

A Tale of Two Contracts, Or, how to minimize the risk of forming an employment contract while acquiring goods, services or construction

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If the following story has you reaching to brush the dust off of a contract you established long ago (or perhaps more recently...), you may not be alone. Across town, your contractor might be doing the same thing, and for entirely the same reason. But, it might not have to be this way. This article looks at what procurement and employment relationships mean and what can be done to minimize or mitigate the risk of an employment relationship forming under what began as a procurement contract, both before it is signed and while the ink is still relatively fresh.

George was well-liked by his colleagues, and had worked hard over the past ten (10) years. From April to October every year, George worked in the field surveying and cataloguing a variety of items of interest to the department. His work began on schedule each spring, with George setting off across the country in the ministry car – not only was he able to get to each work site in a timely manner to complete the work, but the bright logos and word mark on the vehicle enhanced visibility of the ministry's mandate and activities in the communities he visited. Late one afternoon as George set off back to the car, making some final notes with his ministry pen on his logo-covered clipboard, he tripped and fell into the ravine that ran alongside the road. He was not discovered until some time later that evening. As a result of his fall, George was unfortunately unable to continue his survey work. His partner submitted a request for long-term disability to the new manager at the ministry, and was informed that, despite years of dedicated service, George was ineligible for coverage under the public service plan. Some time ago, the ministry had established a multi-year contract with George to provide his annual surveying service. As this came as somewhat

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of a surprise, his partner requested a ruling on the status of George's working relationship with the ministry. Despite the existence of a signed procurement contract, based on an examination of the relationship, the investigation determined that George had been treated as, and was thus in fact, an employee. George and his partner received the much-needed benefits, and the ministry was fined for the un-remitted EI² and CPP³ (plus interest) for the ten (10) years of George's services.

The establishment of a procurement contract support the delivery of any government program or service, is a valid option to obtain the goods, services or construction required to design, develop, implement, maintain, and/or evaluate any short-term initiative or aid in on-going operations. Building internal capacity through staffing can be equally effective. Therefore, prior to initiating any procurement or staffing process government managers must think long and hard about the "make or buy" decision – whether it is most advantageous to develop capacity or products internally to support long-term delivery, or whether a suitable product or service exists in the marketplace that could bring greater benefits to the department than efforts undertaken within.

In some cases, individual projects require access to specialized areas of expertise that are not available through resources already in-house, and for which a staff position does not exist; necessitating access to external contractors to fill the requirement. This may be in support of short-term initiatives, such as a study or assessment; or a concrete piece of development work to enable ongoing delivery or maintenance of a solution by the buying organization. Other operational requirements may be longer term, requiring the deployment of significant levels of resources not available internally; and the decision may be made to outsource an entire operation with the government organization responsible for the delivery of a service to Canadians, through a Contractor.

Like many private sector industries, government departments are also feeling the squeeze from reduced numbers of internal resources due to the demographic shift in the composition of public service membership and increasing numbers of retirements among "Baby Boomers" and "Busters". Coupled with smaller staffing budgets, contracting out for the services of experienced and qualified resources under temporary help or other competitive services contracting arrangements has become a common, practical and valid means for filling short term needs while allowing the time for longer-term solutions to be implemented.

Due to the nature of the work, independent contractors may work in collaboration with and sometimes alongside public service employees to achieve shared objectives and outcomes. Contractors may even, in some cases, be doing ostensibly the same type of work as individuals who operate under a very different type of contract. As George's story shows however, when the line between the buyer and the seller becomes blurred and the Contractor-Client arrangement takes on the form of an Employer-Employee relationship, difficulties can arise for both parties.

A procurement contract is defined as a "contract for service" or business arrangement, whether short or long-term, entered into to complete specific work in exchange for payment. In contrast, an employment

² Employment Insurance.

³ Canada Pension Plan.

contract is a “contract of service” – a relationship, whether short or long-term, entered into to complete specific work in return for payment. Both are governed by the same principles of contract law (MOR 2000; HRSDC 2006). And in those two (2) small words, perhaps lies the potential for the confusion and the risk that one may become the other, whether it was originally intended that way or not. Procurement contracts for services may need to be entered into for a variety of reasons. This in and of itself is not a “bad thing”, and can in fact, in the right circumstances, be quite beneficial to all parties (buyer, seller and the Canadian taxpayer) when contracting is aimed at achieving best value (s 16.1.5 TBS, 2003a).

