



# Proposed New Surety Bonding Requirements for Large Non-P3 Infrastructure Projects

**Submitted to:** Ministry of Infrastructure

**Submitted by:** Ontario Bar Association

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## **Introduction**

The Ontario Bar Association (“**OBA**”) welcomes the opportunity to make this submission in response to the Ministry of Infrastructure’s public consultation regarding new surety bonding requirements for large non-P3 infrastructure projects.

## **Ontario Bar Association**

Established in 1907, the OBA is the largest and most diverse volunteer lawyer association in Ontario, with close to 16,000 members, practicing in every area of law in every region of the province. Each year, through the work of our 40 practice sections, the OBA provides advice to assist legislators and other key decision-makers in the interests of both the profession and the public and we deliver over 325 in-person and online professional development programs to an audience of over 20,000 lawyers, judges, students, and professors.

This submission was prepared by a working group comprised of members of the OBA’s Business Law, Construction & Infrastructure Law, and Municipal Law sections. Members of the working group represent, and understand the needs and perspectives of, virtually every stakeholder on the issue of surety bonding requirements for public projects, including owners/public-sector entities, large contractors, small contractors, and sub-contractors.

## **Executive Summary**

In order for the proposed regulation to help achieve the government’s policy objective of efficient and timely expansion and repair of Ontario’s infrastructure, there are three areas that require increased clarity:



- (1) The circumstances under which the \$250,000,000 modified Bond floor can be safely applied;
- (2) Whether the P3 or non-P3 bonding-level category applies to a particular project. While this may be clear in today's market, evolving delivery models will require the two categories to be better and more purposively defined; and
- (3) The joint application of the bond coverage requirements where there are multiple contractors under a single contract.

## Background

### ***Mandatory Bonding Requirements***

Part XI. 1 of the *Construction Act* (the “**Act**”) requires a contractor that is a party to a “public contract” with a contract price of \$500,000 or more to provide the owner with a performance bond and a labour and material bond (the “**Mandatory Bonds**”). These Mandatory Bonds are designed to provide security:

- (a) to the owner for the completion of the contract; and
- (b) for amounts owing to the subcontractors and suppliers.

The general rule is that the minimum coverage limit for each Mandatory Bond on a public contract is required to be 50% of the contract price (the “**General Rule**”).

### ***Modified Bonding Floor for P3 Contracts***

There is currently a modification of the General Rule for certain P3 Contracts using Alternative Financing and Procurement models. In certain circumstances, the minimum coverage limit for each Mandatory Bond on such P3 contracts can be as low as \$50,000,000 (the “**P3 Bonding Floor**”) even where the contract price is more than \$100,000,000. The use of this P3 Bonding Floor is subject to a condition that requires the entire package of security to be an appropriate balance between adequacy (to ensure payment of persons



supplying services or materials and the performance of the contract) and the cost of the security.

### ***Proposed Modified Bonding Floor for non-P3 Public Contracts***

The proposed regulation would create a similar modification of the General Rule for very large non-P3 public contracts. The current drafting of the regulation contemplates that a contractor that is a party to a non-P3 public contract could only be required to post Mandatory Bonds with a coverage limit of \$250,000,000 (the “**Non-P3 Bonding Floor**”), even where the contract price is more than \$500,000,000. This is subject to the threshold requirements outlined below.

The Statutory and Regulatory Provisions that govern the P3 and non-P3 Bonding Floors are attached as **Annex A** for ease of reference.

## **Ambiguity of the Threshold**

The regulation contemplates a Non-P3 Bonding Floor of \$250,000,000 that is subject to a threshold similar to the one that applies to P3 contracts. Subsection 12.1(3) of the Draft Regulation provides as follows:

(3) Subsection (2) does not apply unless the labour and material payment bond, performance bond and any other security required by the owner, taken together, would reflect an **appropriate balance** between, on the one hand, the adequacy of the security required to ensure, ~~on the one hand~~, the payment of persons supplying services or materials under the public contract and the performance of the public contract and, on the other hand, the cost of the security [emphasis added and redlined to reflect a drafting error with respect to the balancing].

Subsection 12.1(3) of the Draft Regulations permits use of the Non-P3 Bonding Floor only where a package of security would reflect an “appropriate balance” between the cost of the security and the protection it provides to subcontractors and suppliers. There is no



guidance to assist in the interpretation of “appropriate balance”. This introduces ambiguity that:

- (a) has the potential to undermine the policy objectives of the non-P3 Bonding Floor;
- (b) adds uncertainty that increase time, cost and effort; and
- (c) potentially raises the rule of law issues attendant with vague legislation, particularly where the legislating government is a contemplated party to the transactions being regulated.

