirements and issues concerning data security and data protection that may arise on an outsourcing transaction?

The security of data, especially financial information and personal information, is an increasingly critical concern and is an issue in almost all outsourcing agreements. The applicable security standards and the use of SOC 2 reports and audit rights to verify compliance are increasingly common.

8.2 Are there independent legal and/or regulatory requirements concerning information security?

Personal information, in particular, sensitive health information and information that can facilitate identity theft, are protected under a variety of federal and provincial laws, as well as industry standards (such as the Payment Card Industries Data Security Standard).

9. Tax Issues

9.1 What are the tax issues on transferring the outsourced business – either on entering into or terminating the contract?

With a transfer of assets, sales or commodity taxes (and in some cases separate provincial sales taxes) will apply. Exemptions may apply to certain eligible transfers.

9.2 Is there any VAT leakage on the supply of services under the outsourcing contract?

Commodity tax in Canada occurs at the provincial (PST), federal (GST) or depending on the province, on a harmonised (HST) basis and may apply in outsourcing transactions depending on the nature of the goods and/or services supplied by the supplier. Asset transfers can also give rise to the aforementioned taxes depending on the nature of the assets being transferred and the location of the customer and service.

9.3 What other tax issues may arise?

Canadian withholding tax obligations may arise when payments are made to non-residents for services rendered in Canada. Additionally, foreign suppliers may be subject to withholding tax when carrying on business in Canada. In some instances, these taxes may be limited due to tax treaties between Canada and other countries.

10. Service Levels

10.1 What is the usual approach with regard to service levels and service credits?

Service levels prescribe the levels of performance the supplier must meet, and the agreement must detail the consequences of failures to meet such service levels.

Service levels typically measure performance in terms of availability, reliability, responsiveness, accuracy and other similar criteria.

Service levels may take the form of performance objectives (service level objectives or SLOs) or contractual commitments (service level agreements or SLAs). Breaches of SLOs typically result in responses through governance, including potential requirements for root cause analysis, remedial action and executive escalation. Breaches of SLAs typically give rise to fee reductions, responses through governance, and other potential remedial measures such as termination for breach in the event of repeated, significant breaches of SLAs.

Service level fee reductions are typically calculated as a percentage of the fees paid for the services and are intended to better align the interests of the supplier with that of the customer. Such fee reductions are to reflect the reduction in the value of the services to the customer and are not considered a penalty.

In some cases, suppliers may have an opportunity to earn back a portion of the most recent service level fee reduction by successfully implementing changes that enable them to consistently meet expected service levels (substantially above the minimum service levels at which fee reductions apply).

11. Customer Remedies

11.1 What remedies are available to the customer under general law if the supplier breaches the contract?

Contract law generally provides that a customer can recover damages in the event that the terms of an outsourcing contract are breached. Failure on the part of the supplier to perform obligations under the agreement can result in other remedies such as injunctive relief, equitable remedies, or specific performance. Limitations on the types and amounts of damages are typically negotiated in most outsourcing agreements in Canada.

11.2 What additional protections could be included in the contract documentation to protect the customer?

In addition to service level fee reductions (discussed above) and representations, warranties, covenants and indemnities (discussed below), remedial provisions in outsourcing agreements are wide ranging and may include: performance bonds; guarantees from the supplier's parent and/or affiliates; the ability to hold back or reduce fees; rights of set-off; step-in rights; access to supplier intellectual property; and a wide variety of termination rights empowering the customer to terminate the agreement for breach or for convenience.

11.3 What are the typical warranties and/or indemnities that are included in an outsourcing contract?

Representations and warranties can range widely, however, most agreements include a warranty that:

- the services will be performed 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;

- security standards will be complied with, and should any data be damaged or lost, efforts will be taken to recover this data;
- conflicts of interest will be avoided, and no corporate affiliate shall have or acquire any contractual, financial, business or other interest that would materially conflict with the supplier's ability to perform their duties;
- should the supplier become unable to comply with requirements through any change of condition, it will warn the customer as promptly as possible;
- none of the intellectual property contained in the agreement infringe any third party's rights, and there are no pending or anticipated claims against the supplier;
- the supplier has both the legal and corporate authority to enter the agreement and has only provided information that is true, accurate, and complete; and
- the supplier acknowledges it had the opportunity and sufficient time to thoroughly conduct due diligence of the customer's operations before providing the services laid out in the agreement.

Indemnities may also vary, but the supplier typically indemnifies the customer for damages and losses relating to:

- any cause of action or suit brought forward by the supplier, employees or subcontractors, including claims for wages, discrimination or harassment;
- any third-party claims of intellectual property infringement;
- any third-party claims stemming from the supplier's failure to pay any applicable taxes;
- the damage, loss or destruction of any tangible, real or personal property;
- any personal injury, including, but not limited to, actual or alleged bodily injury, sickness, disease, or death arising from provision of the services; and
- the supplier's breach of its confidentiality, personal information and/or security obligations.

