IMLA

Municipal Lawyer

THE JOURNAL OF LOCAL GOVERNMENT LAW

NOV DEC 2023
VOL.64
NO.06

Extern! Extern! Read All About Them!

Law schools want to place them, law students seek the opportunity, and local government law offices can benefit.



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INFRASTRUCTURE

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Canadian Municipal Infrastructure – A Construction Law Perspective

One of the many hats Canadian municipalities wear is that of a builder. Statistics Canada reports that in 2022, municipalities nationwide were collectively responsible for 56% of public investments in infrastructure construction. Provincial governments, collectively, follow at a distant second place with 40% of the investments. In other words, when a Canadian uses any piece of public physical infrastructure – whether a park, highway or water system – there is a greater chance than not that it was built by a municipality.

As Canada's most prolific builders of public infrastructure, municipalities frequently have to contend with legal issues and disputes about construction projects. These legal issues are what this article is about, but Canadian construction law is expansive and attempting a general overview would be meaningless. Instead, this article attempts to provide a selective, "by the slice" flavour of the subject by discussing certain construction law considerations unique to municipalities or Canadian law.

The discussion below is divided into three parts, following the significant phases of a typical infrastructure project – procurement, contracting, and construction.

I. Procurement

Procurement is an area of law where Canadian municipalities are subject to a legal regime significantly different than that in the United States. Municipalities are subject to various domestic and international trade agreements that Canada and its provinces have entered into, e.g., the Canadian Free Trade Agreement (CFTA), a domestic trade agreement that aims to reduce barriers to trade within Canada.

Obligations under trade agreements kick in early in the life of an infrastructure project when the decision to procure construction services is made. Under the obligation to provide "open, transparent, and non-discriminatory access" to procurement (Article 502(1) of the CFTA), municipalities must select their suppliers through an open procurement process when the value is above a certain threshold (for construction, the threshold amount is $302,900 as of 2023 under the CFTA).

Sometimes, a municipality may wish to purchase construction-related services an existing relationship with a builder known to perform good work at a reasonable price. "Sole-sourcing" such work to the said builder is clearly a no-go under the trade agreements. Instead, the municipality must first assess if the estimated purchase amount exceeds the applicable threshold amounts set out in the trade agreements. If yes, and provided no exception applies, the municipality must follow an open procurement process in which the favoured provider may or may not succeed.

While violations of trade agreements are intended to be challenged through special dispute resolution mechanisms outside Canada's system of constitutional courts, bidders have creatively leveraged the trade agreements to obtain remedies through constitutional courts too. This was recently illustrated in *Thales DIS Canada Inc. v. Ontario*, 2022 ONSC 3166, in which an unsuccessful bidder alleged that the selection criteria established by a public purchaser breached national and international trade agreements. Exercising its jurisdiction under administrative law principles, the Ontario Supreme Court quashed the procurement decision and awarded costs to the challenger after concluding that the purchaser's decision was unreasonable.

However, trade agreements are not all that the Canadian municipal purchaser (or their lawyer) must worry about during the procurement stage. Once bids or proposals are received in response to a market call, the purchaser must contend with certain obligations concerning evaluation and selection arising from the landmark Supreme Court of Canada decision in *The Queen (Ont.) v. Ron Engineering*, 1981 CanLII 17.

The central teaching of *Ron Engineering* is that once a purchaser receives a valid bid, the purchaser owes a quasi-contractual duty to the bidder to act fairly. Particularly, a purchaser is prohibited from disqualifying a valid bid or evaluating a bid based on undisclosed criteria. Further, once a bidder is ranked the highest based on published criteria (price-based or otherwise), the purchaser must award the contract to that bidder.

This duty to award the contract to the highest-ranked bidder was at issue in *2708266 Ontario Inc. v The City of Toronto, 2022 ONSC 6315*. After receiving bids in response to a request for tenders (RFT) for sewer construction, the municipality disqualified the lowest bidder based on its opinion that the bidder did not meet minimum experience requirements. The bidder challenged the decision. The Court found that the

municipality's interpretation of the experience requirement in the RFT was unreasonable and, accordingly, the municipality had breached its duty under *Ron Engineering* to enter into a contract with this bidder.

