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LOCAL GOVERNMENT CONTRACTING: COMMON PITFALLS

NOVEMBER 25, 2021

Joseph Scafe

WWW.YOUNGANDERSON.CA

1616 - 808 Nelson Street, Box 12147 Nelson Square, Vancouver, BC V6Z 2H2 | tel: 604.689.7400 | fax: 604.689.3444 | toll free: 1.800.665.3540
201 - 1456 St. Paul Street, Kelowna, BC V1Y 2E6 | tel: 250.712.1130 | fax: 250.712.1180

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I. INTRODUCTION

One of the key powers granted to local governments under the *Community Charter* and the *Local Government Act* is the power to contract. However, local governments are not free to contract in the same way as a business corporation or an individual. The power is subject to various conditions and limitations which if not observed may render a contract void or result in liability. The following is a discussion of some of the most important things to consider prior to a local government signing an agreement.

II. HAS COUNCIL APPROVED THE AGREEMENT?

Municipalities and regional districts are corporations, the operating minds, or governing bodies, of which are the municipal council and the regional board. Every action taken by a local government must be authorized by its governing body. Councils and boards exercise their powers by passing resolutions and adopting bylaws. By extension, every agreement a local government enters into must be authorized by a resolution or bylaw of the council or board.

A. Delegation and Purchasing Policies

Legally, every contract a local government enters into must be authorized by the governing body. In practice, councils and boards do not pass resolutions authorizing the purchase of office supplies or even requests for legal advice. Nonetheless, these actions are invalid unless authorized by the governing body. The authority for such actions is properly contained within a delegation bylaw under section 154 of the *Community Charter* or 229 of the *Local Government Act*. A delegation bylaw delegates to staff, subject to limitations set out in the bylaw, the authority to enter the local government into contracts.

Purchasing policies are different. Purchasing policies are passed by resolution. Properly conceived, purchasing policies are intended to guide staff in exercising the contracting powers delegated to them by bylaw. Purchasing policies that purport to authorize staff to enter into contracts are of questionable legality. They represent an attempt by resolution alone to delegate the power to contract. When the authorizing statute grants the power to delegate by bylaw, it is unlikely that the same power can be effectively authorized by resolution.

B. Open vs. *In Camera*

In most cases a resolution authorizing a local government to enter into a contract must be passed in a meeting open to the public. Section 90 of the *Community Charter* sets out the circumstances in which a local government may close a meeting to the public. If the matter can be characterized as falling within these circumstances, consideration of the matter and even a resolution authorizing the local government to enter into a contract may be passed in the closed meeting. Otherwise, the contract must be considered and authorized within public view.

A few of the circumstances in section 90 bear a closer look. Under section 90(1)(e), a meeting may be closed to the public if the local government will consider the acquisition, disposition or expropriation of land or improvements if the local government considers that disclosure could reasonably be expected to harm the interests of the municipality. It is likely that a local government may rely on this subsection to authorize a binding offer to purchase property in a closed meeting if it wanted the amount of its bid to remain confidential until bid opening.

Under section 90(1)(i), council may close a meeting to the public to consider legal advice. Local governments routinely receive legal advice related to the acquisition or disposition of land or improvements or the purchase of services. However, it is likely that this particular subsection only applies to allow council to consider the legal advice related to the proposed transaction. It is unlikely that a meeting can remain closed while council considers the business terms of the contract or makes the decision to enter into the contract.

C. Invalid Authority

If a local government purports to enter into a contract without the proper authority, either because the contract was not authorized by its governing body or the authorization was improperly made during a closed meeting, the contract may be set aside. The contract will be considered to have never existed. While this means that the local government will not be subject to a breach of contract claim, if the contract has been partly performed the other party may nonetheless be entitled to compensation. In any event, it will leave the parties in an uncertain legal position. For this reason, a local government should always confirm that the governing body has authorized the agreement before putting pen to paper.

III. PUBLIC NOTICE

Many common transactions undertaken by local governments, including the disposition of land and improvements, as well as less common ones like partnering agreements, may only be entered into after the local government publishes notice of the proposed transaction.

A. Content of the Notice

Section 26 of the *Community Charter* sets out the required content of the notice. If the municipality is offering the property to the public for acquisition, the notice must include a description of the property, the nature of the disposition and the process by which it may be acquired. Where the municipality already has an offer it is willing to accept, the notice must include a description of the land or improvements, the person to whom it is to be disposed, the nature of the proposed disposition and the consideration to be received.