#### (a) Ambiguity Undermining policy objectives

As we understand it, the policy objective of the modified Bond Floor in 12.1(2) is to facilitate ambitious infrastructure expansion by broadening the pool of builders able to meet the bonding requirements for public projects, and thus expanding the number of available builders. For this to be effective, owners must be comfortable availing themselves of the modified Bond Floor and setting bond coverage requirements at less than 50% of the contract price. They are unlikely to do so where a vague requirement like “appropriate balance” makes compliance uncertain.

Given the potential liability for setting a bond level that may, after the fact, be determined to have been too low, owners will likely err on the side of caution and set bond levels above the floor. In fact, if the regulation is implemented in its current form, it is very likely that the 50% sizing requirement for Mandatory Bonds will continue to be imposed for many public contracts, which will not expand the pool of builders able to take on the infrastructure projects.

#### (b) Ambiguity increases Time, Cost and Effort

Where undefined and uncertain terms such as “appropriate balance” are used in any form of commercial-transaction legislation, it leads to more upfront time and cost for advice and analysis. It also leads to more after-the-fact disputes in which the courts or other



adjudicators are called on to define the terms. This adds costs for the parties, the administration of justice and, ultimately, the taxpayer. The most effective commercial legislation provides certainty for the parties with respect to their rights and responsibilities – it is far better to drive compliance at the time of contracting and execution than to subject the parties to unfavourable consequences of unpredictable after-the-fact interpretation.

### (c) Rule of Law Considerations raised by Ambiguous Terms

Where, as here, the government itself is a contemplated party to the transactions being regulated, the rule of law demands clarity. The flexibility built into the phrase “appropriate balance” could, in the non-P3 context, allow the government to advantage certain contractors by setting, for example, a prohibitively high Bond level or a commercially unreasonably low bond coverage level. While there is no suggestion that this government is motivated to do so, where legislation opens the door to arbitrary application by a government actor, it compromises the commercial confidence that is supported by the rule of law.

### Recommendation

We recommend that subsection 12.1(3) of the Draft Regulation be re-drafted to give increased certainty as to when a party may avail itself of the Non-P3 Bonding Floor, failing which the Act risks impeding or delaying the construction of priority large non-P3 projects.<sup>i</sup>

There are a number of possibilities for providing the necessary clarity, including, for example, through the use of a scale of appropriate bond levels for different project-costs and additional security scenarios that are included or incorporated by reference in the Regulation.

The OBA would be pleased to work with government on achieving the legislative clarity that would advance the government’s policy objective of ensuring public infrastructure can



be built in a timely and cost-effective way while protecting the livelihood of those parties undertaking the work.

## **Clarity in Choosing the Applicable Bonding Floor in Evolving Markets**

The proposed regulation is part of a regime in which determining the applicable bonding floor depends on distinguishing between P3 contracts and non-P3 public contracts. From a practical perspective, that distinction is clear in today's market. However, as changing market conditions drive evolution in delivery models, the distinction may be blurred, leading to potentially serious categorization errors and resulting non-compliance. In order to ensure the legislative regime continues to provide the necessary clarity as delivery models evolve, consideration should be given to defining the applicable bond floor categories based on the presence or absence of those aspects of a P3 that ground the policy rationale for a lower P3 bonding floor, including:

- (a) The contract funds being held by government entities until the completion of the entire project or well-defined benchmarks;
- (b) The presence of certain security arrangements uniquely present in P3 projects; and
- (c) The presence of third-party finance teams, and attendant underwriters that add a layer of due diligence.



## The 50% Bonding Requirement for Multi-Contractor Contracts

This regulation may provide a good opportunity to clarify one of the aspects of section 85.1 bonding requirements. Section 85.1 requires a “contractor to furnish” each Mandatory Bond in the amount of 50% of the contract price. The regulation, on the other hand, sets requirements for bond “coverage” amounts. The latter is the preferable way to express the requirement as it better contemplates contracts (particularly IPD or Alliance contracts) where there is more than one contractor. While we recognize that “contractor” in the Act is defined to include joint ventures, there are other circumstances in which there may be more than one contractor on a single contract. To the extent that bonding is even necessary at all in those contract structures, it is not sensible to require each “contractor to furnish” a bond that is 50% of the contract price. This would lead to cumulative bonding requirements that exceed the contract price. It is more sensible to require total bonding coverage in the applicable amounts.

In order to better address the multiple-contractor scenario more nimbly than a statutory change, this regulation could provide that:

12.1 (4) for the purpose of this section and subsections 85.1(4) and 85.1(5) of the Act, multiple contractors under a single contract will be deemed to be a single contractor.