Ron Engineering is now more than 50 years old, but the trade agreements are of much recent vintage, so the law governing municipal procurement in Canada is still actively evolving.

II. Contracting

In the days of *Ron Engineering*, most municipal construction in Canada was being performed using the traditional, lowest-price tendering process. While this process has limitations, an advantage is that the contracting that follows selection is straightforward because the contract terms are outlined in the call for tenders and are non-negotiable. However, recent decades have seen a marked expansion in the range of tendering, contracting and delivery methods used by Canadian municipalities. The traditional approach to lowest-price tendering has been replaced to a great extent by qualifications-based selection, and the traditional design-bid-build approach to execution now shares ground with approaches such as design-build and integrated project delivery (IPD).

This wider range of options makes selecting contract provisions a relatively daunting task for municipal project owners. Drafting project-specific contract terms is generally uneconomical or burdensome except for large or complex projects, so municipalities tend to use one of the several form contracts prevalent in the construction industry. The most common set of form contracts in Canadian construction are those published by the Canadian Construction Documents Committee (CCDC). Similar to the form contracts provided by the American Institute of Architects or the Engineers Joint Contract Documents Committee in the United States, CCDC has published a range of forms for different construction contract types; for example, CCDC-2 for stipulated price contracts and CCDC-14 for design-build agreements.

A common refrain among municipal buyers is that CCDC contracts are biased in favour of contractors, which this author agrees is the case. Accordingly, from the municipal perspective, CCDC form contracts nearly always require modifications through supplementary conditions. For example, municipalities typically prefer having firm and enforceable completion dates associated with their construction contracts, but the CCDC-2 form contract contains no liquidated damages provisions.

Thus, despite standard form contracts being widely adopted in Canada, municipal purchasers approach these forms cautiously, as using them without modification could cause prejudice to the owner-municipality. This risk was recently underscored in *Seagate v. Halifax Regional Municipality*, 2023 NSSC 176, which pertained to a facility for which the municipality and contractor entered into a CCDC-2 standard form agreement. The municipality expected the contractor to be responsible for code compliance of the facility and, when provincial regulators shut the project down for non-compliance, refused to pay a portion of the contract price to the contractor who sued. The court found in favour of the contractor, primarily relying on provisions within the CCDC-2 form contract that lessened the contractor's liability for design issues.

III. Issues during construction

The construction phase is undoubtedly where most legal disputes arise on municipal infrastructure projects. The discussion below will selectively focus on three legal concerns unique to municipalities or the Canadian context during construction – builders' liens, payment issues and independence of the payment certifier.

Under Canadian law, municipal property (with narrow exceptions) is lienable if the head contractor is not paid for work performed on the property or the head contractor fails to pay its subcontractors. This is different than some states in the United States, where courts have found that, without express statutory intent otherwise, liens cannot be filed against property owned by municipalities under principles of sovereign immunity.

Contractors' and subcontractors' rights to file liens arise under builders' lien legislation, which each province in Canada has adopted in some form. Municipalities, which typically own the land on which public infrastructure is built, thus face the risk of such liens being placed on their property. Interestingly, the most significant risk to municipalities arises from procedural requirements in lien legislation rather than substantive aspects. Regardless of the merits of the claim, an owner can be prejudiced by not strictly following the formal requirements of the lien process.

This was illustrated in *Loedel v. Swanky*, 1992 CanLII 1504 (BCSC), which pertained to a lien on lands owned by the City of Prince George in British Columbia. The City could have, under the applicable lien legislation, limited its liability by posting a written notice on the lands but failed to do so. This failure resulted in the court refusing to relieve the City of its lien-related liability. The author's anecdotal experience is that such procedural liability often arises because contract administrators or project managers for municipalities are well-qualified in building-related trades but do not have a comparable understanding or experience with lien and associated legal procedures.

The second source of legal risk during the construction phase arises from payment-related issues. Under typical construction contracts, municipalities make payments to contractors in the form of progress payments; i.e., as the work progresses, the municipality periodically pays the contractor for work *after* the work has been performed. However, in rare situations, the municipality may be requested to make an advance payment to the

Continued on page 35



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contractor.