However, Contracting Policy (s. 4.1.9) requires buying organizations to: “ensure that an employer-employee relationship will not result when contracting for the services of individuals in accordance with criteria established by the Canada Customs and Revenue Agency and pertinent court rulings” (TBS 2003b). Under the policy, the accountability to ensure this will not and does not occur, rests with the Contracting Authority; or the individual within the buying organization whose role it is to establish and administer the contract. One would think then that mitigating the risk of the formation of Employer- Employee relationships would be no more than ensuring the right clauses and conditions are included within the contract.

It is not only what is on paper, however, that determines the status of a relationship and the accountabilities of each party to it, but also how the paper relationship is managed in practice.

The responsibility for establishing and managing contracts in many federal buying organizations is often divided between the Contracting Authority and the Project or Technical Authority who needs the work to be completed. This division of responsibilities may be true of both contracts for discrete projects and in the case of anticipatory contracting mechanisms such as Standing Offer Agreements (SOAs) or Supply Arrangements (SAs); where in many departments and agencies the mechanism is “owned” and call-ups issued by a central Contracting Authority, but day-to-day interaction with the Contractor is handled by the Project or Technical Authority.

While the Contracting Authority develops the contract terms and conditions, runs any competition, and establishes and manages the contractual aspects of the agreement with an external contractor, it is often the latter Authority who develops the Statement of Work for the contract, acts as the day-to-day contact with the Contractor for the work being undertaken, and who may review and accept the Contractor’s deliverables and services. In some cases these individuals may even be located within separate branches of the organization, or in a different region of the country. Both roles interacting with a Contractor can pose a risk of forming an Employer-Employee relationship. While these management arrangements can be practical and highly effective from an operational viewpoint, where the ultimate accountability lies with the Contracting Authority to mitigate the formation of these risky relationships, the division of contract management can mean that by the time the accountable party becomes aware of any potential and unintended employment issue within a procurement contract, it may already be too late.

This risk appears relatively reduced in procurement contracts for the

acquisition of goods or construction purchased to support government activities. These contract relationships appear fairly well defined, with a relatively low risk of negative financial or legal consequences to the buyer if the product or work is delivered. In most cases under these types of procurement contracts, the Contractor delivers the high-tech system or builds the bridge; the work is inspected by the buyer; accepted (or corrections required, and made by the Contractor prior to acceptance); the Contractor is paid and moves on to the next order or job. The greatest potential for longer term or day to day interaction with contractors to undertake necessary planning, updates, review and approval activities, and thus, a greater risk for an employer-employee relationship to form unknowingly, appears then to be in the acquisition of services.

Despite neither party to the Contractor-Client relationship intending for it to transform into an “Employer- Employee”, it is a risk, and is perceived to be a significant one, when government (or any) buyers establish contracts for services. The perception of risk is heightened when contracting for the services of individuals (versus teams of contractors or entire companies). The alarm bells start ringing more urgently when contracting for professional services, typically requiring the services of specific specialized individuals, and even more so when establishing contracts for the services of a former public servant – someone who has made the switch from being an employee to being an independent contractor.

There are several well-used tests established by courts and tribunals to determine the status of contractual relationships. The difference between an employee and an independent contractor may be summed up in the following four (4) principles. Each of these principles should be examined individually, but together they combine for a full assessment of whether an existing relationship is better defined as Employer-Employee or Contractor-Client:

- a) **Control over the work** – who determines not only what has to be done, but also how?
- b) **Equipment and tools** – who provides, maintains, and retains them?
- c) **Integration** – is the work integral to the organization’s overall service delivery responsibility, or is the person providing the work integral to the organization’s processes and environment?
- d) **Financial Independence** – who benefits from and who carries the financial risk? (CRA 2006; HRSDC 2006; MOR 2000).

Depending upon the specific context of the contract and the relationship, when one, some, or all of the above may be answered by “the buyer”, chances are the procurement contract has already become an employment contract. But it might not have to be this way. If there is an awareness among both parties about the potential for this change in status to occur, and a means to distinguish one from the other once it has already happened, there must be something that can be done to minimize or mitigate the risk of an employment relationship forming under what began as a procurement contract, before it is signed and while the ink is still fresh.

Start off on the right foot

The following practices are suggested to help reduce the risk of an employer-employee relationship forming under a procurement contract,

by addressing one (1) or more of the four (4) above principles that help define these relationships.

