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## **PROCUREMENT AND ENTREPRENEURSHIP**

**BY JOSHUA MORRY**



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## EXECUTIVE SUMMARY

Procurement, the government's acquisition of goods and services from the private sector, is an integral component of the Canadian economy. Federal procurement alone constitutes approximately 16% of Canada's GDP. It is therefore important that Small and Medium Enterprises (SMEs) are granted access to the procurement market on a fair share basis. This can be achieved by having procurement policies that encourage the use of competitive tendering, and reduce the procurement agent's discretion when such discretion can lead to corruption. The government's standard form contract should also prevent officials from making unilateral changes to the completed contract, provide an impartial forum for contractual dispute resolution, avoid disadvantaging firms in the procurement process because of their equity value or asset base, provide a fair distribution of liability, and allow the private sector contractor to subcontract the work if necessary.

Unfortunately, the Province of Manitoba does not have a sound procurement process. It does not have a policy manual, and those policies it does have are not made available to the public. Manitoba also does not release any consolidated information on its awarded procurement contracts. A report conducted by the Auditor General of Manitoba found that when individual provincial departments procure goods and services, mandatory public disclosure often does not occur in a timely manner, or at all.

By contrast, the federal procurement process run by Public Works and Government Services Canada (PWGSC) is a sound one. It meets all of the criteria outlined above. By analyzing every contract and contract amendment awarded by PWGSC, it can be empirically shown that SMEs are not disadvantaged by the procurement policies of PWGSC. In fact, PWGSC has established an Office of Small and Medium Enterprises (OSME) to assist SMEs in qualifying for procurement contracts. Furthermore, PWGSC's procurement policies mandate a competitive tendering process (with certain exceptions), and attempt to eliminate corruption through a series of internal and external checks and balances.

Public Private Partnerships (P3's) are an alternative way for governments to procure goods and services. While their merits are debated, and they are intensely disliked by labour unions, there can be no doubt that they are a popular procurement tool in many Canadian provinces and at a federal level. They also benefit SMEs. However, Manitoba and PEI are the only provincial governments to never use the P3 model. Manitoba has also recently enacted legislation that makes it more difficult for municipalities to issue P3 contracts. The legislation was enacted under the pretenses of accountability and transparency in procurement, but one cannot help but notice the irony considering that Manitoba's other procurement policies are quite opaque.

## INTRODUCTION

This report on the efficacy of government tendering and procurement policies by the governments of Canada and Manitoba is part the Frontier Centre for Public Policy's *Entrepreneurial Index*. The purpose of the Index is to rate government policies in terms of whether they enable or diminish entrepreneurship. It is a tool for jurisdictions to use when reviewing policies with the aim of enabling entrepreneurship.

The index works by assigning a jurisdictional score to 16 factors essential to entrepreneurship, ranging from "Contract Fairness" to "Anti-Discrimination/Equal Opportunity". Each factor is then weighted against the others in terms of its overall importance. Finally, the jurisdiction is given an overall score, and is benchmarked against the others. The topic of this report, the efficacy of procurement in a particular jurisdiction will comprise one of the 16 factors analyzed by the index.

When asked how entrepreneurship relates to economic growth, job creation, and wealth, the *Canada-United States Law Journal* responded, "The answer is that entrepreneurship is nearly everything".<sup>1</sup> The journal went on to argue that almost every modern innovation from the car to the elevator is the product of an entrepreneurial firm, not a large company. In his book *Entrepreneurship, Growth, and Innovation: The Dynamics of Firms and Industries*,<sup>2</sup> Enrico Santarelli contends that there is a strong correlation between a country's entrepreneurial activity and its economic development. According to Santarelli, entrepreneurship plays a "crucial role" in driving structural change by "breaking with established routines". The thesis of his book is that there is a need for government to enact public policies that allow entrepreneurs to thrive in the western economies. The positive effects of entrepreneurship are not limited to technological innovations. *The American Journal of Entrepreneurship*<sup>3</sup> cited increased social capital in entrepreneurial communities as well as other positive externalities.

Unfortunately, in developed countries like Canada, entrepreneurship, a key driver of innovation, tends to decline as companies and industries become larger and more mature. By definition, entrepreneurship cannot exist in large companies; it is confined to smaller ones. Even when the original entrepreneurial founder of a company is gone, the small company still must interact in the same competitive sphere, and therefore, "Small and Medium Enterprises" (SMEs), those companies with less than 500 employees, are a good proxy for entrepreneurs for the purposes of this analysis. Over 99% of Canadian businesses are SMEs, and they account for 45% of Canada's GDP and 64% of all of Canada's jobs.<sup>4</sup>

Tendering represents an enormous proportion of a country's economic activity. On average, governments in OECD countries spend approximately 19.96% of their respective GDP's on public procurement, equating to \$4.733 trillion (USD).<sup>5</sup> To put that into perspective, Wal-Mart's global capital expenditure in 2015 will be between \$11.8 and \$12.8 billion.<sup>6</sup> In a 2011 ranking of the 34 OECD countries, Canada was 25th in terms of spending, devoting approximately 12% of its annual GDP to public procurement (Australia was 26th, and the United States was 28th).<sup>7</sup>

With procurement being such a large proportion of the Canadian economy, if a firm is too small to successfully bid on procurement due to preferential treatment given to larger firms, inefficiencies in the market, or unfair terms in the call for tender, that firm misses the opportunity to participate in a large portion of the economy. Governments therefore often enact policies to equalize or neutralize those disadvantages in order to ensure that entrepreneurial firms can gain equal access into the procurement market. This report is determining whether entrepreneurs have access to 16% of the economic activity in Canada on a fair share basis, and whether the policies enacted by government are effective in ensuring this end.

The impact of the procurement process on firms of different sizes will also be critically evaluated. Where possible, this analysis will seek to focus on four types of entrepreneurial SMEs:

- (1) Micro - single person to 5 people;
- (2) Small - 6-20 people;
- (3) Medium - 21-200 people; and,
- (4) Large - 200+ people. Approximately 54.6% of all Canadian SMEs are considered "micro" in size.<sup>8</sup>

The reason for this breakdown is that the managerial dynamic for the self-employed owner is different given the number of people to be managed.

Government procurement is diverse across industries, and constitutes a large proportion of a country's GDP. It is easy to get lost in a sea of information. To keep this analysis focused, the federal government and each province will be analyzed using the following four criteria:

1. How does procurement influence that particular economy?
2. What factors affect the entrepreneur's ability to submit a tender offer in that particular jurisdiction?
3. What factors affect the entrepreneur's ability to be awarded a government contract in that particular jurisdiction?
4. How is the law evolving in that particular jurisdiction?

## WHAT IS PROCUREMENT

Public procurement is the “purchase by governments and state owned enterprises of goods, services, and works”. The OECD offers a more specific definition:

*“[Public] procurement is defined as the sum of intermediate consumption (goods and services purchased by governments for their own use such as accounting or IT services), gross fixed capital formation (acquisition of capital excluding sales of fixed assets, such as building new roads) and social transfers in kind via market producers (goods and services produced by market producers, purchased by government and supplied to households)”.*<sup>9</sup>

Note that public tendering is a transparent requirement of public procurement; in fact, it is the preferred mechanism by which the government awards contracts to contractors.

## GOVERNMENT OF CANADA PROCUREMENT

### Barriers to Contract Award

The goal of this section is to determine if there are any imperfections in the federal government’s procurement market that would prevent SMEs from participating on a fair share basis. The analysis will focus on the potential for corruption, and preferential treatment given to larger firms.

The Department of Public Works and Government Services (PWGSC) has the authority to facilitate the procurement process for the federal government. Through its workforce of more than 14,000 people,<sup>10</sup> PWGSC procures resources for more than 100 federal departments and agencies, ranging from Aboriginal Affairs and Northern Development to the Department of Western Economic Diversification. In fulfilling its mandate, each year PWGSC awards over \$16 billion worth of procurement contracts to private contractors.<sup>11</sup> Some departments and agencies have the authorities to buy their own goods, but are limited to \$25,000 or less for goods, and \$2,000,000 or less for services.<sup>12</sup>

### Corruption

Corruption is the abuse of power for private gain, and it hinders the development of SMEs. According to the United Nations Industrial Development Organization (UNIDO), “corruption hurts all, but the pain is greatest among SMEs”. Although the costs of corruption are the same for all companies, the costs “represent a higher percentage of profits [for SMEs] than that paid by larger companies”.<sup>13</sup> The UNIDO went on to find that corruption can “impose opportunity costs on small business”. A World Bank and IFC Enterprise Survey revealed that on average, 38% of SMEs believe that “corruption is the major constraint for doing business”.<sup>14</sup> There may be some truth to this fear. In a global study conducted by the US Agency for International Development, it was found that the cost of capital is higher the more corruption there is in an economy, and there is less startup investment available for companies.<sup>15</sup>

According to a report for the European Commission conducted by PWC and Ecorys, the main forms of corruption in public procurement are:<sup>16</sup>

1. Bribes and kickbacks;
2. Vertical corruption (between an official of the government and one bidder);
3. Horizontal corruption (between bidders);
4. Bid rigging.

While all corruption reduce the effectiveness and integrity of the procurement process, this analysis focuses on vertical corruption, the corruption that leads to “a public contract [being] awarded on a basis other than fair competition”,<sup>17</sup> because this form of corruption is most difficult for SMEs.

