



Finance Circular 2006/03

To all agencies under the *Financial Management and Accountability Act 1997* (FMA Act agencies)

Limited Liability in Information and Communications Technology Contracts

Purpose

This Circular articulates and provides guidance on the Australian Government's policy on the capping of liability when entering into Information and Communications Technology¹ (ICT) contracts.

Target Audience

This Circular applies to all agencies subject to the *Financial Management and Accountability Act 1997* (FMA Act).

The Policy

1. Australian Government policy is that the liability of ICT suppliers contracting with agencies should, in most cases, be capped at appropriate levels. Unlimited liability clauses should only be required when there is a compelling reason.
2. The policy governing limited liability for ICT contracts is to be an Australian Government policy for the purposes of Regulation 9 of the *Financial Management and Accountability Regulations 1997* (FMA regulations) and the *Commonwealth Procurement Guidelines* (CPGs).

Context

3. For the purpose of this policy, a liability cap on supplier's liability is defined as an arrangement whereby a supplier's liability for damage or loss incurred by the Commonwealth is limited to a certain amount. A liability cap only applies to the parties to the contract and does not include:
 - limiting the supplier's liability to compensate a third party; or
 - compensating the supplier for damage suffered directly by the supplier.

¹ Information and Communications Technology is a term that encompasses the use of hardware, software and services to create, store, retrieve, transfer, process and present information.

4. The Australian Government has a general principle in regard to risk management that risks should be borne by the party best placed to manage them - that is, the Commonwealth should generally not accept risks which another party is better placed to manage.
5. Unlimited liability should not be requested for ICT procurement contracts unless it is an accurate reflection of the potential risks.
6. The Government's policy on capping liability in ICT contracts, as detailed in this Circular, creates greater certainty for ICT suppliers and for agencies. The policy also promotes efficiencies for suppliers when developing their tenders and efficiencies for both agencies and suppliers in the contract negotiation process.
7. It is important that officials continue to obtain appropriate advice, including risk management and legal advice, in relation to the liability clauses to be included in ICT contracts.

Background

8. The CPGs sets out the Australian Government's policy on procurement, reflecting its overarching policy on risk management:
 - risks should be borne by the party best placed to manage them;
 - if there is a compelling reason to limit a supplier's liability, any indemnity, liability cap or similar arrangement should be of limited scope and with specified maximum liabilities;
 - as part of considering such a limit, FMA Act agencies should refer to the requirements set out in Finance Circular 2003/02 and the accompanying *Guidelines for Issuing and Managing Indemnities, Warranties, Guarantees and Letters of Comfort*. These Guidelines provide definitions of indemnities, warranties, guarantees and letters of comfort, information on how they may be used, and considerations regarding the application of FMA Regulations 9 and 10. Care should be taken when drafting clauses to ensure an arrangement is a liability cap as opposed to an indemnity arrangement. Regardless of whether the clause is called a liability cap, indemnity, release or by any other name, it is the effect of the clause that must be taken into account;
 - for each proposal to limit a supplier's liability to the Australian Government a risk management process must be undertaken, including undertaking a risk assessment and obtaining legal advice where appropriate, having regard to the complexity of the purchase and the level of risk; and
 - the potential costs of any liability cap must be considered when assessing value for money.

Applying the Policy

9. Officials should refer to their agency's Chief Executive's Instructions for information on risk assessment and procurement procedures.
10. The following provides a step-by-step approach that agencies can follow when applying the policy of capping liability in ICT contracts.

Step 1 – Determine the appropriate liability regime for your ICT project.

- With a default starting position of applying a liability cap, a formal risk assessment assists in establishing whether the size, complexity or inherent risk of the project are such that the agency should reconsider whether a liability cap should be offered.

Step 2 – Determine the appropriate level for the initial estimate of the liability cap.

- Whenever an agency is considering capping a supplier's liability for an insurable risk, the agency should contact Comcover to determine whether its own insurance cover is affected. It is a condition of Comcover's agency coverage that it have the rights of the agency to recover a loss – this is known as subrogation.
- In the event of a claim by an agency for a loss arising from an event for which a supplier has legal liability, but is protected by a liability cap, Comcover's subrogation rights may be prejudiced. Where this occurs, Comcover may limit its coverage of the agency to the amount that Comcover may recover from the supplier. The agency would then be required to bear any loss above the cap.
- Contact with Comcover should initially be pursued through an agency's Chief Finance Officer area or Risk Management Area.

Step 3 – Determine how the liability issues will be handled in the procurement process and contract.

- Agencies can consider using either of the following approaches when going to the market:
 - identify the liabilities to be capped within the request documents and state the proposed level of the liability cap, allowing (if desired) tenderers to propose an alternative level (or range of levels) of liability cap in their submissions and adjust pricing accordingly; or
 - inform potential suppliers that due to the nature of the procurement a cap will not be applied, but only in circumstances where the size, complexity or inherent risk of the procurement require that a liability cap not be offered.

Step 4 – Establish agreement and complete the contract.

11. It is particularly appropriate for agencies to consider negotiating liability caps in ICT contracts in relation to the following matters:

- standard breach of contract in relation to service delivery obligations; and
- supplier liability arising from negligent acts or omissions, (other than negligence related to personal injury and property damage and other than losses that result from a breach of intellectual property rights, confidentiality, privacy and security obligations or unlawful conduct as explained below).

12. Unless there is a compelling reason otherwise, it is generally appropriate for agencies to retain unlimited liability clauses in ICT contracts in relation to the following matters:

- personal injury including sickness or death - it is preferable that agencies require unlimited liability rather than placing a value (liability cap) on personal injury or death caused by a supplier;

- unlawful or illegal acts - suppliers should not have their liability limited in relation to unlawful acts or illegal activity;
- damage to tangible property - standard contract practice includes unlimited liability with respect to property damage and it would be unusual to treat ICT contracts differently;
- intellectual property obligations - liability for intellectual property infringement in respect of ICT products supplied by a supplier is a fundamental consideration in such contracts as ownership and title of intellectual property rights need to be properly protected;
- confidentiality and privacy obligations - limiting liability in ICT contracts may interfere with the proper implementation of principles, protocols, practices and legislative obligations with respect to confidentiality and privacy; and
- security obligations - it would not be prudent to dilute or affect the Australian Government's position with respect to security matters by capping the liability of suppliers in procurement.

Record Keeping

13. Agencies' decisions when approving a spending proposal, including whether to have unlimited liability, must be properly documented.

Additional Resources

14. Readers should also be aware of these additional resources which may have a bearing on the capping of a supplier's liability:
 - Department of Communications, Information Technology and the Arts (DCITA), *A Guide to Limiting Supplier Liability in Information and Communications Technology (ICT) Contracts with Australian Government Agencies*.
 - *Commonwealth Procurement Guidelines*.
 - Finance Circular 2003/02 *Guidelines for Issuing and Managing Indemnities, Guarantees, Warranties and Letters of Comfort*.

Contacts

15. Questions with regard to this Circular should be directed to the Procurement Agency Advice Branch at procurementagencyadvice@finance.gov.au or visit Finance's website at <http://www.finance.gov.au> (under the Government Finances menu).
16. Questions regarding the DCITA publication *A Guide to Limiting Supplier Liability in Information and Communications Technology (ICT) Contracts with Australian Government Agencies* should be directed to DCITA's ICT Development Branch at cappingliability@dcita.gov.au.

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