

CONTRACT TENDERING: OVERVIEW AND APPLICATION TO LOCAL GOVERNMENTS

F u l t o n & C o m p a n y

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A. PURPOSE OF TENDERING

The basic premise of contract tendering arises from the desire of an owner to obtain the most competitive price for his job. Over time a system of tendering has been developed through common law, legislation and private contractual rights. Inevitably, those systems were challenged in the courts by either the owners or the contractors resulting in a further defining of the tendering system. Ultimately, the purpose of the tender system is to provide competition, and thereby to reduce costs.

This paper is meant to set out a brief review of the leading case law and principles which govern behaviour of parties in the tendering system.

At present the leading cases on contract tendering come from the construction industry. These include: *The Queen v. Ron Engineering and Construction (Eastern) Ltd.* (1981), 119 D.L.R. (3d) 267; *MJB Enterprises Ltd. v. Defence Construction (1951) Ltd.* (1999), 44 C.L.R. (2d) 163; and *R v. Martell Building Ltd.*, 2000 S.C.C. 60.

B. PRE AND POST *RON ENGINEERING*

Prior to *Ron Engineering*, the common law permitted an owner almost unfettered freedom in his use of tenders. One of the leading authorities on contract tendering, Goldsmith on Canadian Building Contracts states:

an owner who invites a tender is not, in the absence of a binding agreement to that effect, obliged to accept the lowest, or any, tender, or to reject a tender which may be irregular.

In the 1981 case of *Ron Engineering*, the Supreme Court of Canada was asked to review the overall process associated with contract tendering and provide direction to the construction industry. This case has long been considered as establishing the framework of the law of tendering in Canada. This facts involved the request by the contractor of his tender deposit as a result of an error discovered by the contractor and indicated to the owner prior to any tender being accepted by the owner. The most lasting effect of the decision given by the Supreme

Court of Canada in the case was its adoption of a contractual analysis to describe the tendering system.

The Supreme Court held that in a tender situation there were actually two contracts contemplated by the parties. The first contract (Contract A) was established as a form of unilateral contract. This would be akin to a homeowner putting out a unilateral offer to any person interested that if they would cut his lawn, he would pay them a dollar. No contract is formed until such time as somebody accepts his offer. With tendering, the unilateral contract is in the invitation to tender made by the owner. The acceptance of that offer and the formation of Contract A is made when one or more parties submits a tender in response to the owner's offer. Each tenderer then has a separate Contract A with the owner and the owner has multiple Contract A's with as many parties who have submitted tenders. The terms of Contract A are defined by the terms of the tender documents.

Once the owner has selected the successful tenderer the owner is then free to enter into a formal contract with that tenderer. The contract was referred to by the Supreme Court of Canada as Contract B. Although there could be multiple Contract A's there could only be one Contract B; with the successful tenderer. The use of the terms "Contract A" and "Contract B" have now come to be used by the tendering industry as a method of describing the tendering process. *Ron Engineering* may have been decided in favour of the owner (the tenderer was not permitted to withdraw his tender); however, the ongoing impact of *Ron Engineering* was felt to be more in favour of tenderers than owners. Owners were now bound by the terms of their tender where they had previously viewed those same terms as guidelines only.

C. LEGAL PRINCIPLES ARISING OUT OF THE CASES THAT FOLLOWED THE *RON ENGINEERING* DECISION

I. IRREVOCABILITY

Subsequent case law established that once submitted by the tenderer, a tender had to be irrevocable before Contract A came into existence. In pure contract terms, the irrevocability was the consideration which passed from the tenderer to the owner in exchange for the owner's commitment to comply with the terms of Contract A (the rules of the tender process).

II. COMPLIANT V. NON-COMPLIANT BIDS

The post-*Ron Engineering* cases generally showed a willingness of the courts to allow a distinction between "minor" tender irregularities and "serious" tender irregularities. In many

cases, the courts have held that the minor irregularities were those which could be waived by the owner if they reserved those rights to themselves in the tender documents. The serious tender irregularities were those which would render a bid unacceptable. In many cases, these decisions allowed the owners, through the use of privilege clauses combined with other provisions in the tender documents, to have a free hand in determining what was an irregularity and whether or not they wished to overlook that irregularity. Such decisions were regularly made by owners notwithstanding tender requirements that terms of the tender document had to be strictly complied with.