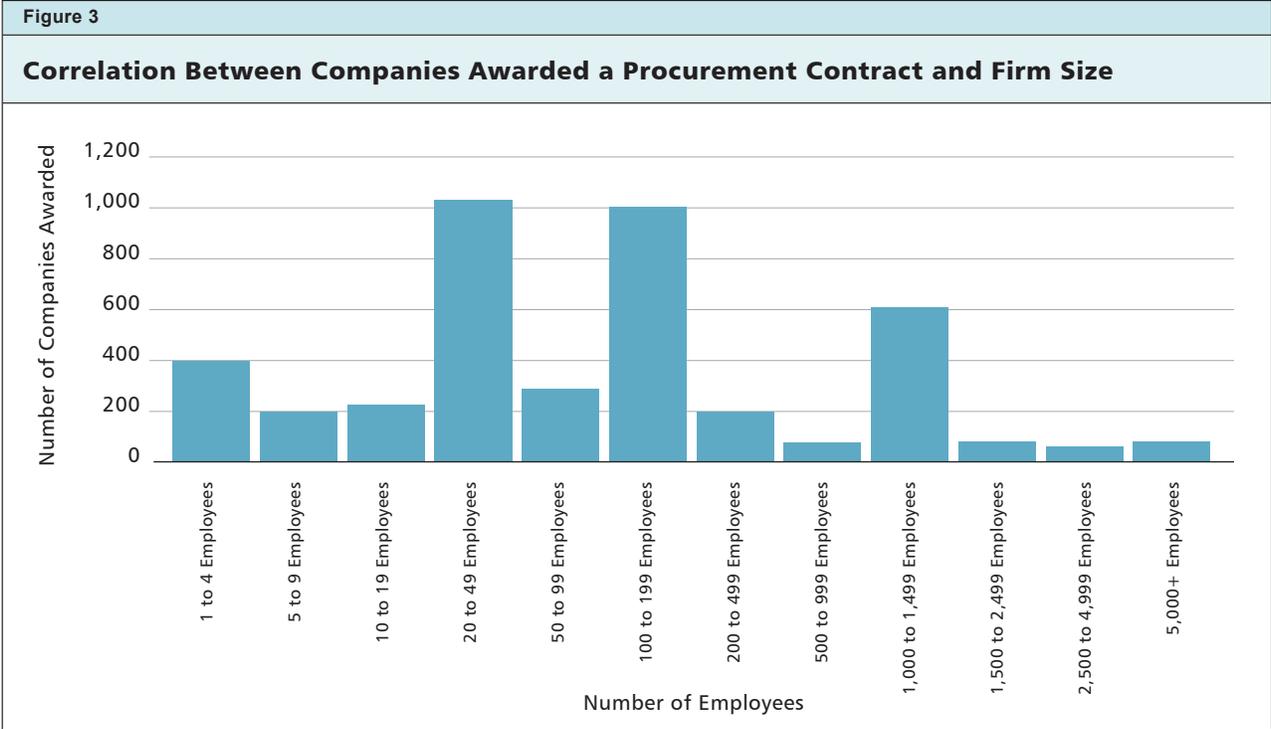
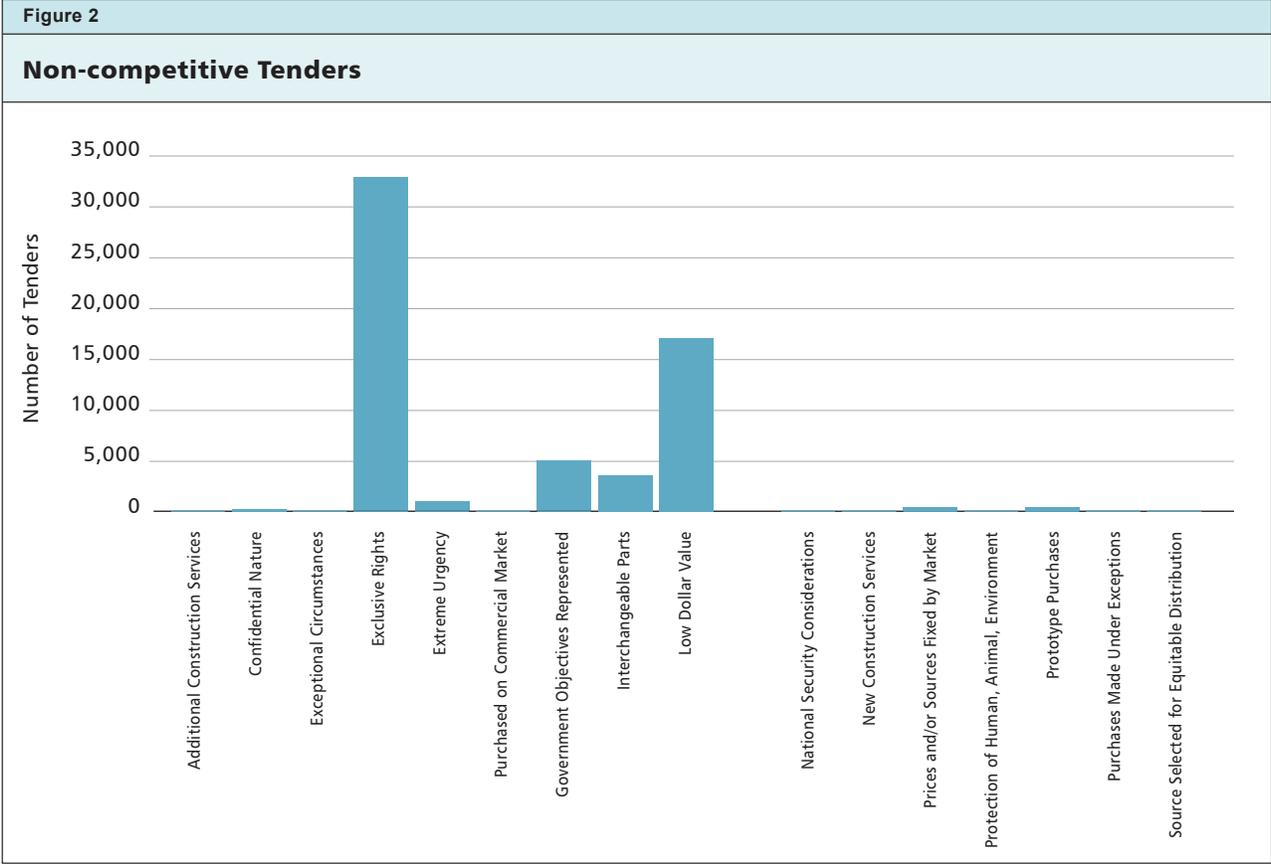
The report *The Many Faces of Corruption: Tracking Vulnerabilities at the Sector Level*,<sup>18</sup> which was prepared for the World Bank, set out what author Glenn Ware stated to be “sound public procurement system”:

Figure 1	
A sound system is based on rules	“Countries should have an adequate legal and regulatory public procurement framework in place to promote fairness and discourage discrimination and favoritism.”
A sound system encourages competition in bidding for government contracts	“There should be clear rules to limit discretion in deciding when to use alternate modes of procurement.”
A sound system promotes transparency	“Transparency requires the timely release of data and information that is sufficient to allow understanding of the way the procurement system is intended to work, as well as how well it is functioning in practice.”
A sound system strengthens accountability	“Government officials [must] be held responsible for the proper implementation of public procurement rules and regulations and the decisions they make in actual procurement cases.”
A sound system is efficient	“Procurement rules and procedures must encourage the completion of the process within a reasonable length of time.” (This will be covered further in the analysis.)

The OECD refers to exceptions to competitive bidding as a “grey area in the public procurement process”,<sup>19</sup> as they provide greater opportunity for government officials to engage in corrupt behaviour. Therefore, it is important for governments to maintain transparent and fair policies that limit or eliminate, non-competitive bidding.

Although some procurement contracts are awarded directly to companies without the use of a competitive framework, PWGSC primarily awards contracts through a tendering process in order to obtain goods and services for the government in the most cost effective manner, and to avoid the potential for corruption. The PWGSC 2014 guidelines mandate that “whenever possible, contractors must be selected using a competitive process” (tendering).<sup>20</sup> The guidelines go on to hold that a non-competitive model is only justified if at least one of the following can be shown: (1) there is a pressing emergency, (2) the expenditure does not exceed \$25,000 (3) the nature of the work is such that it would not be in the public interest to solicit bids (4) there is only one person capable of performing the contract.<sup>21</sup>

By analyzing raw data made available by PWGSC, it can be shown empirically that to a large extent, the department has been following its policies. From 2009 to 2014, of the 253,100 contracts (including amendments) that PWGSC procured for federal departments, 76% of them were awarded after a competitive tender. Of the procurement that was not awarded through a competitive framework, 55% was justified under exception 4, namely that there was only one company that had the exclusive ability to perform the contractual obligations. A further 28% of the non-competitive contract awards were justified under exception 2, citing the low dollar value of the contract. It seems promising that only 8% of the non-competitive contract awards were justified under exception 3, with PWGSC explaining that it would be in the best interests of the public and the government to keep the process non-competitive (that’s only 1.92% of all contracts awarded).<sup>22</sup> This seems to be the most discretionary of the exceptions, and the most difficult for entrepreneurial firms to circumvent. This data is presented in Figure 2, next page.

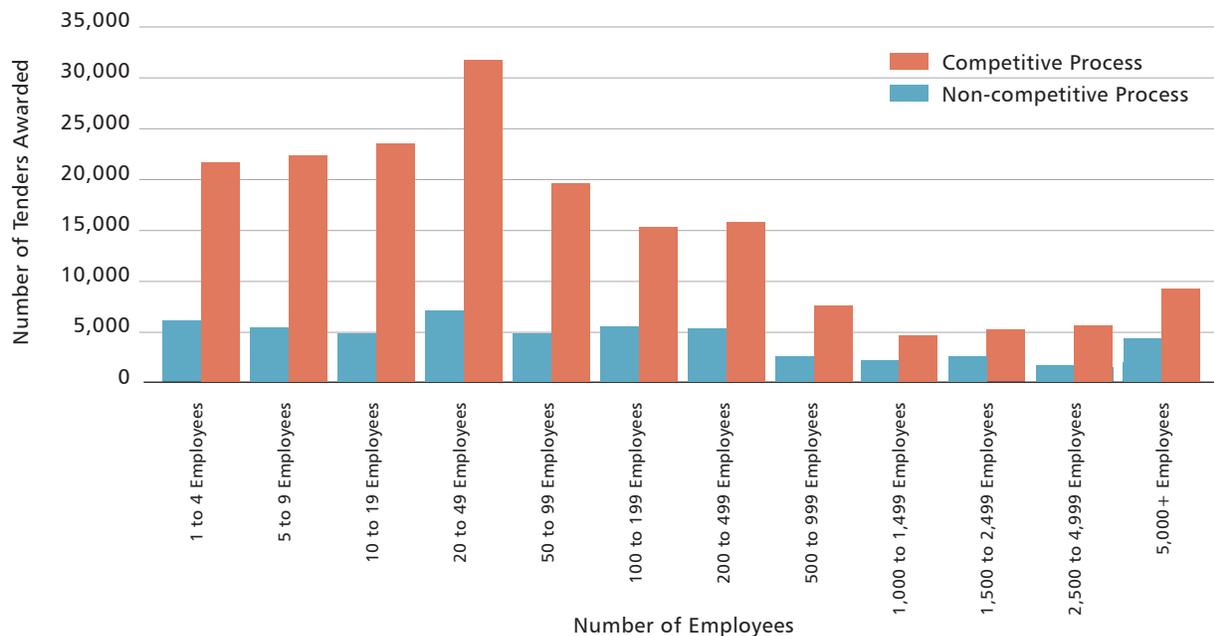


Furthermore, despite the fact that the exception is rather arbitrary, it does not seem to adversely impact SMEs. Looking at the data presented in

Figure 3, it is clear that there is no correlation between being awarded a procurement contract under this exception and firm size.