With limited exceptions Regional Districts must offer land or improvements to the public. The required content of the notice is set out in section 286 of the *Local Government Act*.

B. Publication

Notice of a proposed disposition by a municipality must be published in accordance with section 94 of the *Community Charter*. The notice must be published in a newspaper that is distributed at least weekly in the municipality and the notice must be published once each week for two consecutive weeks.

This means that notices of disposition are generally published once a week for two consecutive weeks. However, if a daily newspaper is published in the municipality, the municipality could likely meet its public notice obligations by publishing the notice on a Saturday and a Sunday. Notably, this interpretation requires that a week begin on Sunday. While there is no statute that deems when a week begins, historically and biblically a week began on Sunday. Standard calendars also depict weeks beginning on Sundays. On the other hand, many people conceive the week beginning on Monday likely because it is the beginning of the work week.

C. Dispositions of Lesser Interests

The obligation to publish public notice extends beyond sales of land. Dispositions of lesser interests, including leases, easements, rights of way, covenants, options to purchase, rights of first refusal, and other interests in land are all subject to the public notice requirement. This is because the *Interpretation Act*, the definitions of which apply to the *Community Charter*, defines "land" as including any interest in land and defines "dispose" to mean "to transfer by any method and includes assign, give, sell, grant, charge, convey, bequeath, devise, lease, divest, release and agree to do any of those things."

Notably, the inclusion of "release" in the definition of "dispose" would appear to require a municipality to publish public notice whenever it discharges a covenant or a statutory right of way. In the writer's opinion, no notice is required when the covenant is a development covenant the provisions of which have been fulfilled or an obsolete statutory right of way because the municipality is not "disposing" of an interest – the instrument is spent.

D. Timing

At the latest, public notice must be published before the municipality signs the agreement. This was the finding in *Coalition for a Safer Stronger Inner City Kelowna v. Kelowna (City)*, 2007 BCSC 605, in which a community group sought to have a council resolution authorizing a lease set aside on the basis that the resolution was passed before publication of the notices. The Court held that the resolution that authorized the execution of the lease was not itself a disposition of land, it merely provided the authority for staff to sign the agreement that would dispose of the interest under the lease.

The Court did not comment on the language in section 26 that requires notice to be published of the "proposed disposition". In the writer's opinion, a council resolution authorizing the disposition indicates council's intent to dispose of property such that a notice published after such a resolution cannot be considered a notice of "proposed" disposition. On the other hand,

until the lease was signed council could have “changed its mind” by rescinding the resolution. The Court also confirmed that the obligation to publish notice of a proposed disposition does not give rise to a right to be heard in respect of the matter.

E. Notice of Assistance

Under section 24 of the *Community Charter*, a municipality must publish notice of its intention to provide assistance under an agreement. Since a municipality is prohibited from providing assistance to business, notice under this section is only required when the municipality intends to provide assistance to a society or to provide assistance to a business under a partnering agreement under section 21 of the *Community Charter*.

IV. FETTERING

A local government cannot agree to exercise its legislative or administrative powers in a manner that benefits the other party to a contract. This rule prohibits obligations to issue a permit or to adopt, or to forbear from adopting, a bylaw. It also likely prohibits an obligation on a local government to compensate the other party if the local government exercises its power in a certain way. Obligations like these are considered unlawful fetters on the local government’s obligation to exercise its legislative and administrative powers in the public interest.

A. Agreements Conditional on Regulatory Action

An agreement under which a local government agrees to sell land that is subject to a condition that the land be rezoned or that a development permit be issued is not an unlawful fettering of the local government’s powers as long as it is clear that the condition is within the sole purview of the governing body and is not influenced by the potential of the transaction completing.

That said, a local government stands to benefit financially from the transaction completing. For this reason, the courts have said that a local government must be meticulously fair in making the decision to rezone the property or issue the development permit. This means that a local government must ensure that it strictly adheres to all procedural fairness requirements, including by providing notice and an opportunity to be heard in respect of the matter and must consider the relevant planning considerations when making the decision, all the while being transparent regarding the financial impact of the transaction.

B. Language

In order to avoid a contract being declared void as an unlawful fetter, a local government should ensure that its agreements do not require it to exercise any legislative or administrative powers in a certain way, or to view a rezoning application or an application for a development permit favourably.

The language of contract of purchase and sale that is conditional on a regulatory decision of the local government should make it clear that the condition is within the sole discretion of the council or board and that the decision is not subject to or affected by the terms of the agreement.

