



Canadian International
Trade Tribunal

Tribunal canadien du
commerce extérieur

CANADIAN
INTERNATIONAL
TRADE TRIBUNAL

Procurement

ORDER AND REASONS

File No. PR-2005-035

Averna Technologies Inc.

v.

Department of Public Works and
Government Services

*Order and reasons issued
Tuesday, October 10, 2006*

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IN THE MATTER OF a complaint filed by Avera Technologies Inc. under 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 under subsections 30.15(2) and (3) of the *Canadian International Trade Tribunal Act* that Avera Technologies Inc. be compensated for the profit that it could have made if it had been awarded the designated contract that was the subject of the complaint;

AND FURTHER TO a determination made under section 30.16 of the *Canadian International Trade Tribunal Act* that Avera Technologies Inc. be awarded its reasonable costs incurred in preparing and proceeding with the complaint;

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

BETWEEN

AVERNA TECHNOLOGIES INC.

Complainant

AND

THE DEPARTMENT OF PUBLIC WORKS AND GOVERNMENT SERVICES

Government Institution

ORDER

The Canadian International Trade Tribunal awards Avera Technologies Inc. costs in the amount of \$2,400 for preparing and proceeding with the complaint and directs the Department of Public Works and Government Services to take appropriate action to ensure prompt payment.

The Canadian International Trade Tribunal hereby recommends that the Department of Public Works and Government Services compensate Avera Technologies Inc. in the amount of \$279,734.80 for the profit that it could have made if it had been awarded the designated contract that was the subject of the complaint.

Pierre Gosselin
Pierre Gosselin
Presiding Member

Hélène Nadeau
Hélène Nadeau
Secretary

STATEMENT OF REASONS

INTRODUCTION

1. In a determination made on February 13, 2006, under subsection 30.14(2) of the *Canadian International Trade Tribunal Act*,¹ the Canadian International Trade Tribunal (the Tribunal) determined that the complaint filed by Averna Technologies Inc. (Averna) on November 14, 2005, was valid. Pursuant to subsections 30.15(2) and (3) of the *CITT Act*, it recommended, as a remedy, that the Department of Public Works and Government Services (PWGSC) cancel the contract awarded to Néosoft Technologies Inc. and award the contract to the only qualified bidder, Averna, if it accepts it, as soon as possible, in order to meet the established delivery times.

2. In the alternative, the Tribunal recommended that Averna be compensated for the profit that it could have made if it had been awarded the contract. The Tribunal indicated that, if PWGSC elected to compensate Averna, and the parties were unable to agree on an amount to be paid, the parties could apply to the Tribunal for a determination of the amount of compensation. Since PWGSC had decided to compensate Averna and the parties were unable to agree, on May 10, 2006, Averna applied to the Tribunal for a determination of the appropriate amount of compensation and argued that such compensation should be in the amount of \$279,734.89. On May 29, 2006, PWGSC filed comments on Averna's claim. On June 9, 2006, Averna filed a reply submission.

3. In its determination of February 13, 2006, the Tribunal also awarded Averna, under section 30.16 of the *CITT Act*, its reasonable costs incurred in preparing and proceeding with the complaint, which costs were to be paid by PWGSC. The Tribunal's preliminary indication of the level of complexity for this complaint case was Level 2, and its preliminary indication of the amount of the cost award was \$2,400. The Tribunal indicated in its determination that, if any party disagreed with the preliminary indication of the level of complexity or the preliminary indication of the amount of the cost award, it could make submissions to the Tribunal. The Tribunal reserved jurisdiction to establish the final amount of the award.

COMPLAINT COSTS

4. Noting that there have been no submissions contesting the preliminary indication of the level of complexity or the preliminary indication of the amount of the cost award, the Tribunal confirms its preliminary indications by awarding Averna costs in the amount of \$2,400 for preparing and proceeding with the complaint and directs PWGSC to take appropriate action to ensure prompt payment.

COMPENSATION FOR LOST PROFIT

5. Averna argued that the profit (before taxes) that it could have made if it had been awarded the contract corresponds to the gross profit associated with the project. It submitted that the amount of the gross profit associated with the project is calculated by subtracting the direct labour costs from the value of the contract. According to Averna, it is not appropriate to subtract from the amount of gross profit associated with the project a percentage of the general expenses because, even though that project will not be undertaken by Averna, it has already committed funds or already made the payments relating to the general expenses associated with the project. Averna stated that it had sufficient physical facilities to undertake the project without incurring additional costs and that it had a sufficiently large administrative and commercial

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

team that represented a level of occupancy below 100 percent, which enabled it to undertake the project without incurring additional costs in this regard.