Figure 4

## Correlation Between Number of Procurement Contracts and Firm Size



As a whole, non-competitive tendering conducted by PWGSC does not seem to hurt SMEs. Figure 4 compares the number of contract awards by firm size. The red represents contracts awarded after a competitive process, and the blue represents contracts awarded after a non-competitive process. Both the red and the blue seem to track each other quite closely, and importantly, non-competitive processes at a federal level do not seem to favour larger firms. In fact, SMEs are awarded contracts after a non-competitive process *more often* than larger firms.

As previously discussed, more than an open tendering process is needed to ensure a “sound procurement system”. There needs to be both transparency and accountability. PWGSC is incredibly transparent in the information that it provides to the public on its procurement process. Since 2004, PWGSC has had a policy whereby it publishes every contract award valued over \$10,000.<sup>23</sup> In 2008, that policy was

expanded to include contract amendments valued over \$10,000. In 2003, a new policy was introduced whereby it became mandatory for all travel and hospitality expenses for select PWGSC officials to be published.<sup>24</sup> *The Public Servants Disclosure Protection Act* allows for public servants to report on “serious wrongdoings” that occur in the department without fear of reprisal. The act further states that after a wrongdoing is found, the department must provide the public with a description of the wrongdoing, the recommendations made, and the corrective action taken.<sup>25</sup>

Since 2013, anyone can access every federal call for tender, and browse through the details of every contract that was awarded in the last five years, competitive or not. Many other jurisdictions, including many of the provinces only show calls for tender and such statistics to companies that subscribe to a procurement registry.

## Equal Opportunity

In order to assist SMEs in gaining access to the government procurement market, PWGSC created the “Office of Small and Medium Enterprises” (OSME) in 2005. OSME attempts to achieve its objective by:

1. Understanding and reducing the barriers that prevent SMEs from participating in federal procurement;
2. Advising government buyers and policy makers on SME concerns;
3. Recommending improvements to procurement tools and processes to encourage SME participation in federal procurement.<sup>26</sup>

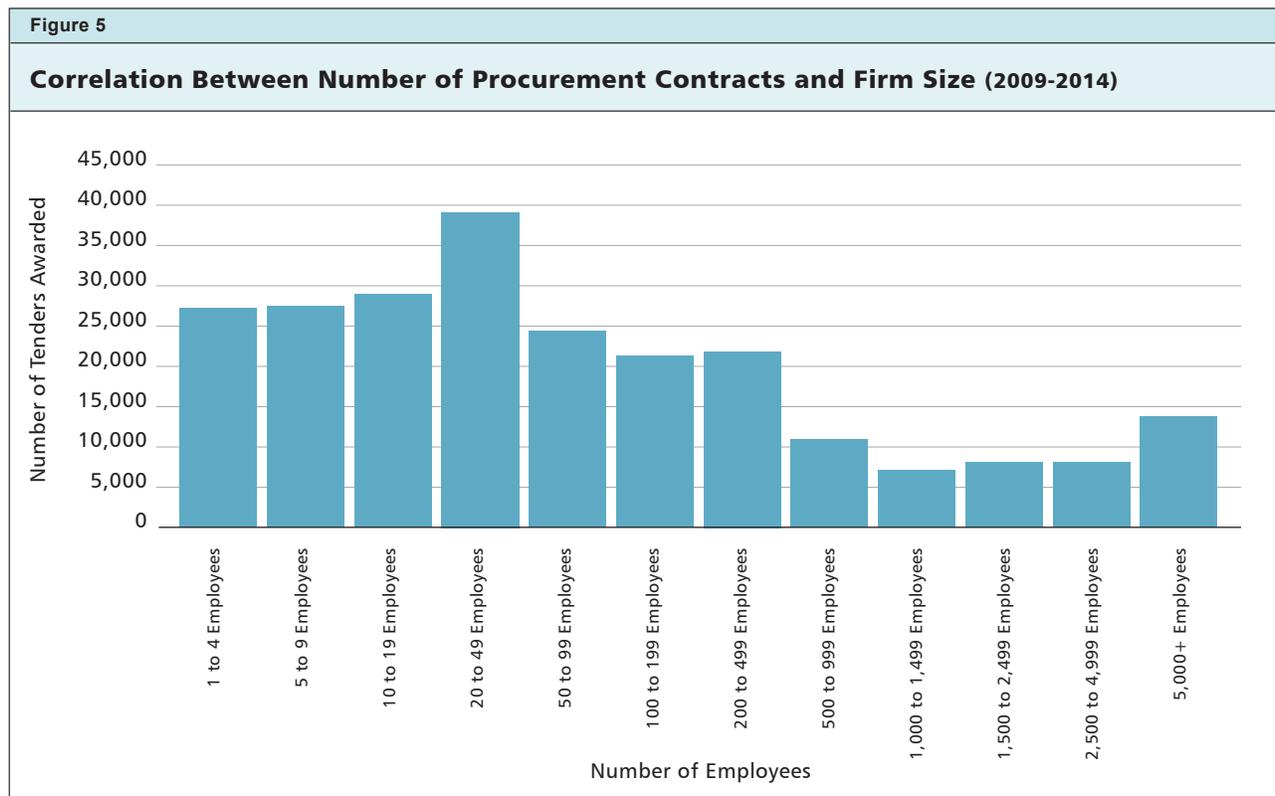
According to PWGSC, approximately 76% of the contracts awarded in 2012, composing 40% of the value, go to SMEs, and 80% of contracts worth less than \$1 million are awarded to SMEs. This trend remains consistent over the past five years, indicating that PWGSC is doing a good job of ensuring that SMEs have access to procurement.<sup>27</sup> Analyzing the raw data of contracts awarded between 2009 and 2014, it becomes strikingly clear that there is no correlation between the size of the company and

its ability to be awarded a tender contract. The data is summarized in Figure 5 below.<sup>28</sup>

In light of all the evidence, OSME phrased it aptly when it stated that “SMEs matter to procurement”,<sup>29</sup> in its study entitled *Integral to the Economy, Integral to Procurement: 2012 Study of Participation of Small and Medium Enterprises in Federal Procurement*. The purpose of OSME’s study (much like this one) was to determine how the tendering process impacted smaller companies. Some of the conclusions corresponded with anecdotal evidence, yet some were quite surprising.

Out of the 350 companies that PWGSC surveyed of all sizes, 84% indicated that they have less than one person dedicated full time to finding government business, indicating that the procurement process is not strenuous enough to require a full employee to perform the task.<sup>30</sup> The top reasons that companies chose not to participate in a tendering process, or became frustrated were:

1. The volume of paperwork required to participate;
2. The contracts are awarded on the basis of lowest price rather than overall best value;



3. The cost of bidding;
4. Clarity of the Solicitation Documents.<sup>31</sup>

One would think that the above list would impact SMEs more than larger firms, yet the study found that there was no correlation between expressing the above concerns and firm size. One would also think that the barriers to entry for newer and smaller firms would be quite high, but the study found that 35% of companies surveyed had been supplying the government for less than 5 years, indicating that the barriers are not debilitating, and can be overcome.<sup>32</sup>

There was found to be no apparent correlation between the size of the firm and the way in which that firm found out about the tendering opportunity. Smaller firms were contacted by the PWGSC just as often as larger firms. However, those firms (big or small) that had provided business to the government for longer were more likely to be contacted directly.

The survey also found that for companies big or small, PWGSC is a reliable customer. Of those companies surveyed, 68% indicated that their percentage of total dollar sales with the government has remained constant over the last five years.<sup>33</sup> Having the government as a reliable customer is important for SME development. In a report in the *Journal of Small Business and Enterprise Development*, it was shown that the increased commercial risks of customer dependency are outweighed by reduced “technological and operational risk”. The authors found that SMEs with stable customers are able to devote more capital towards R&D, and actually report higher gross margins.<sup>34</sup>

In terms of the cost of bidding, one would expect larger firms to be able to have better bids as they can devote more time and resources to the process, but this does not seem to be the case in practice. The study found that for federal calls for tender, there was no correlation between the contract value and the cost of bidding. Also, the study found that there was no correlation between the contract value and the amount of time it took to bid, measured in working days. Surprisingly, over half the respondents from the construction industry indicated that they allocated 0% of the contract value to the bidding process.<sup>35</sup>

## Barriers to Answering a Call for Tender

So far, this analysis has established that once SMEs successfully answer a call for tender, PWGSC does not have a systemic bias against awarding SMEs procurement contracts. There does not seem to be any evidence of corruption that works against SMEs, and there is no evidence of preferential treatment given to larger firms. In fact, the opposite is true. PWGSC through the OSME has made an active effort to ensure that SMEs are not disadvantaged in the federal procurement market.

Having said that, this analysis has only established that once SMEs qualify for a call for tender they are not disadvantaged. The next question should be if there is anything in PWGSC's standard form call for tender that puts SMEs at a disadvantage compared to larger firms. This portion of the analysis will determine if there is anything in PWGSC's standard call for tender that would impair the ability for SMEs to enter the federal procurement market either by design or by effect.