1. State the Intent of the Contractual Relationship up front: CRA (2006) notes that, the usual first step in determining the status of parties within a contractual relationship is to examine the intent of the parties when it was established. This includes an assessment as to whether the intent of the contractual arrangement was clearly known to both parties, and whether it was held in common. One means to support this clear and common understanding is to ensure it forms an integral part of the contract documents themselves. Most government contracts include some variation on a standard clause, which identifies that the Contractor is not an employee of the government and that the Contractor is responsible for its own deductions and remittances (PWGSC, 2008). Including the resulting contract terms and conditions as part of any competitive.

Request for Proposals can highlight this (and other) intentions of the buying organization with respect to the resulting relationship, and provides for transparency of contract terms in the competitive procurement process. In submitting a Proposal, the resulting Contractor is identifying that he or she has read and understands the terms of the contract – a common understanding.

2. Establish Fixed Price Contracts, where possible: As noted above, one of the defining characteristics of the status of a Contractor- Client relationship is the existence of both the opportunity for profit and the risk of loss on the part of the Contractor (CRA, 2006; MOR, 2000). In an employment relationship, individuals are sheltered to a much greater degree from the vagaries of the marketplace than is an independent consultant. For an employee, if business is good, the employee receives his or her salary and benefits. If business is less favorable the next year, notwithstanding a grave economic crisis, the employee should receive their same salary and benefits as stipulated in the employment agreement between the employer and the individual. Contractors, however, are more exposed to the whims of the marketplace, and in engaging in their work, to the opportunity for profit. This is one key component of performance-based contracting – in submitting its Proposal or undertaking the work, the Contractor promises the ability to deliver outcomes and end products or services that will meet the client's objectives, as established in the contract. To support achieving this outcome and simultaneously mitigating the risk of an employer-employee relationship forming, a fixed price should be established for the work. In contrast to a per diem or time-based basis of payment, which could be viewed as establishing a salary payable for on-going work more suited to an employment relationship; a fixed price is payable only upon the delivery of a specific piece of the work.

Under this basis of payment, the government buyer may have more assurance that the costs associated with the completion of the specified deliverables will not be subject to any future escalation. This basis of payment also places maximum accountability on the contractor to control the cost of the work, and thus how the work is to be done (OAG 1996; PWGSC 2006).

While a fixed price may be seen as the best means to set up the contract

basis of payment to mitigate the risk of an employment relationship, it may not always be possible. For example, in multi-phased projects where the scope and timing of subsequent phases may depend on the outcomes of the first phase, a fixed price may not be realistic, or could actually serve to inflate costs when it is established in order to cover future unknowns; or where contracts are placed to provide day-to-day operational-type services over the short term, specific deliverables may not be defined in the contract.

Contracts based on time rates are therefore entirely appropriate for specific types of services, they just require a different type of management by the buyer to achieve results and maintain the Contractor-Client relationship status.

3. Establish a sound Statement of Work, and let both parties work to it: In best practice, a Statement of Work defines the scope of a Contractor's engagement and what the outputs or outcomes will be, but remains relatively silent on how the work is to be conducted. This silence on the part of the buyer is intended to be filled by the Contractor's Proposal, which should detail the methods that will be undertaken to achieve the outcomes and provide the deliverables required; and by the work of the Contractor once the contract is in place. While some requirements may need a greater degree of specificity by the buyer in relation to "how", such as the use of specific recognized methodologies, techniques or tools (for example to ensure congruency to departmental standards or other components of related work under a project), buyers should refrain from over specifying approaches, methodologies and tools to be used, as there should still be something unique, specialized or innovative the Contractor is bringing to the table in terms of how the work will be conducted that provides for value under the contract.

This approach and methodology can also be a critical aspect of what differentiates one supplier from another in a competitive procurement process and can provide for an effective evaluation criterion to select the Contractor that provides best value. A complementary approach within the Statement of Work might also be to include a formal Service Level Agreement (SLA), which can, if appropriate to the work, also be tied to financial holdbacks, or incentives. Under such an SLA, the Contractor retains ultimate accountability for results and maintains the potential for risk of profit or loss, as he or she may have to forego the profit on the contract in full if the outcome is not delivered.