6. Averna argued that, if the above calculation method was not used by the Tribunal, the historical profitability of its division that offers engineering services in testing and measuring should be used as the basis for determining its lost profit.

7. PWGSC argued that Averna had clearly indicated in its proposal filed in response to the Request for Proposal that its gross margin on the total price of the contract was lower than the gross margin that it is now claiming. It submitted that the method used by Averna to calculate lost profit is contrary to generally accepted accounting principles, in that it does not take into account that general and administrative expenses must be subtracted from the value of the gross profit in order to obtain the value of the actual profit that it would have made. It submitted that general and administrative expenses do not constitute profit, but rather expenses associated with performing a contract, and that any contract involves direct labour costs and general and administrative expenses. PWGSC submitted that Averna's claim that the performance of the contract would not have resulted in additional expenses is not compatible with Averna's financial statements. PWGSC submitted that Averna would like the Tribunal to compensate it without taking into account the fact that a very large part of the value of its contract would have been used to pay all of the direct labour costs and general and administrative expenses.

8. PWGSC submitted that the compensation paid out to Averna should be based on the gross margin indicated by Averna in its proposal and on its average annual profit before taxes for the years 2004 and 2005.

9. PWGSC also submitted that the compensation paid out to Averna should be based on the fact that only two of the three years of the contract were authorized. It stated that, even if the contract had been awarded to Averna, there was no guarantee that the third year of the contract would be completed.

10. In response to PWGSC's claims, Averna submitted that, actually, this contract is exceptional because additional general expenses are not involved. In other words, almost all the general expenses associated with performing this contract have already been committed and the gross margin on this contract would have directly increased Averna's net income before taxes. Averna also submitted that the amount of the compensation should be calculated according to the term of the entire contract, that is, three years, since there was no indication that the contract would not be performed as anticipated in the Request for Proposal.

ANALYSIS

11. In determining the amount of lost profit, the Tribunal relied on subparagraph 3.1.2 of the *Procurement Compensation Guidelines*,² which states the following:

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.

12. The Tribunal must first decide on the term of the contract on which to base its calculations. PWGSC indicated that the calculations should be made on the basis of two years since the Government may not authorize the third year of the contract. Averna submitted that the contract is for three years and that the calculation should be made on the basis of that period. According to the Tribunal, the contract is for three

2. Revised (June 2001).

years and, since no evidence was filed to show that the term of the contract could be shortened, the compensation should be calculated on the basis of a three-year period.

13. In order to determine the amount of lost profit associated with a designated contract, the costs of performing the contract must be subtracted from the gross revenues (that is, from chargeable expenses) associated with performing the contract. The applicable costs can be divided into two categories: direct costs and related indirect costs. Direct costs include material costs and direct labour costs. Related indirect costs include other costs associated with performance of the contract, such as a certain amortization, rent and salaries relating to supervision.³

14. The value of Averna's proposal, and thus the gross revenues that must be used to calculate lost profit, is not contested. Since the price indicated in Averna's proposal is confidential, the Tribunal cannot reveal it in this statement of reasons.

15. Averna submitted that its direct costs included only "labour" costs and that these costs represented a certain percentage (confidential) of the price indicated in its proposal. That percentage, which represents direct labour costs, is not contested by PWGSC and, when compared with the ratio of Averna's direct labour costs to its gross revenues as per its financial statements,⁴ does not seem to be understated. The Tribunal therefore accepts Averna's position in this regard.

16. PWGSC stated that the general and administrative expenses must be subtracted from the value of the contract in order to obtain the actual profit that would have been made. As indicated earlier, when calculating the lost profit associated with a designated contract, the related indirect costs must be subtracted from the gross revenues, that is, those associated with the contract. Averna stated that, with regard to the designated contract that is the subject of the complaint, it had already committed funds or had already made payments relating to the general expenses associated with the project and that, therefore, it was not appropriate to subtract amounts from gross revenues other than the amount that represented direct labour costs.