12. Insurance

12.1 What types of insurance should be considered in order to cover the risks involved in an outsourcing transaction?

Typically, customers will require suppliers to obtain and maintain certain insurance policies during the term of the outsourcing agreement. The types of insurance that should be considered will largely depend on the nature of the services and/or goods being provided. The following is a non-exhaustive list of various types of insurance that may apply: employer's liability; workers' compensation; general commercial liability; cyber security; E&O; automotive; property; and fidelity insurance.

13. Termination

13.1 How can a party to an outsourcing agreement terminate the agreement without giving rise to a claim for damages from the terminated party?

There are several avenues by which parties may terminate an agreement early. The most straightforward method to terminate an agreement arises when both parties agree to terminate the contract at a specified time.

A party may also terminate an agreement for convenience, but it is more common for this option to be available to the customer unilaterally. While terminating an agreement for convenience will not give rise to damages, termination for convenience often imposes notice and payment obligations on the terminating party.

Other grounds for terminating an agreement may include for a change in control, frustration of a contract, failure to achieve a milestone, and an event of force majeure.

13.2 Can the parties exclude or agree additional termination rights?

The parties are generally free to exclude or include any additional termination rights (providing such rights are consistent with public policy). Additional termination rights often include termination upon a material breach that is not cured during a specified period, less serious recurring breaches, repeated service level breaches, insolvency or a change of control of the supplier.

13.3 Are there any mandatory local laws that might override the termination rights that one might expect to see in an outsourcing contract?

There are no mandatory local laws that would prevent parties from establishing termination rights (providing such rights are consistent with public policy).

14. Intellectual Property

14.1 How are the intellectual property rights of each party protected in an outsourcing transaction?

Intellectual property rights in Canada are typically protected by statutory intellectual property laws (consistent with international treaties), and express contractual provisions. Outsourcing agreements usually include express provisions allocating ownership and license rights in the intellectual property developed and used under such agreements.

14.2 Are know-how, trade secrets and other business critical confidential information protected by local law?

Under Canadian common law, confidential information is protected through contractual obligations to keep such information secret and to use it only for the purposes agreed to by the parties.

14.3 Are there any implied rights for the supplier to continue to use licensed IP rights post-termination and can these be excluded from the agreement?

Supplier rights to use IP licensed from the customer are typically limited to those expressly provided for in the outsourcing agreement, and may be limited to prohibit the use of such IP rights post-termination.

14.4 To what extent can the customer gain access to the supplier's know-how post-termination and what use can it make of it?

The customer's rights to use the supplier's know-how after termination will typically be limited to those rights expressly agreed to in the outsourcing agreement. That said, it is not unusual for an outsourcing agreement to provide that both parties may continue to use information of general application retained in their unaided memories which are learned during such engagements (provided that such use does not disclose any confidential information of the disclosing party).

15. Liability

15.1 To what extent can a party limit or exclude liability under national law?

Parties are generally free to limit and exclude liability, unless the exclusion is interpreted as being unconscionable (being manifestly unfair) or violating public policy, such as excluding liability for fraud. It is common for limitations and exclusions of liability to be heavily negotiated. The supplier typically seeks to limit or exclude their liability for indirect, consequential, incidental and special damages, including any loss of business, profit or revenue where the loss constitutes a direct loss. Conversely, the customer seeks to ensure it can recover all direct losses. If the outsourcing arrangement is one where the supplier has access to the customer's confidential information, the customer typically seeks to have the supplier be fully liable for all damages relating to any breach of the supplier's confidentiality obligations.

15.2 Are the parties free to agree a financial cap on liability?

Parties are free, and it is common practice, to include a financial cap (or caps) on liability, typically subject to a number of exceptions. The financial cap (or caps), and exceptions, in each outsourcing agreement depend on a variety of factors, including the nature of the services, the term of the agreement, the relative bargaining power of the parties, and prevailing industry practice.

16. Dispute Resolution

16.1 What are the main methods of dispute resolution used?

When entering into an outsourcing agreement, customers and suppliers typically will agree to a progressive approach to dispute resolution. The first stage usually involves escalating communications to designated parties for each of the customer and supplier with a goal of resolving the dispute. The second stage is often non-binding mediation, followed by either arbitration or litigation.

The level of detail included in the dispute resolution provision will depend on the sophistication of the parties, as well as the subject matter of the outsourcing agreement. The parties may, for example, wish to identify a roster of arbitrators, who have a particular expertise. The parties may also exclude certain areas from binding arbitration. For example, disputes arising from IP infringement may be excluded from the dispute resolution process so that the injured party is not limited from seeking relief from the courts.

17. Good Faith

17.1 Is there any overriding requirement for a customer and supplier to act in good faith and to act fairly according to some objective test of fairness or reasonableness under general law?

There is a limited common law duty to act in good faith in the performance of contractual obligations. In 2014, in *Bhasin v. Hrynew*, [2014] 3 SCR 494, the Supreme Court of Canada ruled that good faith is a general organising principle and that contractual duties must be performed honestly. The duty of good faith extends to the duty of honesty; however, it remains unclear if the duty extends to reasonableness, and not acting arbitrarily. Contracting parties may include provisions attempting to minimise the scope of good faith obligations, however courts are unlikely to enforce such provisions.

In Quebec, Articles 6 and 7 of the Civil Code of Quebec codify a duty of good faith, which extends to the negotiation and performance of contracts

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