While a limited Statement of Work and a Service Level Agreement may be best targeted for discrete contracts or one-off projects to which a Contractor can propose a solution, this does not necessarily mean that less defined contracts need to be un-scoped. For anticipatory contracting mechanisms, such as SOAs or SAs, which are typically established with time rates, each Call-up or Task forms a separate contract. Where possible, the Project Authority should meet with the Contractor at the outset of each Call-up or Task to fully scope out the work and enable him or her to provide a Proposal, including approach and (potentially fixed) price.

If the work is already under way in the absence of such a defined framework, one possible method of enhancing the Contractor's accountability for results is to request, as a paid deliverable, the development of a Work Plan, to be developed by the Contractor; that lays

out the specific deliverables or milestones the buyer can expect to receive as the work progresses. Outcomes achieved can then be measured against the Work Plan, helping the Project Authority (the buyer) to maintain his/her right to exercise control over the end result of the product / service, and the Contractor to maintain control over how the work is completed.

4. Watch whose pen is used, but not too closely: The buyer sometimes needs to provide resources, specialized tools or equipment to enable the Contractor to complete his or her work. While our story's protagonist used relatively simple tools, reflective of the type of services he was providing, in some cases buyers might need to provide access to specialized software, systems, raw materials for manufacturing or testing, or background materials or even components of documentation that is being developed under a contract.

On the Contractor's side, much work has been completed by government, which could contribute valuable background to support current undertakings. Resources such as previous studies, reports and other materials can not only support the planning and conduct of contracted work to meet the established contract objectives, in some cases essential components of the work may have already been completed, whether internally or under previous contracts. Where it is possible to share these earlier results and developments with the Contractor, it can reduce or mitigate the potential for re-work, and support the achievement of the primary objective of contracting – Best Value to the Crown and the Canadian people (s.1 TBS, 2003b).

Where possible, the buyer should document any available and needed resources in advance within the Statement of Work – both the tools and resources the government can commit to providing, and those that the Contractor will be required to supply. Where contracts are already under way, managers can work with the Contractor at the planning and scoping stages of projects or service delivery, and at milestones in the work, to identify what resources are required that may already be in existence. In most contracts, the primary location of work should be the Contractor's own premises, however in some cases there are valid operational or security requirements necessitating the buying organization to provide the space in which the work will take place. When contracted resources need to work on site to access needed resources or, to support a day-to-day operational function, the buyer should avoid "hands-on" oversight and direction which can lead unintentionally to a transfer of control over how the work is done. Instead, formal review of deliverables should take place at identified milestones in the contract or the project. "Hands-off" management applies equally to the Contractor – the buyer should not ask the Contractor to supervise the work of organizational employees.

As noted above, although ownership and maintenance of tools can be a factor in determining whether an employment relationship exists, it is not the only factor (MOR, 2000). But the point is, if it drives like an employee, it might be one.

In a similar vein, Contractors should provide their own business cards and where required and where possible, their own phone access, and not be listed in an organization's directory unless he or she is clearly identified as a Contractor.

If a Contractor is working on site or when attending meetings, it is

reasonable to greet the Contractor politely and even warmly, and treat him or her with the same respect as one would an employee.

While George's unfortunate story ended up with a supportive outcome for George and his family, if not for the manager left answering pointed questions from his ministry, being dubbed an "employee" is most often neither intended nor desired by either party in what was originally established as a Contractor-Client relationship. Investigations into the status of working relationships can be initiated by the buyer (government) or the seller (Contractor) or may come about through random audit activities. While government managers are largely aware of the impacts of such a ruling on their departments' budgets; it is important to note that the impact on the Contractor's side is also not necessarily positive. Being "turned" suddenly into an employee can result in unforeseen tax complications and may also lead to great difficulty in establishing future contracts for his or her business.

The risk of transition of a Contractor- Client relationship to Employer-Employee status has true concerns for both parties, which need to be respected. However, all of this is not to say that cordial and professional business relationships cannot be established with contractors. Sound management, as applied to every project, program and service, can be equally applied to the contracts through which they are delivered; and with both parties to the procurement contract relationship having common understanding, intent and interest in maintaining its status, the risk of forming an Employer-Employee relationship can be, if not eliminated, mitigated.

For more information on mitigating the risk of Employer-Employee relationships during the development or at the outset of your contracting arrangements, speak with your Contracting Authority and review your contract's Statement of Work looking for enforceability and management of performance-work processes. Should you have any concerns regarding the status of one of your organization's current relationships with a contracted party, contact your internal Human Resources representative, Human Resources and Social Development Canada, or your organization's legal services for a context-based analysis.

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