The factors shown below have significant influence over the ability for SMEs to qualify for tender. Each factor has been rated out of 10 to determine how well PWGSC accommodates SMEs. The importance of each factor for SMEs, as well as the methodology used to obtain the rating will be presented in the analysis that follows.

Figure 6	
Factor	Score
Does the tenderer have to have a specified amount of sales, assets, or equity to qualify?	9/10
Does the call for tender stipulate how disputes are to be resolved?	9/10
Can the department unilaterally change the terms of the contract including price?	10/10
Does the contract transfer a significant amount of liability from the department to the tenderer?	8/10
Does the contract allow for subcontracts?	9/10

## PWGSC's Standard Form Contracts

Many of PWGSC's standard clauses are found in its Standard Acquisition Clauses and Conditions (SACC) Manual.<sup>36</sup> The manual contains both reference and full text clauses. In order to reduce the size of the finalized contract, reference clauses refer the parties to the text of specific clauses in the SACC Manual. In contrast, full text clauses are those clauses where the complete text of the clause must be written into the completed contract. The manual is organized into five sections: (1) standard instructions, (2) templates, (3) general conditions, (4) supplemental general conditions, (5) standard procurement clauses. General conditions apply to "specific classes of contracts" (medium complexity – goods), whereas supplemental general conditions apply to "specific subclasses of contracts" (telecommunications services and products). Finally, the standard procurement clauses section contains clauses that are standardized across different types of contracts.

According to the SACC Manual, it must be read as a complementary document to the PWGSC Supply Manual.<sup>37</sup> S. 1.10.10 of the Supply Manual holds that a best practice for employees of PWGSC in the procurement process is to use standard documents in order to promote a "common look and feel". Both manuals will be discussed in the following analysis where appropriate.

## Sales, Assets, or Equity

When it comes to SMEs, PWGSC is in a difficult position. It wants to ensure that SMEs gain equal access to the procurement market, but it also wants to reduce its own risk in order to fulfill its statutory mandate of allocating Canadian tax dollars in the most efficient manner. The question for this portion of the analysis is whether PWGSC *unfairly* limits the participation of SMEs in procurement by requiring eligible bidders to have a certain capital structure, sales profile, or asset profile that is difficult for SMEs to obtain. Of course, not every limitation is unfair to SMEs as there are some projects that may simply be too big for an SME to participate in, and PWGSC still has to secure the best contractor for its client department. Therefore, some subjectivity as to what is unfair will undoubtedly enter into this analysis.

According to a 2008 IMF study, it is often difficult for SMEs to obtain bank financing as they have a very short credit history, and few assets to provide security for a loan.<sup>38</sup> Without collateral, banks would be providing debt capital with the same risk as equity, without the upside potential. That makes it difficult for banks to be capital providers at the early stage of SME development. However, approval rates for Canadian SMEs in 2011 were quite high, at 89.9% for debt financing, 97.4% for lease financing, 75.5% for equity financing, 98.5% for trade credit, and 83.8% for government financing. Out of those who were denied debt financing, 47.6% were given the reason that they had insufficient collateral, and 35.9% were told they had insufficient sales or cash flow.<sup>39</sup> While capital does not necessarily come easily to SME firms, very few SMEs have considered it to be their biggest problem, according to a national survey.

Within PWGSC's supply manual, s. 5.60 deals with the financial capabilities of the contractor. According to the section, firms that are financially capable are those "which have the technical, financial, and managerial competence to discharge the contract", and it is up to PWGSC's officer(s) to make this determination. It is interesting to note that a financial opinion is not always required, but when it is, there is a standard form that PWGSC officers

must use. For bid solicitations in a tendering process, that form is A9033T found in the SACC manual. The form holds that if PWGSC requires any financial information, the bidder has within 15 working days to provide it. The financial information on the form includes, but is not limited to:

1. Audited financial statements for the past three years including:
  - a. Balance sheet,
  - b. Statement of retained earnings,
  - c. Income statement;
2. A confirmation letter from all of the financial institutions that have provided short term financing to the bidder outlining any amount that remains available and has been withdrawn;
3. A monthly cash flow statement covering all the bidder's activities for the first two years of the contract duration;
4. Any security that PWGSC deems necessary including:
  - a. An irrevocable letter of credit from a registered financial institution drawn in favour of Canada,
  - b. A performance guarantee from a third party,
  - c. Some other form of security as determined by Canada.

If PWGSC chooses, it can hold the security deposit as security during the bidding process. Security is essential for the contract, as S. 5.60.5 of the Policy Manual holds that "if a bidder submits a bid which includes insufficient security, that is, less than the exact financial security stipulated, or none at all, the bid will be considered non responsive." Furthermore, if a bidder refuses to enter into the contract it has been awarded, the security deposit will be forfeited to the department under clause E0003T in the SACC. When bid security is required during the bid solicitation process, PWGSC officials use clause E0004T. The clause provides that bidders must post financial security consisting of: (1) a security deposit, and (2) a bid bond form. The security deposit is defined in clause E0008T as a bill of exchange, a government guaranteed bond, an irrevocable letter of credit, or any other instrument

that PWGSC would accept. Clause E0004T also allows PWGSC to set the deposit as a percentage of total bid price.

PWGSC also has the option to demand contract security under clause E0005C. Article 5 of that clause allows Canada to convert the security deposit into cash if *any* circumstance exists which would entitle Canada to terminate the contract by default, but such conversion will not terminate the contract.

There was nothing in the SACC manual or the supply manual that required eligible bidders to have a certain capital structure or asset/sales profile. It seems that PWGSC obtains its security almost entirely based on security deposits, credit rating scores, and audited financial statements. Interestingly, in PWGSC's selection criteria found in its supply manual, credit profile does not seem to be a major determinant of bid ranking. In S. 5.60.1 article d, the Supply Manual states, "if the selection of the bidder is competitive, and the contract is for commercially available goods or services, the risks of financial loss to Canada are minimized because of the ability to find alternate sourcing".

Despite PWGSC mainly relying on credit profile and ability to post security deposits, SMEs may still be disadvantaged as compared to larger firms. An OECD report published in 2012 showed that from 2007-2010, the percentage of SMEs asked to post collateral when borrowing from a financial institution increased from 47.7% to 66.7%. Furthermore, the business risk premium, which measures the difference between the small business interest rate and the business prime rate increased from 1.4% to 3.2% over the same period.<sup>40</sup> With all the debt required to participate in a PWGSC tendering process, it seems as though the scales are tipped against SMEs.

## Dispute Resolution

It is difficult for SMEs to take contractual disputes to court, as the costs are prohibitive, and the procedure is drawn out. Furthermore, the Government of Canada employs very experienced lawyers, and it is difficult for a small business to take an entity as large as PWGSC to court and win. This portion of the analysis is asking two questions. The first is whether the standard form contract with PWGSC provides any dispute resolution other than going to court (alternative dispute resolution (ADR)), and the second is whether that resolution process defaults to an independent mediator/arbitrator, or is kept in house by PWGSC. These questions can be answered by once again turning to PWGSC's supply manual.

Before beginning with an account of the different methods of dispute resolution set out by the Supply Manual, it is important to note that the courts are always available to resolve disputes between PWGSC and its suppliers for a breach of contract. *Ron Engineering v Ontario*<sup>41</sup> is the seminal Supreme Court of Canada that set out the framework of how to analyze the tendering process in a contractual dispute between a contractor and the government. Two subsequent cases are worth mentioning as well. The first is *MJB Industries Ltd v Defence Construction*,<sup>42</sup> a 1951 decision of the Supreme Court of Canada, where the Court found that there's an implied term in all calls for tender to only accept compliant bids. The second key case in this area is *Martel Building Ltd v Canada*,<sup>43</sup> a 2000 decision of the Supreme Court, where the Court found that there is an implied term in a call for tender to treat all bidders fairly. Should any express or implied term in the call for tender be breached, the contractor can have a court adjudicate the proper remedy.

Canada is a signatory to a number of international trade agreements including the North American Free Trade Agreement (NAFTA), the World Trade Organization Agreement on Government Procurement (WTO-AGP), the Canada – Chile Free Trade Agreement (CCFTA), and the Canada – Peru Free Trade Agreement (CPFTA). In 1994, Canada, along with the First Ministers of each province signed the Agreement on Internal Trade (AIT),

which "aims to reduce barriers to the movement of persons, goods, services, and investments within Canada"<sup>44</sup> by prohibiting the federal government from discriminating against goods and services from a particular province or region of Canada. These international trade agreements require that each signatory have an "independent bid challenge authority". In Canada, the bid challenge authority that oversees the above agreements is the Canadian International Trade Tribunal (CITT).

According to the mandate of the CITT, "suppliers may challenge federal government procurement decisions that they believe have not been made in accordance with ... any applicable trade agreement. Any potential suppliers who believe that they may have been unfairly treated during the solicitation or evaluation of bids, or in the awarding of contracts on a designated procurement may lodge a formal complaint with the tribunal."<sup>45</sup> While the tribunal usually decides the case based on written submissions by the complainant and PWGSC, it does have the power to schedule a public hearing. Within 90 days of the filing of the complaint, the tribunal must render its findings and recommendations. Recommendations can include, but are not limited to "the issuance of a new solicitation, the re-evaluation of the proposal, the termination of the contract, the awarding of a contract or monetary compensation".<sup>46</sup>

It is worth noting that the subsection 30.11(1) of the CITT Act<sup>47</sup> only allows complainants to file a complaint about the "procurement process". According to 2009 CITT decision of *Reicore Technologies Inc. v The Department of Public Works and Government Services*,<sup>48</sup> all the treaties mentioned above provide that the procurement process "begins after an entity has decided on its procurement requirement, and continues through to the awarding of the contract". The CITT does not have the authority to adjudicate complaints based on contract administration, as it is outside the procurement process as defined by the agreements.