A similar change would need to be made to the requirements for the P3 Mandatory Bonds.

If this is deemed to be an inappropriate change to primary legislation by subordinate legislation, the Act should itself be amended to ensure multiple contractors under a single contract are subject to a cumulative requirement, whether it be the 50% requirement, or the lower requirement contemplated by this regulation.



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<sup>i</sup> We acknowledge that the language in subsection 12.1(3) of the Draft Regulation mostly replicates the language in subsection 1.1(4).3. of the *Construction Act* applicable to P3 projects. It may be necessary to amend section but as outlined in the current market the appropriate balance in the P3 context has been defined over time.



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## ANNEX A

### Mandatory Bonds

#### SURETY BONDS

#### Application of [s. 85.1](#) of the [Act](#)

12. [Section 85.1](#) of the [Act](#) applies to a public contract if the contract price is \$500,000 or more.

#### Bonds and public contracts

##### Definition

85.1 (1) In this section,

“public contract” means a contract between an owner and a contractor respecting an improvement, if the owner is the Crown, a municipality or a broader public sector organization. [2017, c. 24, s. 56.](#)

##### Application

(2) Subject to the regulations, this section applies to a public contract if the contract price exceeds the amount prescribed for the applicable owner. [2017, c. 24, s. 56.](#)

##### Exception

(3) This section does not apply in the case of a contractor who is an architect or an engineer. [2017, c. 24, s. 56.](#)

#### Requirement for labour and material payment bond

(4) On entering into a public contract, a contractor shall furnish the owner with a labour and material payment bond, in the prescribed form, that,

- (a) is of an insurer licensed under the [Insurance Act](#) to write surety and fidelity insurance;
- (b) has a coverage limit of at least 50 per cent of the contract price, or such other percentage of the contract price as may be prescribed; and
- (c) extends protection to subcontractors and persons supplying labour or materials to the improvement. [2017, c. 24, s. 56.](#)



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## Requirement for performance bond

- (5) On entering into a public contract, a contractor shall furnish the owner with a performance bond, in the prescribed form, that,
- (a) is of an insurer licensed under the [Insurance Act](#) to write surety and fidelity insurance; and
  - (b) has a coverage limit of at least 50 per cent of the contract price, or such other percentage of the contract price as may be prescribed. [2017, c. 24, s. 56.](#)

## **P3 BONDING MODIFICATIONS**

### ALTERNATIVE FINANCING AND PROCUREMENT ARRANGEMENTS

#### **Surety bonds, minimum coverage**

3. For the purposes of paragraph 2 of [subsection 1.1 \(4\)](#) of the [Act](#), the minimum coverage limit is,
- (a) 50 per cent of the contract price, if the contract price is \$100,000,000 or less; or
  - (b) \$50,000,000, if the contract price is more than \$100,000,000.

#### **Specified modifications, Part XI.1**

1.1 (4) [Section 85.1](#) applies with the following modifications:

1. The agreement between the special purpose entity and the contractor is deemed, for the purposes of the section, to be a public contract between the Crown, municipality or broader public sector organization, as the case may be, and the contractor.
2. The Crown, municipality or broader public sector organization, as the case may be, may require a coverage limit other than one specified in [clause 85.1 \(4\)](#) (b) or [\(5\)](#) (b), provided that it meets or exceeds any coverage limit that may be prescribed for the purposes of this paragraph.
3. Paragraph 2 does not apply unless the bonds required under [subsections 85.1 \(4\)](#) and [\(5\)](#) and any other security required by the Crown, municipality or broader public sector organization, as the case may be, taken together, reflect an appropriate balance between the adequacy of the security required to ensure the payment of persons supplying services or materials under the public contract on the one hand and the cost of the security on the other. [2017, c. 24, s. 3 \(1\).](#)



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## **PROPOSED NON-P3 BONDING MODIFICATIONS**

### **Coverage limit**

**12.1** (1) Except as otherwise provided in this section, the minimum coverage limit for a labour and material payment bond required by subsection 85.1 (4) of the Act or a performance bond required by subsection 85.1 (5) of the Act is 50 per cent of the contract price.

(2) If a public contract has a contract price that is more than \$500,000,000, the coverage limit shall be the amount specified by the owner, which must be at least \$250,000,000.

(3) Subsection (2) does not apply unless the labour and material payment bond, performance bond and any other security required by the owner, taken together, would reflect an appropriate balance between the adequacy of the security required to ensure, on the one hand, the payment of persons supplying services or materials under the public contract and the performance of the public contract and, on the other hand, the cost of the security.