V. THE "5 YEAR" RULE

Under section 175 of the *Community Charter*, a municipality may only incur a liability under an agreement having a term of longer than 5 years with the approval of the electors. This restriction applies to Regional Districts via section 403 of the *Local Government Act*.

The applicability of the rule in section 175 is limited by two regulations. The first is *Municipal Liabilities Regulation*. Section 6 of that regulation, and section 2 of the companion *Regional District Liabilities Regulation*, provide that approval of the electors is not required under section 175 unless the liability is of a capital nature or if it is a loan guarantee.

A. Capital Liabilities

The *Municipal Liabilities Regulation* does not define what constitutes a liability of a capital nature. However, it does provide that the terms within the regulation are to be interpreted consistently with the recommendations and guidelines issued by the Public Sector Accounting Board as authorized by The Canadian Institute of Chartered Accountants. Note that the *Regional District Liabilities Regulation* does not contain a similar provision.

The courts have not interpreted what constitutes a liability of a capital nature under the regulation. However, there is a body of case law interpreting whether for income tax purposes an expense can be considered operating and therefore deductible from revenue or whether it is a capital expenditure that cannot be deducted from income.

In *Marklib Investments II-A Ltd. v. Canada*, [1999] T.C.J. No. 716, the Tax Court considered whether the expenditures made by the taxpayer for repairs to three apartment buildings it owned were properly deductible from its income. The Court quoted the reasoning in *Atherton v. British Insulated & Helsby Cables Ltd*., a 1926 decision of the English House of Lords, in which the Court held:

> … when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.

The Court in *Marklib* then considered whether the repairs in question could be characterized as building renovations, which would be considered capital, or merely intended to maintain the present condition of the building, which would be operating expenses. Since the buildings were relatively unchanged following the repairs the Court concluded that the repairs were an operating expense which was deductible from the taxpayer's income for the year.

B. Approval-Free Liability Zone

The *Municipal Liabilities Regulation* and *Regional District Liabilities Regulation* contain specific exemptions from the obligation to obtain elector approval for liabilities that extend beyond 5 years. However, the *Municipal Liabilities Regulation* also contains an exemption of general application. Under section 7, if the annual cost of servicing the aggregate liabilities of the municipality and the proposed liability does not exceed 5% of the annual revenue collected in the previous year, as calculated in accordance with the regulation, then no elector approval is required for an agreement of longer than 5 years containing a liability of a capital nature.

C. Indemnity and Maintenance Obligations

The second regulation that limits section 175 of the *Community Charter* is the *Approval of the Electors Exemption Regulation*. That regulation provides that section 175 does not apply to an agreement under which a municipality or regional district acquires an interest or right in land as long as the obligation is to maintain the land or indemnify the grantor of the interest. Without this exemption, a local government could not, without elector approval, enter into a lease of a facility for a term longer than 5 years if the lease contained an obligation to maintain the land or building. Likewise, local governments would be unable to take statutory rights of way, covenants or easements that contain an obligation to indemnify the owner for any damage arising from the local government's activities on the land.

D. Term

The rule applies only to liabilities in agreements for longer than 5 years, or which could exceed 5 years through the exercise of rights of renewal. It is important to note that an agreement that contains a right of renewal that is within the sole discretion of the local government, and which does not by imposition of a penalty or otherwise influence the local government in its decision whether to renew, does not render the agreement subject to the rule.

VI. ASSISTANCE

Under section 24 of the *Community Charter* and 273 of the *Local Government Act*, local governments are prohibited from assisting a business, including by providing a grant, benefit or advantage, disposing of land or improvements for less than market value, lending money, guaranteeing borrowing and providing exemptions from taxes and fees.

A. What is a Business?

Business is defined in the *Community Charter* as carrying on a commercial or industrial activity or undertaking of any kind or providing professional, personal or other services for the purpose of gain or profit. It is important to note that the definition in the *Community Charter* focusses on the activity, not the form of the entity carrying it on. Accordingly, an individual carrying on the development of housing for sale or rental can be considered a business. It is also possible, but unlikely, that a court could find that a non-profit society carrying on commercial activities constitutes a business.

B. Obtaining Market Value

The prohibition against assistance to business includes any transaction in which the local government does not receive fair market value. The easiest way for a local government to ensure it has obtained market value for the purchase or sale of property is to purchase or sell the property through a public process, such as a request for proposals. Once the local government has tested the market in this way it will be very difficult, if not impossible, to establish that the property was not purchased or sold for market value.