Not every contract that PWGSC grants is governed by international trade agreements however, as many agreements only apply to contracts worth more

Figure 7

<b>Top Procurement Contracts Complaints (2010-2013)</b>			
<b>Top Procurement Related Issues</b>	<b>2010-2011</b>	<b>2011-2012</b>	<b>2012-2013</b>
Evaluation and Selection Plan (eg. restrictive criteria or biased rating method)	29	32	28
Evaluation of Bids (eg. unfair evaluation process)	33	22	28
Procurement Strategies (eg. non-competitive)	19	27	26
Statement of Work or Specification (eg. unclear or biased)	13	24	13
Contract Execution (eg. altering the contract)	16	14	13
Payment (eg. late payment)	10	6 (not in top 6)	13

Figure 8

<b>Top Procurement Contracts Complaints (2010-2013)</b>				
<b>Total ADR Files 2012-2013</b>	<b>Outside OPO Jurisdiction</b>	<b>Department Declined to Participate</b>	<b>Request Withdrawn</b>	<b>ADR Conducted and Settlement Reached</b>
4	2	1	1	1*

than a stipulated amount. Therefore, CITT does not have jurisdiction to adjudicate contractual disputes for some contracts. The Procurement Ombudsman is another agent for resolving contractual disputes by providing alternative dispute resolution (ADR) if both parties agree to participate. The position of the Ombudsman was created by an amendment to the *Department of Works and Government Services Act*.<sup>49</sup> The Ombudsman is tasked with providing a remedy for contractual disputes for the award of a contract for the acquisition of goods below the value of \$25,000 and services below the value of \$100,000, and for complaints regarding the administration of a contract regardless of the dollar value.<sup>50</sup>

Figure 7 highlights the top 6 complaints that suppliers brought forward to the Procurement Ombudsman about the tendering process from 2010 – 2013. The data is taken from the 2012 – 2013 Annual Report of The Procurement Ombudsman.<sup>51</sup>

In terms of Alternative Dispute Resolution (ADR), the ombudsman provides a free service that allows the department and the supplier to attempt to resolve their dispute outside of the court. The results of the ADR process from 2012 – 2013 are summarized in Figure 8.<sup>52</sup>

## Unilateral Changes

Entering into a contract where one party can unilaterally change its terms or discharge its contractual obligations is difficult for any business, but especially for SMEs. As stated above, SMEs typically have fewer resources than large firms to challenge government decisions in court. Moreover, statistics released by PWGSC show that many SMEs have not reduced their risk through contract diversification. 14% of respondents to the OSME survey discussed above said that 75% of the value of their sales is with the government. Of the respondents who reported that 25% or more of their sales were with the government, 54% sold to three departments or less.<sup>53</sup> Therefore, an argument can be made that it would be good policy for PWGSC to have mechanisms in place that stop such unilateral action.

This section will ask two questions. The first is whether PWGSC is able to unilaterally change terms within an existing contract such as price or delivery date, and the second is whether PWGSC can unilaterally discharge its contractual obligations.

Contract amendments are dealt with in s. 8.70.5 of the PWGSC Supply Manual. Clause A states that contract amendments are “used to formally delete, modify, or introduce new conditions in the original contract”. The clause goes on to state “amendments are subject to agreement by both parties to the contract”. This clause implies that such amendments cannot be conducted unilaterally by PWGSC.

Although it is clear that PWGSC cannot unilaterally alter the terms of the contract, it still must be determined whether it can unilaterally terminate the contract. S. 8.135 of the Supply Manual discusses the various types of terminations available to PWGSC after a contract has been formed.

S. 8.135.1 allows PWGSC to issue a stop work order as an alternative to cancelling the contract. This section is used in conjunction with clause J0500C in the SACC Manual. The clause holds that when a stop work order is invoked, the supplier must stop all work, and incur no additional expenses for the contract. Following a stop work order, if PWGSC chooses to

reinstate the contract, the stop work order must be cancelled pursuant to clause J0G01C of the SACC Manual. When the original contract is reinstated, it may be necessary to adjust the delivery terms and/or contract price. Should an amendment be deemed necessary, Policy, Risk, Integrity, and Strategic Management Sector (PRISMS) provides settlement services by “assessing the contractor’s request for any upward adjustment of the contract price”. Such a request must be referred to the termination claims officer before any new agreement is reached with the contractor.

It seems as though PWGSC can hurt the contractor by issuing a stop work order then not agreeing to a price increase. The PWGSC Supply Manual and SACC Guide remain silent on what conditions constitute adequate grounds for a stop work order, which is troubling. Of course, stop work orders hurt PWGSC as well by undermining the procurement process and delaying the acquisition of goods and services, but clearer policies would be beneficial in order to ensure that there is less opportunity for mismanagement on the part of a PWGSC official.

After issuing a stop work order, it is also possible that PWGSC’s client department will prefer to terminate the contract rather than reinstating it. S. 8.135.5 of the Supply Manual covers Termination for Convenience of Canada. PWGSC may choose to terminate a contract on behalf of its client department when there is a “curtailment of funds, discontinuation of a government program, or other circumstances which make the procurement of a good or service unnecessary”. The section goes on to hold that Canada may also terminate for convenience “to protect the integrity of the bid solicitation process, if it has determined that the contract was mistakenly awarded to a bidder other than the lowest one”. Clause b goes on to state that a termination for convenience can apply when three conditions are met:

1. The client has requested termination;
2. A termination for default cannot be considered because the contractor is not in default; and,
3. A termination by mutual consent would not be more advantageous to Canada.

If the client department chooses to go forward with the termination for convenience process, the termination claims officer will conduct a review of the contract that has been performed up until the termination date. The officer then proceeds to negotiate a settlement with the contractor. Should the contractor refuse the settlement, the officer will then notify the contractor of the various ADR avenues available (see above section).

Termination for Default is covered in s. 8.135.15 of the Supply Manual. This section applies when the “contractor is in default in carrying out any of the obligations under the contract”. The section goes on to state that it usually applies when there has been non-performance or delayed delivery. Annex 8.4 of the Supply Manual goes into a more detailed explanation of termination for default. The annex provides a list of what constitutes default:

1. The contractor fails to make progress so as to endanger performance of the contract;
2. The contractor fails to perform any provision of the contract;
3. The contractor fails to deliver goods or perform services within the time specified in the contract;
4. The contractor becomes bankrupt or insolvent.

PWGSC has the ability to grant contractors a “reasonable period of time” to rectify the situation (usually 10 days), although it does not have to. The annex goes on to state that when there is a delay in the performance of the contractual obligation “in the absence of excusable delays, Canada has the right to terminate the contract immediately, regardless of how slight the delay may be”.

After a contract is terminated for default, annex 8.4 provides that PWGSC will determine the amount of damage suffered by Canada. This estimate includes “any amount in excess of the contract price, which Canada may be obliged to pay in procuring the goods or services elsewhere”. If PWGSC cannot negotiate a settlement with the contractor, the file will be referred to legal services for corrective action.

Two other types of termination are termination by mutual consent, and a request for termination by the contractor. Termination by mutual consent is relatively rare, and it is very straightforward. Request for termination by the contractor, covered in s. 8.135.25 of the supply manual is more interesting. Should the contractor request termination; the section holds that PWGSC will not grant it. Should the contractor refuse to carry out the contractual obligations, the contract will be terminated for default.

Once again, this is where subjectivity enters into the analysis. Those who argue that PWGSC’s duty is to provide federal departments with goods and services at the lowest price would favour such strict rules. However, for SMEs, even delivery of the good or service that is one day late is grounds for termination of a contract, and with few resources to fight a legal battle against the government, it is possible for smaller companies to be taken advantage of.

## Liability

This portion of the analysis will determine if PWGSC's standard form contract transfers an unfair amount of liability to the contractor over matters that are not reasonably within their control. While this would of course be difficult for business of all sizes, SMEs would have particular difficulty for the reasons stated above, namely the prohibitive costs of litigation, and the dependence on government contracts.

Contractor liability is covered in the Supply Manual as well as the SACC Guide. In the Supply Manual, the first relevant section is s. 3.200, Contractor Liability. In that section, the Treasury Board Secretariat Policy on Decision Making in Limiting Contractor Liability in Crown Procurement Contracts is summarized. The policy contains four procurement models that attempt to limit contractor liability.

The first model is the most commonly used, and represents about 90% of all procurement contracts. When using this model, only the contractor's liability to Canada, also known as first party liability, can be limited without appealing to the Treasury Board for approval. Under this model, if PWGSC chooses to limit contractor liability to third parties or indemnify the contractor, it must seek Treasury Board approval. As discussed in s. 3.200.5, the default position of Canada when it comes to indemnification in procurement, the requirement for one party to a contract to make the other whole when the latter has suffered a loss, is to remain silent. This is so that the parties can use common law and statute law to determine their positions in the event of a loss.

S. 4.70.90 of the Supply Manual delves further into the limitation of liability for contractors. It holds that "limiting a contractor's liability should be an exception to the normal practice of using standard

conditions". Liability should only be limited when the PWGSC agent has demonstrably shown that the risks have been analyzed, and Canada still has "adequate protection". When PWGSC has agreed to limit a contractor's liability to Canada, but not damage caused to third parties, the standard form clause N0001C must be used. The clause states that liability includes damages caused by the contractor as well as damage caused by employees, subcontractors, agents, representatives, and any of their employees. This is stricter than common law, which holds that an individual is not responsible at law for the actions of their subcontractors. The clause goes on to state that each party is still fully liable for any damages caused to third parties. If Canada is required to pay the third party for any damages caused by the contractor as a result of joint and several liability, the contractor agrees to reimburse Canada for that amount.

The standard form clause N0002C is even more difficult on SMEs. The clause once again defines liability as actions committed by subcontractors as well as employees, but goes even further. It holds that "the contractor agrees to pay Canada the amounts of all of Canada's losses, liabilities, damages, costs, and expenses resulting from any claim made by a third party relating to the contract, including the complete costs of defending any legal action by the third party. The contractor agrees that Canada is not required to have satisfied its liability to the third party before the contractor is obliged to pay Canada in respect of that liability. The contractor also agrees, if requested by Canada, to defend Canada against any third party claims." This is an example of an indemnification clause, and because of its incredible breadth without a cap on liability; it has the potential to be very expensive for the contractor depending on the nature of the legal action and its insurance provider.