III. DUTY OF FAIRNESS

The analysis of this Contract A/Contract B process eventually led the courts to imply an obligation of fairness from the owner in choosing the successful tenderer. A British Columbia case *Chinook Aggregates Ltd. v. Abbotsford (Municipal District)* (1990), 35 C.L.R. 241 held that an owner could not use secret criteria or undisclosed policy in reaching its decision as to who would be a successful tenderer. The courts held that the owner's obligation of fairness to all tenderers overrode any privilege clause that may have been provided to the owner in the tender documents. Cases subsequent to *Chinook Aggregates* have clarified this obligation. As long as an owner was clear in its privilege clause and exercised the privilege clause equally and fairly to all tenderers, then the privilege clause would be permitted.

IV. DAMAGES

The issue of damages was not addressed by the *Ron Engineering* case and remained unsettled until the advent of the *MJB Enterprises* case. The only consistency that the courts had with respect to the awarding of damages for breach of tendering process (by owners or tenderers) was inconsistency. In many cases, breaches by the owner resulted in the tenderer being able to recover only the cost of preparing the tender. The owner was limited to recovering damages calculated as being the difference between the lowest tenderer and the next lowest tenderer. It was only on rare occasions when there was particularly objectionable behaviour by the owner that a tenderer was awarded damages based on the profit he would have made had Contract B been awarded to him.

D. **MATTERS ARISING OUT OF THE *MJB* CASE**

The Supreme Court of Canada heard the *MJB Enterprises* case on the 6th of November, 1998 and the Reasons for Judgment were released on the 22nd of April, 1999. The case was an appeal from the Alberta Court of Appeal and the judgment was given as a unanimous judgment from

the Supreme Court; This case permitted the court to deal with issues that would have a vital impact on all areas of commerce in which tenders or requests for proposals are made. The court limited the issues it would address to those surrounding the privilege clause in the tender terms. The issues directed by the Supreme Court were as follows. Does the privilege clause:

1. Allow the person calling for tenders to completely disregard the lowest proper and acceptable valid tender and award the contract to anyone, including a non-compliant tenderer or to a contractor which did not submit a tender through the tendering process;
2. Allow the person calling for tenders an absolute and unfettered discretion in awarding the contract; and
3. Allow the person calling for tenders to then commence bid shopping with contractors submitting tenders and contractors not submitting tenders.

I. ISSUES ADDRESSED BY THE COURT

The facts of the *MJB* case are as follows: The original specifications of the tender documents contemplated that tenderers would submit a per lineal metre price for construction of the water system. There were three different types of material in which water pipe might be laid and with which the trenches for the pipes might be backfilled, type two large gravel fill, type three native backfiller, type four slurry concrete.

The site engineer would determine the type of material required at various parts of the distribution system. Since the lineal costs of the different fills varied widely, the specifications included a schedule of quantities which allowed the tenderers to submit their bids on a basis which would make the final cost contingent on the amount of the different fills required (i.e. the tenderer could set out different amounts per lineal metre of each of types two, three and four fill). However, the amendments to the tender documents deleted the schedule of quantities. The effect of this was to require the tenderers to submit only one price per lineal metre of the water distribution system regardless of the type of fill which would ultimately be designated by the engineer during construction. As a result, the contractor would receive the same set unit price per lineal metre of measurement regardless of actual costs incurred by the contractor. The tender submitted by the successful tenderer included a hand-written note that indicated that the unit prices were based on type three but if type two material was required, then the owner would be required to add \$60.00 per metre to the tenderers bid price. All other tenderers complained that the note was a qualification of a tender and invalidated the tender. The owner determined that the note was merely a clarification and accepted the bid. *MJB* as one of the

unsuccessful tenderers brought an action for breach of contract claiming that the successful tenderer should have been disqualified and that MJB's tender should have been accepted as the lowest valid bid. On the first issue directed by the Supreme Court of Canada, the court held that the privilege clause did not allow for a person calling for tenders to accept a **non-compliant tender**. The court indicated that where there is no explicit term in the tender documents that indicates Contract B would be awarded to the lowest valid tenderer, then an implied term based on the presumed intention of the parties must be necessary to give business efficacy to a contract. The implied term in the tendering process was that the owner would accept only a compliant tender. The tender privilege clause in *Ron Engineering* read as follows:

“the lowest or any tender shall not necessarily be accepted.”

Although this privilege clause appeared to permit the owner to accept any form of tender whether or not they were compliant, the court determined that the owner could not reject a compliant tender in favour of a non-compliant tender. The court also supported the previous decision in *Chinook Aggregate* by indicating that a tender could not be accepted on the basis of some undisclosed criteria.

On the second issue as to whether or not the person calling for tenders had unfettered discretion in the awarding of the contract the court held that “the privilege clause is only one term of Contract A and must be read in harmony with the rest of the tender documents. To do otherwise would undermine the rest of the agreement between the parties.”

With respect to issue number three, bid shopping, the court held that once a person calling for tenders commenced the tendering process that person could not negotiate over the terms of the tendered documents. The court indicated further that the intent of the tendering process is to eliminate negotiation in favour of competition between numerous tenderers.

II. DAMAGES

The court did not specifically address the issue of damages as a separate issue (i.e. it was not one of the three original issues it asked the parties to address before them.) The court declined to add that as a formal issue to the hearing but ended up dealing with it in any event. The court did, however, deal with the issue of damages in relation to what were the proper damages that could be expected by an aggrieved party in the tendering process.

As noted above, there was a great diversity in opinion among the Canadian courts as to the

proper measure of damages for breach of Contract A. On this issue, the court returned to what is considered the standard measure of damages for breach of contract: expectation damages, which is calculated as the profits the party expected to receive under the contract. The court has indicated that each circumstance involving a breach of contract would be examined on its own facts and the balance of probabilities would support or refute any claim for damages that would have arisen out of Contract B had it been awarded to a different party. The court did, however, indicate that they did not feel that damages based on a loss of Contract B were too remote to arise from a breach of Contract A. In other words, if the owner improperly accepted the Contract A of a non-compliant tenderer and awarded Contract B to that non-compliant tenderer then it would be foreseeable to the owner that one of the tenderers who submits a compliant bid will suffer a loss and damages from not being awarded Contract B.

III. CONSEQUENCES OF THE *MJB* DECISION

1. No bid shopping is allowed by the person calling for tenders once the tender closes.
2. The owner has the right to list the criteria upon which an award of Contract B will be awarded. That criteria must be set out in the tender documents.
3. The owner cannot award Contract B on the basis of undisclosed criteria.
4. The owner does not have absolute and unfettered discretion in awarding Contract B to any tenderer. Only compliant tenders can be accepted by the owner.
5. A privilege clause allows the owner to award Contract B to any tenderer as long as the tenderer is compliant.
6. Notwithstanding the privilege clause, the owner has an obligation to award the tender to a tenderer that best meets the criteria stated in the call for tenders.
7. Damages will be awarded on the basis of expectation due to the loss of Contract B.

E. MATTERS ARISING OUT OF THE *MARTELL* CASE

While the initial aspect of this case dealt with a determination of whether or not a common law duty of care under the law of negligence was owed by an owner to the tenderers that issue was summarily dismissed by the courts. They determined that such a duty would create uncertainties rather than clarify the tender process. At present no such duty of care exists in tendering law. However, the court did express an opinion with respect to an obligation towards fairness.

The duty of fairness is owed to the tenderers within the tendering process. Similar to the *MJB* decision the court determined that an implied duty of fairness should be read into the tendering documents. The court supported this position by indicating that fair and equal treatment:

is consistent with the goal of protecting and promoting the integrity of the bidding process, and benefits all participants involved. Without this implied term, tenderers, whose fate could be predetermined by some undisclosed standards, would either incur significant expense in preparing pre-trial bids or ultimately avoid participating in the tender process.