Such situations are highly risk-prone for the municipality, and such advance payments are best avoided. Yet, occasionally, the reasons to make such advances are compelling; for example, the contractor is short of operating capital, threatening to delay project execution. The principal risks arising from advance payments are (a) potential loss of coverage under performance bonds and (b) increased liability under builder's lien legislation.

Legal risk related to performance bonds arises out of a legal quirk involving sureties: If advances are made to a contractor contrary to the terms of the construction contract, courts have found that the surety is relieved from its obligations. This situation was seen in *Town of Mulgrave v. Simcoe and Erie General Insurance Co.*, 1977 CanLII 1813 (NSCA), where the Town entered into a contract for a contractor to construct a water system. At some point, money was advanced to the contractor by the Town. When the contractor later defaulted and the Town invoked the performance bond, the surety refused to perform on the grounds that the advance payment by the Town released the surety from its obligation. The court agreed, and dismissed the Town's claim.

Advance payments sometimes result in lien-related liability when municipalities advance such payments without retaining the statutory holdback. If a lien is subsequently filed, the municipality risks having to pay this amount out of pocket to release the lien. This risk was illustrated in *Iberdrola Energy Projects Canada Corporation v Factory Sales & Engineering Inc. d.b.a. FSE Energy*, 2017 BCSC 1776, rev'd in part 2018 BCCA 272. In *Iberdrola*, the contractor encountered financial difficulties and, to complete the project, the owner agreed to make advance payments to subcontractors. The owner failed to retain holdback on these advance payments. Ultimately, the contractor abandoned the project, and in action between the owner and subcontractors, the advance paid by the owner came into issue. The court found that, under lien legislation, the advances were still payments made under the contract and, thus, the owner should have retained holdback on the advances. By not retaining holdback, the owner faced higher liabilities than it would have otherwise.

Finally, let us look at another source of liability for municipal owners arising from a common law principle unique to Canada – the duty of independence of the payment certifier. (The term 'payment certifier' is used here to generally mean the person or entity who verifies, on behalf of the owner, what progress payment is owed to a contractor; other prevalent terms for this person or entity are 'consultant' (see CCDC-2) or simply 'engineer' or 'architect'.) In addition to the payment-certifying function, payment certifiers are typically also required to render a decision when a dispute arises between the owner and contractor about a contract term. Because the payment certifier is paid by the owner (and is sometimes an employee of the owner), there is an inherent conflict of interest when the payment certifier acts in the role of judging a contract dispute.

This conflict of interest has been subject to treatment by a line of cases in Canada that have adopted the decision in the English case of *Hickman & Co. v Roberts* (1913) AC 229. In *Hickman*, the payment certifier failed to issue a certificate of payment for work adequately completed by the contractor because the owner (i.e., the payment certifier's client) would not allow it. The House of Lords held that the payment certifier had a duty of independence and had improperly allowed the owners to influence him.

The principle from *Hickman* and its Canadian progeny is essentially that a payment certifier, though otherwise loyal to the owner, is obligated to act objectively when providing an opinion on a contractual dispute between owner and contractor; their decision must be based on relevant facts and not influenced by extraneous factors (see, e.g., *Welcon (1976) Limited v. South River (Town)*, 2009 NLCA 59, leave to appeal denied 2010 CanLII 17169 (SCC)).

The other side of the *Hickman* rule is that if a payment certifier properly approves an invoice, the owner is obligated to pay the contractor, and failure to do so could result in liability. In *JCR Construction Ltd. v. Colwood (City)*, [1991] B.C.J. No. 3218, the municipality (i.e., the project owner) refused to make a progress payment that had been certified by the architect. The court found that the contract was clear that payment became due once payment was certified, and the municipality had breached its contractual obligation to pay.

To conclude, Canadian municipalities must continuously deal with construction-related legal risks because building and upkeeping infrastructure is an inalienable part of what municipalities do. To some extent, municipalities must contend with the same legal considerations that any other project owner – public or private – must contend with, whether in Canada or elsewhere. However, some legal considerations apply especially to municipalities in Canada because of their municipal status or because of rules unique to Canadian law. Examples are the duty of open procurement that arises under trade agreements and the payment certifier's duty of independence. ML