## Ability to Hire Independent Contractors

The purpose of this section is to determine if PWGSC's standard form contract restricts the ability for those contractors that have been awarded a procurement contract to hire independent contractors to assist in fulfilling their contractual obligations.

In his book *Independence and the Death of Employment*,<sup>54</sup> Ken Phillips makes the argument that it is often easier for SME's to hire independent contractors over employees. SMEs that hire independent contractors are not subject to vicarious liability for the actions of those contractors, while employers may face liability for the actions of their employees if those actions occur within the course of their employment. Companies that hire independent contractors do not have to answer to unfair dismissal allegations, as the firmly established principles of contract law settle disputes arising from relationships with independent contractors. Furthermore, unlike employees, independent contractors cannot unionize. Independent contractors are also helpful for startup companies, as the startup need only pay for the service it requires, nothing more, and it has access to an individual with a developed skill set. It is much more difficult for startups to hire such competent individuals full time. For small companies that want to engage in procurement opportunities, contractors are also helpful for capacity management, as they can be hired when there is more work to be done, and released when the project is completed.

S. 8.85 of the PWGSC Supply Manual states that a contractor must obtain the consent of the contracting officer of PWGSC before subcontracting. The policy states that in order to obtain permission, the "contractor must certify that the proposed subcontract is subject to all the same conditions as contained in the contract". However, clause 2030 of the General Conditions in the SACC Manual holds that the contractor is not required to obtain consent for subcontracts for "any incidental service that would ordinarily be subcontracted in performing the work", and "any part of the work up to a total value of 40 percent of the contract price". While it does not seem as though PWGSC has a bias against allowing companies to hire independent contractors, perhaps it could be made clearer as to when consent would not be granted.

As discussed above, clause N0001C of the SACC Manual holds that the contractor is liable for all the actions caused by its employees and independent contractors. This clause in the standard form contract is in effect reversing the common law, which holds that an individual is not vicariously liable for the actions of their independent contractors. Although this clause is difficult on SMEs that choose to hire independent contractors in order to limit their liability, one could see how it's in Canadian taxpayers' best interests to hold all those who fall below a standard of reasonableness responsible.

## GOVERNMENT OF MANITOBA PROCUREMENT

### Barriers to Contract Award

This section shows that there are imperfections in Manitoba's provincial procurement market that prevent SMEs from participating on a fair share basis. Like with PWGSC above, this analysis will focus on the potential for corruption, and preferential treatment for larger firms.

Government procurement in Manitoba is structured differently than the federal framework. Most of the procurement in the province is organized and facilitated by Manitoba Infrastructure and Transportation (MIT) through its "central providers". MIT is a department of the provincial government, and has a larger mandate than PWGSC, as it is "responsible for the development of transportation policy and legislation, and for the management of the province's vast infrastructure network".<sup>55</sup> The Procurement Services Branch (PSB) procures all goods for the provincial government worth more than \$2,500, while the individual provincial departments procure goods valued at less than \$2,500 for themselves. According to its website, PSB awards over \$100 million worth of contracts each year.<sup>56</sup> Other central providers include the Accommodation Services Division (ASD), which procures new building construction and building maintenance for the provincial government, and Engineering and Operations, which is responsible for the construction and maintenance of provincial roads and bridges. Individual government departments have the authority to procure their own services at any value, as no legislative authority in Manitoba covers the purchase of services.<sup>57</sup>

### Corruption

As discussed above, corruption hurts businesses of all sizes, but its effects are especially detrimental to the development and growth of SMEs. That's why in his report, author Glenn Ware set out the principles that govern a "sound procurement system".<sup>58</sup> The principles were used to evaluate PWGSC, and will be therefore be used to evaluate provincial procurement in Manitoba.

Figure 9	
A sound system is based on rules	"Countries should have an adequate legal and regulatory public procurement framework in place to promote fairness and discourage discrimination and favoritism."
A sound system encourages competition in bidding for government contracts	"There should be clear rules to limit discretion in deciding when to use alternate modes of procurement."
A sound system promotes transparency	"Transparency requires the timely release of data and information that is sufficient to allow understanding of the way the procurement system is intended to work, as well as how well it is functioning in practice."
A sound system strengthens accountability	"Government officials [must] be held responsible for the proper implementation of public procurement rules and regulations and the decisions they make in actual procurement cases."
A sound system is efficient	"Procurement rules and procedures must encourage the completion of the process within a reasonable length of time."

As discussed above, PWGSC's extensive Supply Manual sets out best practices for government officials to use during the procurement process. It establishes when a competitive framework should be used, and when exceptions are appropriate. It guides PWGSC officials on when to seek legal assistance for questions, and what standard form clauses to use in different types of contracts. Perhaps most importantly, the PWGSC Supply Manual is available to the public at no charge on its website.

Unfortunately, there is no equivalent manual for best practices for the procurement process in Manitoba. When the author of this report called PSB to inquire about the existence of such a manual, the response was that one is being prepared, but even once it has been finalized, it will likely not be available to the public.

The current governing documents for procurement in Manitoba includes:

1. Procurement Administration Manual (PAM)
2. General Manual of Administration (GMA)
3. Financial Administration Manual (FAM)
4. Agreement on Internal Trade (AIT)

Out of these four documents, only the Agreement on Internal Trade is available for the public to view, as that is applies across the country. In fact, the only way to see any of the PAM, FAM, and GMA, is to read governmental audits that make passing references to them.

As discussed above, Manitoba is a signatory to the AIT, which is a Canadian agreement that attempts to limit trade barriers between the provinces. The AIT requires that all goods over \$25,000 and services over \$100,000 must be competitively tendered. Note that the trade agreements such as NAFTA that apply to PWGSC do not apply to Manitoba government tenders. Like with the PWGSC Supply Manual, and the AIT, the Procurement Administration Manual (PAM) states that procurement must be obtained using a competitive process unless it can be shown that the procurement is being conducted under a stated exception. The PAM refers to a non-competitive process as a “waiving of competitive bids”. In order to justify a non-competitive process, the existence of one of four exceptions must be proven:<sup>59</sup>

1. Sole Source
2. Single Source
3. Emergency
4. Urgent

The sole source exception is where only one supplier is permitted to provide the goods/services. This can occur when that supplier has a statutory monopoly, or has copyrights that exclude others from distributing the product. The single source exception is when only one supplier is considered by the procurement authority to be capable of meeting all the criteria desired. An emergency is an unforeseeable event that threatens life, health, property, public security, or order. In an emergency, the government can procure goods or services as

fast as possible, regardless of whether it uses a competitive process. Finally, the urgent exception applies when there is an immediate need, and “failure to obtain certain goods/services in a timely manner will result in significant disruption to the program”.<sup>60</sup> These exceptions to competitive tendering are quite similar to PWGSC’s exceptions discussed above.

In March 2014, the Auditor General of Manitoba conducted an audit of goods and services procured by provincial government departments. It was found that in the 18-month audit period, at least \$274 million was awarded in non-competitive contracts. Only 48% of those contracts, composing approximately \$30.6 million were justified for reasons other than one of the above four exceptions, or as the audit refers to them, non-“acceptable circumstances”. Such justifications include the fact that the contractor was used in the past, the contractor was in the area, and the contractor possessed qualities desired by the department.

In terms of transparency, despite the fact that the PAM requires “public disclosure” of non-competitive contract awards over \$1,000, such disclosure is only accessible on one computer on the second floor of the Manitoba Legislative Building.<sup>61</sup> This perhaps meets the strict definition of public disclosure, but it is hardly acceptable considering that PWGSC has every contract award, competitive or not, on its website, which is easily accessible to the public. The audit found that only 13% of the non-competitive contract awards were recorded in a public access database within the required one month of being awarded. Many were not recorded at all.<sup>62</sup>

Furthermore, the audit found that despite the fact that the PAM requires thorough documentation to show compliance with procurement policies, justification and proper documentation for waiving competitive bids were only available for 52% of the contracts surveyed. For 36% of the contracts, only a reason for a non-competitive tender was given (without supporting documentation), and for 12% of the contracts, no reason was documented at all.<sup>63</sup>

Amongst other problems, the audit found that there was no compliance monitoring for untendered contracts. No departments surveyed by the Auditor

General conducted any reviews of their procurement policies, and PSB does not internally audit them. Recall that PWGSC uses the independent Office of the Procurement Ombudsman in order to ensure that the policies in the Supply Manual are being complied with. Each year, the Ombudsman releases a report assessing how well PWGSC is adhering to its policies. Manitoba has no such report.

One well known case of the government not complying with its own tendering policies was in 2011 when the Department of Health entered into a 10-year \$159 million services purchase agreement with the STARS ambulance service without the use of a competitive tender. The contract did not fall within one of the listed exceptions for waiving competitive tenders. Because Manitoba does not require PSB to tender service contracts at any amount, the Department of Health was able to tender for itself. For a federal service contract of this size, PWGSC would have conducted the procurement. Moreover, the Department of Health did not comply with the Financial Administration Act, as it did not provide the non-competitive contract information to the Minister of Finance within one month of the date the contract was entered into.<sup>64</sup>

Unfortunately, a more detailed analysis of the empirical success of Manitoba's tendering policies is difficult, as PSB refuses to release its database of awarded contracts to the public. With the disorganization that the auditor general found in the filing process, it is questionable as to whether such a database exists at all. The PAM, a manual that presumably sets out best practices for the procurement process, is also not available for the public to scrutinize.

While the system does seem to be based on rules, those rules are not always followed, they are not available for the public to see, and the auditor general found that it was not always clear to whom those rules apply.<sup>65</sup> The process, unlike PWGSC's, does not seem to encourage competitive bidding, as there are not the same internal safeguards in place to ensure that the process is conducted fairly. Furthermore, it is abundantly clear from the Auditor General's report that the system in Manitoba certainly does not promote transparency. To use the words of this analysis, Manitoba does not have a "sound" procurement system.