Where the local government does not go to the market in the case of a proposed disposition of land, the local government should conduct some due diligence to satisfy itself that the disposition is for market value. The amount of due diligence required should be commensurate with the value of the transaction. For a significant transaction an appraisal of the land is recommended. For smaller transactions a local government may reasonably rely on the assessed value of the land. Where the land is not assessed, such as in the case of the sale of a roadway, a local government could value the roadway based on the assessed value of the parcel with which it will be consolidated.

VII. PRE-AWARD CONTRACTS

The foregoing are matters which should be considered prior to a local government signing a contract. However, when procuring goods or services a local government may find itself bound to a contract before signing one. This is due to the pre-award contract that in some circumstances is created between a tendering authority and each contractor participating in a tender opportunity.

A. Contract A/Contract B

This pre-award contract, known as Contract A to distinguish it from the contract for the good or service being procured, known as Contract B, is a creation of the courts. It arises when a tendering authority calls for tenders, and bidders submit bids that are compliant with the tendering authority's instructions. Conceptually, the courts have held that the call for tenders constitutes an offer by the tendering authority to enter into Contract A and a bidder's submission of a bid in compliance with the tender call constitutes acceptance of the offer thereby forming Contract A.

The terms of Contract A are made up largely of the terms of the tender documents. However, in addition to the express terms of the tender documents the courts have also implied obligations of the tendering authority into Contract A.

B. Implied Terms

Two implied terms in particular have been a consistent source of concern, consternation and liability for local governments: the implied obligation to not accept a bid that is materially non-compliant with the tender instructions and an implied obligation to treat bidders fairly and equally.

At first blush, an obligation to not accept a materially non-compliant bid does not seem particularly onerous. However, tendering authorities are often inclined to accept a materially non-compliant bid because it is the lowest bid or the only bid within its budget. In addition, bidders make errors in their bids with alarming frequency. Determining whether these errors are "material" is the job of the tendering authority. Depending on the type of error, making such a determination can be difficult. Many litigated tender cases involve allegations that the tendering authority improperly accepted a bid which contained a material error. Conversely, a tendering authority is just as likely to be sued by a bidder who alleges that its bid should not have been rejected because an error contained within it was not material.

Similarly, the obligation to treat bidders fairly seems like something a local government would do as a matter of practice. Unfortunately, the concept of fairness is subjective – what is seen as "fair" by one person may be seen as "unfair" by another. If the first person is the local government or its procurement manager and the second a judge, the difference can result in large damages awards against the local government.

C. Avoiding Liability

There are three ways to avoid liability arising from Contract A. The first is by avoiding Contract A altogether. The courts have held that the terms of Contract A are the terms of the tender documents and any implied terms not inconsistent with the tender documents. Like any contract, the formation of Contract A requires the mutual intention of the parties to form. So, a local government may include a term in its tender documents that expressly denies any intent

to enter into Contract A with any bidder. It would be difficult for a bidder to claim a Contract A exists when its existence is expressly disclaimed in the tender documents. That said, in order to avoid the creation of Contract A there must be no contrary intentions expressed in the tender documents. Tender documents that oblige bidders to submit irrevocable bids, or to supply a bid bond, imply contractual intent.

A second way of avoiding liability is to exclude particular terms of Contract A, including the implied obligations to accept only a materially compliant bid or to treat bidders fairly and equally. These obligations can be expressly disclaimed by clear language in the tender documents. For example, a tendering authority could include in its tender documents a clause that provides that the tendering authority is entitled to accept any bid, whether or not it fails to conform with the tender instructions in any respect, including in any material respect.

The third method of avoiding liability is to exclude or limit damages arising from a breach of Contract A. The courts have ruled that such clauses are enforceable but in some cases they have interpreted them narrowly. In order to avoid a narrow interpretation the clause should be clear. A less risky approach is to include a clause that limits liability to an amount that is not worth pursuing in litigation. Rather than eliminating a bidder's ability to enforce Contract A by claiming damages, the clause would limit the utility of doing so, thereby retaining contractually enforceable rights in favour of both parties – a state of affairs with which a court is less likely to interfere.

Unlike the matters discussed in this paper that call for local governments to exercise care before signing an agreement, avoiding liability in procurement requires local governments to scrutinize its tender documents before calling for tenders. Failing to do so could result in the local government inadvertently entering into a contract that restricts how it may conduct the procurement and which may result in liability.