17. According to PWGSC, the amount that Averna would have received in exchange for performing the contract would have been used not only to cover the expenses relating to the contract but also to cover the general and administrative expenses. Thus, being awarded the contract would have allowed Averna to cover some of its general and administrative expenses once the direct costs and the indirect costs associated with the contract had been paid.

18. However, according to the Tribunal, if it accepted PWGSC's position that the amount of compensation should be calculated by subtracting from gross revenues not only direct and indirect costs associated with the contract but also the part of those gross revenues that could be used to cover general and administrative expenses, the remaining amount would not be enough to cover the general and administrative expenses. Since the object of compensation is to place the complainant in the position in which it would have been, but for the Government's breach, according to the Tribunal, it seems proper to grant an amount that will allow Averna to cover some of its general and administrative expenses, just as Averna could have done if it had been awarded the contract. Consequently, the Tribunal is of the opinion that, in determining the amount of compensation, it is not appropriate to subtract an amount for general and administrative

3. *Re Complaint Filed by CSI Consulting Inc.* (22 March 2006), PR-2003-070 (CITT) at 6.

4. Averna's financial statements received by the Tribunal on May 15, 2006, at 22 [Averna's financial statements].

expenses from gross revenues when the expenses are not associated with performance of the designated contract that is the subject of the complaint.⁵

19. PWGSC stated that a review of Averna's financial statements reveals that an increase in revenue leads to an increase in general and administrative expenses. According to the Tribunal, where being awarded a given contract would have actually led to an increase in general and administrative expenses, it is appropriate to subtract from the revenues the amount of that increase when calculating lost profit.

20. In response to PWGSC's argument, Averna stated that its general and administrative expenses increased on the basis of its sales predictions, not on the basis of its actual sales. It indicated that a growing company such as Averna must speculate on future revenues and commit funds in anticipation of its growth. It states that certain factors, such as a training period for new personnel in sales and operations management, the high costs associated with long-term commitments of its work environment and the tight delivery deadlines required by its clients, in large part, account for its corporate structure and its planning and long-term permanent-commitment processes.

21. The Tribunal is satisfied with Averna's explanations of its management practices and the changes in its general and administrative expenses. Furthermore, Averna's financial statements confirm its explanations, in that they show that the ratio of general and administrative expenses to gross revenues can vary substantially.⁶

22. Averna stated that it had sufficient physical facilities to undertake the project without incurring additional costs and that it had a sufficiently large administrative and commercial team that represented a level of occupancy below 100 percent, which enabled it to undertake the project without incurring additional costs in this regard. The Tribunal notes that this statement is supported by the substantial increase in the ratio of general and administrative expenses to gross revenues between 2004 and 2005.⁷ This progression is consistent with Averna's assertion concerning the availability of its resources to perform the contract without incurring additional costs. The Tribunal therefore accepts Averna's statement.

23. In light of the foregoing, it is appropriate to compensate Averna as it has requested. PWGSC states however that Averna itself, in the financial section of the proposal that it filed in response to the Request for Proposal, indicates a gross margin that is much lower than the amount that it now claims. The Tribunal notes that the price for each of the elements of the financial section of the proposal (e.g. the price for developing each of the 27 systems described in the Request for Proposal) could also include an element of profit and that, therefore, the separate line that asked bidders to indicate the gross margin on the contract does not necessarily reflect the actual profit from the contract. Thus, the Tribunal is of the opinion that the determination of Averna's lost profit resulting from not being awarded a contract must be made according to the method that the Tribunal used earlier, in light of the facts in this case.

24. Consequently, the Tribunal is of the opinion that the amount of lost profit must be determined, in the present case and in light of the evidence on file, by subtracting Averna's direct labour costs from the gross revenues that it would have made if it had been awarded the designated contract that is the subject of the complaint. The calculated amount is \$279,734.80.

5. *Re Complaint Filed by Ready John Inc.* (23 August 2005), PR-2003-005R (CITT) at v-vi.

6. Averna's financial statements at 22-23.

7. *Ibid.*

CONCLUSION

25. The Tribunal awards Averna costs in the amount of \$2,400 for preparing and proceeding with the complaint and directs PWGSC to take appropriate action to ensure prompt payment.

26. The Tribunal hereby recommends that PWGSC compensate Averna in the amount of \$279,734.80 for the profit that it could have made if it had been awarded the designated contract that was the subject of the complaint.

Pierre Gosselin
Pierre Gosselin
Presiding Member