## Equal Opportunity

Unlike PWGSC, Manitoba has made no information available to the public about how its procurement process impacts those who participate. Manitoba does not have any studies available discussing how procurement impacts firms of different sizes, and justifies this by stating that most firms in Manitoba are SMEs anyways. Having said that the category of SME is rather wide. It includes any firm that has 500 employees or less. It would still be beneficial to assess how the procurement process affects small entrepreneurial firms, as those firms are often the drivers of change.

Unlike PWGSC, which has since moved away from the MERX online tendering system, Manitoba still uses MERX to post tender opportunities online. MERX is a private company based out of Montreal, and is used by other provinces as well for their provincial tendering. According to a Globe and Mail article published May 2013<sup>66</sup> (when PWGSC moved away from MERX), MERX is not always easy for small businesses to use. The Canadian Federation of Independent Businesses (CFIB) also supported the federal move away from MERX. The article states “MERX can pose challenges for many users. You had to know where to get the information”. While the new PWGSC online system allows the public to view tenders for free, MERX requires those interested to subscribe to their service, and pay to view each tender opportunity.

In a report conducted by the CFIB entitled *Wanted: Government Vision for Small Business*, SMEs in each province were posed the question of whether “the bidding process for procurement in my province/territory makes it easy for my business to participate”. In Manitoba, only 6% of SMEs agreed, while 41% disagreed. 54% didn’t know, or the question wasn’t applicable to them.<sup>67</sup> Overall, the Manitoba government had the lowest approval rating from local business owners out of any provincial government.

## Barriers to Answering a Call for Tender

Manitoba has used agreements called Project Management Agreements (PMAs) for its major construction projects. Such projects include the Red River Floodway Expansion Project, the East Side Road Project, and many Manitoba Hydro projects. This analysis will break down the PMA used on the East Side Road Project,<sup>68</sup> as it is an updated version of the Red River Floodway agreement, and applies to the East Side Road Project as well as all new contracts awarded on the Floodway Extension.

Article 1 clause 1.2 holds that “Contractors, including subcontractors, who are contracted to perform on the project will be governed by all terms and conditions of the PMA as if a party thereto”. One of the reasons why the Province supports the use of PMAs is because of Article 5, which states that contractors, subcontractors, and their employees who belong to unions cannot picket, strike, or lockout the project.

In order to achieve its goal of preventing unions from striking on a project, the PMA imposes restrictive conditions on all the contractors involved.

Article 12 deals with union security. While the PMA does not require all employees employed by contractors to join a union, clause 12.2 requires them to “pay an amount equal to the amount normally required to be paid by a union member”. The Province advertises that employees on the Floodway Expansion Project and the East Side Road Project “*will not*”<sup>69</sup> be required to join a union. This is technically true, however it is misleading, as those employees still must pay union dues, regardless of whether or not they agree with the union or its policies.

Article 13 requires employers of non-unionized employees to pay into a Health Care Spending Account (HSA), and a Group Registered Retirement Savings Plan (GRRSP) for the benefit of its employees. Even if the employer has an existing plan for its employees, clause 13.5(d) holds that “if the sum of the employer’s required overall contributions to the employer plans are less than the sum of the employer’s required contributions to the [HAS or

GRRSP], then the resulting deficit amount shall be contributed by the employer to the GRRSP or the HSA.

The requirements for employees to pay union dues, and for contractors to pay extra into retirement savings plans and health care accounts are difficult for SMEs. According to Harvey Miller, the general manager of Merit Contractors of Manitoba, some of the companies he represents did not bid on the Floodway Extension because of the PMA's restrictive conditions.<sup>70</sup> In fact, this issue will soon be resolved before the Manitoba Queen's Bench.

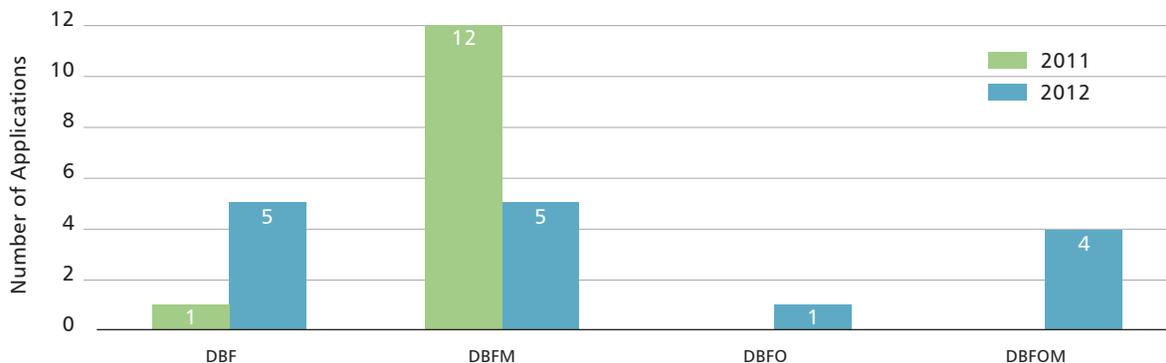
## PUBLIC PRIVATE PARTNERSHIPS

The Public Private Partnership (P3) model is an alternative way for governments to procure public infrastructure projects. P3's are becoming increasingly popular in Canada. In 2012, Deloitte rated Canada first overall in terms of countries that had the most P3 activity over the last year. Canada also ranked first on a Deloitte survey that asked respondents "which country has the most desirable P3 model".<sup>71</sup>

PPP Canada, one of three federal agencies that enter into P3 contracts on behalf of the federal government, and advises provincial, territorial, and municipal government defines a typical P3 as "a procurement where a private proponent designs, builds, finances and operates/maintains a given infrastructure asset".<sup>72</sup> If the project meets specified criteria, it is eligible to be funded up to 25% by PPP Canada. According to a report conducted by the Association of Consulting Engineering Companies Canada (ACECC), P3's are only suitable for large projects because the P3, procurement process is more expensive, and the cost is higher for private firms than it is for government. Consequently, the report suggests that P3's should only be used when the construction cost is greater than \$40 million.<sup>73</sup> The Royal Institute of Chartered Surveyors found that only 20% of public infrastructure procurements were obtained using the P3 model.<sup>74</sup>

Proponents of P3's cite many benefits to the model. When using P3's, the government is theoretically able to transfer the risk of the project to the private sector and capital markets by deferring payment until the project is completed and operational. The government is also able to pay the private contractor based on the asset's performance, which unlike traditional procurement, aligns the financial incentives of the contractor and the government department. In many P3's, the private sector will also manage the asset after completion. A more cynical view is provided in *Public Private Partnerships in Canada: Theory and Evidence*, which says that P3's allow politicians to "provide voters with the benefits of the projects, but can defer the costs to future politicians".<sup>75</sup>

Figure 10

**Application of P3 Procurement Models by Year**

There is considerable debate about the effectiveness of P3's, and a full analysis would require a report of its own. A strong argument was made in the journal article *Municipal Bonds as Alternatives to PPPs: Facilitating Direct Municipal Access to Private Capital*,<sup>76</sup> that it would be a good policy alternative to allow cities to issue tax free municipal bonds, as can be issued in the United States. The purpose of this analysis however is much narrower. It is to solely consider how the P3 model affects SMEs in Canada.

There are three main P3 models in Canada:

1. Design Build Finance (DBF);
2. Design Build Finance Maintain (DBFM);
3. Design Build Finance Operate Maintain (DBFOM).

When using the DBF model, P3 contracts are awarded using a competitive tender process, but unlike the procurement practices outlined in the preceding sections, the public partner transfers the responsibilities and risks for design, construction, and financing to the private sector partner. It does so by making a single payment to the private partner following delivery of the completed asset. A DBFM contract is still awarded through a competitive tendering process, but in addition to designing, building, and financing the asset, the private contractor also maintains the asset for a specified time period after its completion. In Winnipeg, this model was used for the Disraeli Bridge, the Charleswood Bridge, and the Chief Peguis Trail extension. Finally, in the DBFOM model, tenders

are sought for companies to assume operational responsibility for the assets they create. The DBFM model has been the most commonly used, as demonstrated by Figure 10.<sup>77</sup>

In the report *Public Private Partnerships a Guide for Municipalities*,<sup>78</sup> the Canadian Council for Public Private Partnerships, in conjunction with PPP Canada, set out a list of steps for government partners to take when engaging in the P3 process. After sending out the request for proposal documents, the guide states that the public partner should evaluate bids based on:

1. Financial capacity;
2. Financing capability;
3. Experience, resources, and track record.

Proponents of P3's argue that these requirements are fairer to smaller business, because in many traditional procurements, price is the main consideration.

Surprisingly, Manitoba is the only province that lacks an agency that assists government departments in the P3 process.<sup>79</sup> The provincial organizations in most other provinces have their own internal best practice guidelines for the P3 procurement process. Manitoba has established no such guidelines and the Government web page discussing P3's links viewers to websites in other provinces for P3 guidelines.<sup>80</sup> In 2012, the Manitoba Provincial Government passed Bill 34, *The Public Private Partnerships Transparency and Accountability Act*.<sup>81</sup>

The Act requires the provincial government or any municipality wishes to enter into a P3 contract, to:

1. Conduct a detailed risk analysis to determine if the P3 is the best alternative (s. 5(1));
2. Make information about the project public and provide a reasonable opportunity for members of the public to comment on it (s. 5(3));
3. Appoint a fairness monitor for the project (s. 7(1));
4. Report the results of the agreement (s. 8(1)); and,
5. Provide updates on the agreement at least once every four years, or every time there has been a contract amendment (s. 8(1)).

These rules are expensive, time consuming, and make it difficult for municipalities and the Province to enter into P3 arrangements. It is somewhat ironic that the Province has remained silent on its internal policies concerning traditional procurement, and does not publicly release the results of completed procurement contracts, yet mandates complete disclosure of every contract award and amendment to a P3 agreement.