VIII. TRADE AGREEMENTS

Local governments are also subject to another source of liability in procurement – the trade agreements. The agreements I refer to are the Canada – European Union Comprehensive Economic and Trade Agreement, the Canadian Free Trade Agreement, and the New West Partnership Trade Agreement. Despite not being signatories to them, each of these agreements is binding on local governments and requires them, generally speaking, to conduct open, transparent and non-discriminatory procurements.

A. Canada – European Union Comprehensive Economic and Trade Agreement (CETA)

The signatories to the CETA are Canada, the European Union and its member states. The CETA applies to procurements of construction services that exceed a value of $9.1 million and procurements of goods and other services that exceed a value of $365,000. The CETA requires procuring entities to conduct procurements in a transparent and impartial manner using open tendering or selective tendering and in a manner that avoids conflicts of interest and prevents

corrupt practices. Open tendering means a tender process in which bid opportunities are widely publicized, whereas selective tendering is when a tendering authority uses lists of pre-qualified bidders and distributes opportunities among them. The CETA prohibits limited tendering, which is essentially sole-sourcing, except in emergencies or in a few other limited circumstances, such as where the nature of the good being procured means that it cannot be offered by more than one bidder.

B. Canadian Free Trade Agreement (CFTA)

The signatories to the CFTA are the 10 provinces, the 3 territories and the federal government. The CFTA applies to procurements of construction services that exceed a value of $302,900 and procurements of goods and other services that exceed a value of $121,200. The CFTA requires local governments to provide open, transparent and non-discriminatory access to procurements. The CFTA contains an express prohibition on local preferences – the practice of preferring local suppliers over the lowest bid when the local supplier is within a specified range of the lowest bid. Like the CETA, certain procurements are exempt from the CFTA, including financial services, legal services, goods and services required on an emergency basis, and goods that are purchased to ensure compatibility with existing property.

C. New West Partnership Trade Agreement (NWPTA)

The signatories to the NWPTA are British Columbia, Alberta, Saskatchewan and Manitoba. The NWPTA applies to procurements of construction services that exceed a value of $200,000 and procurements of goods and other services that exceed a value of $75,000. The NWPTA requires local governments to provide open and non-discriminatory access to procurements. With respect to open tendering, the NWPTA specifically requires that procurement opportunities be posted on BC Bid. There are a few industry-specific carve-outs, including water and services pertaining to water, health and social services, legal services, and where it can be demonstrated only one supplier can meet the requirements of a procurement.

D. Bid Protest Mechanism

A supplier who believes a local government has conducted a procurement in contravention of the CETA, CFTA or NWPTA may challenge the decision through the new bid protest mechanism (BPM) under NWPTA. The bid protest mechanism is a protocol to NWPTA that came into force on January 1, 2019. Although municipalities are not signatories to any of the trade agreements, arbitral awards made under the BPM are enforceable against municipalities in the same manner as court orders under the *Enforcement of Canadian Judgments and Decrees Act*.

A dispute under the BPM is resolved through arbitration before a single arbitrator. A supplier has three remedies available to it: a tariff costs award, an operational costs award and a bid preparation costs award.

A tariff costs award is designed to reimburse part of the supplier's legal costs and disbursements incurred in pursuing its claim under the BPM. The maximum award is $5,000.

An operational costs award is usually issued against the unsuccessful party that is comprised of the costs of the arbitrator and administrator appointed under the BPM to adjudicate the dispute. There is no cap on these costs but the average operational cost awarded among published BPM decisions is approximately $5,000.

Bid preparation costs are the demonstrable costs a supplier incurs in preparing a bid in the procurement at issue, including material and labour costs, to a maximum of $50,000.

Notably, BPM awards do not include lost profits or any other forms of damages.

The takeaway is that if a local government conducts a procurement that falls above the thresholds mentioned above and which is not open, transparent and non-discriminatory, an aggrieved bidder may challenge the procurement. If the supplier is successful, the local government may be subject to costs awards totaling approximately $10,000 and the supplier's cost of preparing its bid, to a maximum of $50,000.

Since a supplier may not claim lost profits, in comparison to a Contract A claim the trade agreements represent a lesser source of liability. However, a local government can take steps to limit or eliminate its liability under Contract A. The trade agreements cannot be avoided. For this reason, local governments should carefully review their tender documents before posting and again before awarding to ensure that the procurement does not contravene the trade agreements.

IX. CONCLUSION

The foregoing is not intended as an exhaustive list. However, they represent the key conditions and limitations that should be, but occasionally are not, considered by local governments before signing an agreement or issuing tender documents. I hope this review will be of use to local governments as they exercise their power to contract to provide services and good government to their communities.

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