In a poll of Canadians, approximately 70% support P3's.<sup>82</sup> Unions, however, do not. In a statement by the Canadian Union of Public Employees (CUPE) praising the government's enactment of Bill 34, it is evident that the Union does not support P3's because it views them as privatization, which is inherently bad for governmental unionized employees. CUPE's statement reads as follows:

*"We enjoy good quality of life thanks to public services. Canadians know they can count on public services to be accountable, accessible, locally-controlled and a wise investment of tax dollars.*

*Privatization undermines these community values. Contracting out and public-private partnerships are risky and expensive for municipalities and citizens. Costs rise, quality suffers and local control is weakened. Services are less accessible, and projects are delayed. Public funds are diverted from core services to corporate profits.*

*There is a better way. When services are public and well-funded, they deliver a solid, reliable foundation Canadians can count on."<sup>83</sup>*

How much of this statement is accurate? The Canadian Council for Public Private Partnerships identifies four completed P3 projects currently operational in Manitoba:

- (1) The Charleswood Bridge
- (2) Chief Peguis Trail Extension
- (3) The Disraeli Bridges, and,
- (4) The Winnipeg Wastewater System.<sup>84</sup>

CUPE's claim will be fact checked by looking at the nature of each of the projects below. It is important to note that the city of Winnipeg has been very open with all information concerning its P3's, even before Bill 34 was enacted. All of Deloitte's independent reports on each project are available free on Winnipeg's website.



Charleswood Bridge over the Assiniboine River

## The Charleswood Bridge

The Charleswood Bridge was a 1995 Winnipeg municipal P3 project, using the DBFM model. It was constructed and operated by a consortium of three companies called DBF Ltd.<sup>85</sup> DBF Ltd. was comprised of Ernst Hansch Construction Ltd, a local Manitoba company, Wardrop Engineering Inc., which at the time was a local Winnipeg company (it has since been purchased by Tetra Tech), and RBC Dominion Securities, which presumably assisted in financing the project. The project was completed in one year, which according to a report entitled Public Private Partnerships: a Novel Way to Get Things Done, was "half the time it would usually take to construct a bridge of this size and design".<sup>86</sup>



Chief Peguis Trail Extension

### Chief Peguis Trail Extension

To procure the Chief Peguis Trail Extension, a project that used the DBFM model, the City of Winnipeg used a two-stage procurement process consisting of a Request for Qualification (RFQ), followed by a Request for Proposal (RFP). At right, Fig. 11, the Chief Peguis Trail Extension evaluation criteria that the City of Winnipeg used are outlined.<sup>87</sup>

The consortium that was awarded the project DBF2 Ltd, was composed of the following companies:

- (1) Terracon Development Ltd – a local Manitoba SME,
- (2) Bituminex Paving Ltd. – a local Manitoba SME,
- (3) Taillieu Construction Ltd. – a local Manitoba SME,
- (4) Gateway Construction & Engineering Ltd. – a local Manitoba SME,
- (5) Genivar Consultants Limited Partnership, and
- (6) Kupskey Consulting Ltd. – a local Manitoba SME.

The project was completed a year ahead of scheduled and on budget.<sup>88</sup>

**Figure 11**

Chief Peguis Trail Extension	
Evaluation Criteria	Overall Category Weighting
Project Lead - Organization, competitive advantage and management plan - Experience and qualifications of Project Lead - Experience and qualifications of Key Individual(s)	25
Design-Construction Team Member of Respondent's Team - Organization and plan - Team members' experience and qualifications - Key Design Individual(s) experience and qualifications - Key Construction Individual(s) experience and qualifications	30
Maintenance Member Respondent's Team - Organization and plan - Team members' experience and qualifications - Experience and qualifications of Key Individual(s)	20
Financing Member of Respondent's Team - Financing approach and plan - Financial condition - Financial capability - Track record and experience	25
	100



The Disraeli Bridges

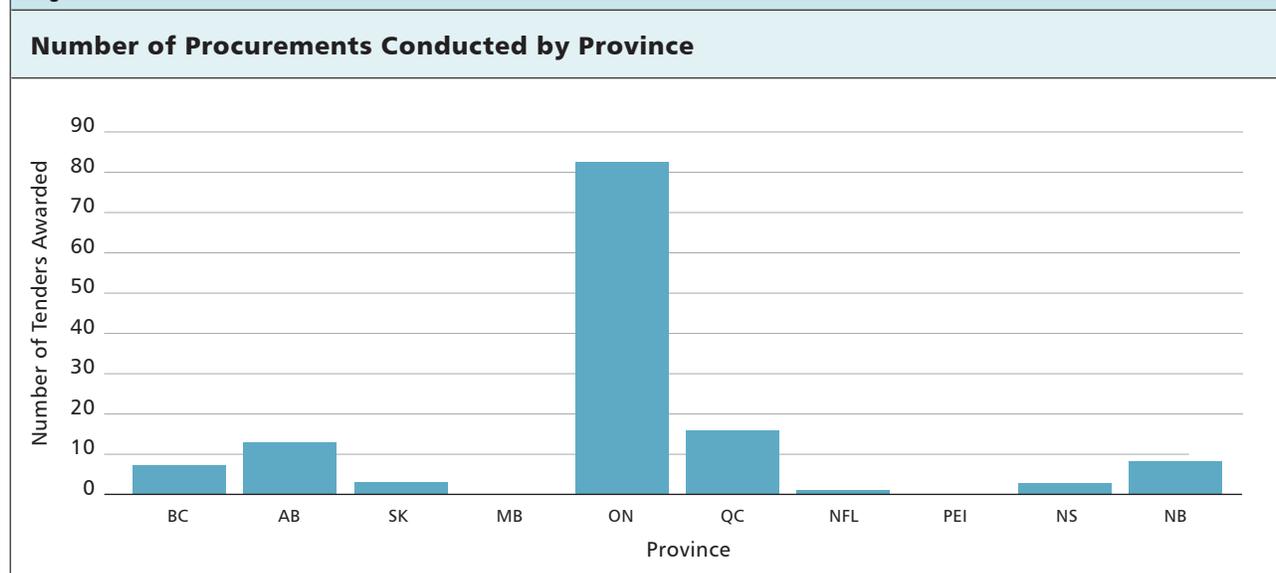
### The Disraeli Bridges

This was another P3 project that used the DBFM model also used a two-stage procurement process consisting of an RFQ and an RFP. Lower right, Fig. 12, The Disraeli Bridges evaluation criteria that the City of Winnipeg used are presented.<sup>89</sup>

**Figure 12**

The Disraeli Bridges	
Evaluation Criteria	Overall Category Weighting
Project Lead - Organization, competitive advantage and management plan - Experience and qualifications of Project Lead - Experience and qualifications of Key Individual(s)	25
Design-Construction Team Member of Respondent's Team - Organization and plan - Member organization(s) experience and qualifications - Key Design Individual(s) experience and qualifications - Key Construction Individual(s) experience and qualifications	30
Maintenance Member Respondent's Team - Organization and plan - Team members' experience and qualifications - Experience and qualifications of Key Individual(s)	20
Financing Member of Respondent's Team - Financial condition - Financial capacity - Track record and experience - Approach	25
	100

Figure 13



The Disraeli Bridges project was awarded to a consortium, Plenary Roads Winnipeg, which consisted of:

- (1) Plenary Group – an international infrastructure business that focuses on P3's, and,
- (2) PCL Constructors Canada – an Edmonton based company that has significant presence in Winnipeg.

The project employed 120 local construction workers, and the Plenary Group's website makes it clear that it subcontracted a significant amount of the work to local Manitoba contractors. In an independent analysis conducted by Deloitte, it is estimated that using a P3 rather than a traditional procurement procedure saved the city approximately \$47.7 million.<sup>90</sup>

### Winnipeg Wastewater System

Finally, the Winnipeg Wastewater System involved a P3 agreement with Veolia to help manage Winnipeg's wastewater. Veolia is a French public company, with its North American Operations based in Chicago. On Winnipeg's website, the terms of the contract are set out, and it seems to be quite favorable to the city. The parties agree to use ADR to resolve disputes and avoid courts, and Winnipeg can terminate the contract at any point with a penalty, while Veolia has limited capacity to terminate the contract.<sup>91</sup>

It is evident that CUPE's claim is unsubstantiated. Many of the companies awarded P3 contracts in Manitoba have been local SMEs. Even when a company isn't based in Manitoba, it still employs Manitobans either as direct employees, or hires Manitoba SMEs as subcontractors. Just as PWGSC does not award all federal procurement contracts to Canadian firms, it is doubtful that Manitoba's traditional procurement is awarded all contracts to local firms. One thing that is common to all the P3 contracts, however, is that they do not require contractors to use unionized labour or a union like arrangement.

Since Bill 34 was enacted, there have been no new P3 projects in Manitoba.

The provincial government has never used the P3 model for any of its own projects. All of the P3 projects in Manitoba were procured by the City of Winnipeg. Figure 13 compares the amount of P3 procurement conducted by each of the provinces.<sup>92</sup>

Manitoba and Prince Edward Island are the only provinces never to use the P3 framework for a provincial project.

## CONCLUSION

Given the impact of procurement on the economy, Manitoba needs a procurement process that ensures that entrepreneurs can access the market for government goods and services on a fair basis. It is troubling that the Province has maintained an ineffective and inefficient system for so long.

The Provincial Government needs to have clear policies and rules that achieve transparency, and those policies must be made available for public scrutiny so the government is accountable. The Province should be reporting all completed contracts and contract amendments to the public like the PWGSC does, and it should attempt to centralize the procurement process in a single agency, like PWGSC, so it is clear when and to whom those rules apply. A centralized agency is also important so that the politicians and citizens know who to hold accountable when rules are broken.

Moving away from the often confusing and expensive MERX procurement program to a free program available on a government's website would assist small businesses in the procurement process.

It cannot be said that such a procurement process is too difficult or expensive because the framework already exists in Canada. The Federal Government has enacted a sound procurement process that has been shown to aid in the involvement of small entrepreneurial firms while maintaining transparency and accountability. If Manitoba were truly in the process of developing a unified procurement manual, one would hope that the manual borrows heavily from the PWGSC Supply Manual. Unfortunately, much more than a new manual is needed to fix the Province's weak procurement system.

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