The duty of fairness, however, is to be defined with consideration to express contractual terms of the tender. Unless the privilege clause or some other terms of the tender documents indicate that the owner is entitled to act unfairly in determining the awarding of the tender (which is not likely to occur since no tenderer would expend the funds necessary to prepare a tender if they were not guaranteed to be treated fairly) then the duty of fairness would survive the terms of the tender documents.

The two main points that can be taken from the *Martell* decision are that there is a duty of fairness that is required to be exercised by the owner within the tendering process and also that there is no duty of care within the tendering process.

F. ALTERNATIVE PRICING/ALTERNATIVE TENDERING

Unless alternative tendering or alternative pricing is specified in the tender documents, such pricing cannot be utilized by local governments in reaching a decision as to the successful tenderer. If the use of the alternative pricing or alternative tendering is used by a tenderer without being requested in the tender package, then very likely such a tender would be non-compliant, and could not be accepted by the local government as a successful tender.

If alternative pricing or alternative tenders are desired by the local government, then the government should determine how they will choose the successful tenderer and that method of determination should be expressly indicated in the terms of the tender document. There are three trains of thought in the construction industry relating to the use of alternative tenderers:

1. Do not use any alternative pricing or alternative tenders since doing so complicates the preparation and valuation of the bid.
2. Alternative tenders can be provided, however, they will not be used until the successful

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compliant tenderer has been chosen based on non-alternative pricing. Thereafter the local government may review the alternative tender or alternative pricing of the successful tenderer and at their discretion elect to choose such alternative pricing. Such alternative tender should be an addition to, and not a substitution, for a tender which conforms to the requirements of the tender documents.

3. While complicating the process, local governments can indicate that the successful tenderer will be chosen on the basis of the combination of the original tender document specifications and acceptable alternative prices provided in accordance with the alternative pricing specifications set out in the tender documents.

Most of the bodies which prepare standard form documents recommend against the third option as it provides unnecessary complication to the tender process and adds to the workload of the administration of the local government in choosing the successful tenderer. In addition, the more factors that are required to be considered by the local government in choosing the successful tenderer, the more likelihood there is that an error may be made and that an unsuccessful tenderer may have an argument that they were treated unfairly or not equally with other tenderers or that the local government in choosing the successful tenderer did not fully examine the significant cost differences associated with the alternative pricing. In the Master Municipal Construction Document the Instructions to Tenderers state as follows:

6.1 Tenders which contain qualifications or omissions so as to make comparisons with other tenders difficult, may be rejected by the Owner.

6.2 A tenderer may at the tenderer's election, submit an alternative tender ("Alternative Tender") which varies the materials, products, designs or equipment from those approved under the Contract Documents or approved by the Owner as Approved Equals as the case may be, but an Alternative Tender must be an addition to, and not a substitution for, a tender which conforms to the requirements of the Contract Documents.

6.3 The only Alternative Tender that the Owner may accept is an Alternative Tender submitted by that tenderer whose conforming tender, submitted as required by paragraph 6.2 of these Instructions to Tenderers – Part II, would have been accepted by the Owner in preference to other conforming tenders, if no Alternative Tenders had been invited.

The British Columbia Construction Association in their guide to bidding procedures has the following recommendation:

alternate, separate, itemized and unit prices complicate the preparation and the evaluation of the bid; therefore, they should be avoided. If these prices are required, the bid document should specify that the prices be provided within 48 hours after the bid closing by the lowest bidder only.

The World Bank Standard Bidding Documents have the following with respect to instructions to bidders:

...bidders wishing to offer technical alternatives to the requirements of the bidding documents must first price the employer's design as described in the bidding documents and shall further provide all information necessary for complete valuation of alternative by the employer, including drawings, designs calculations, technical specifications, breakdown of prices, and proposed construction methodology and other relevant materials. Only the technical alternatives, if any, of the lowest evaluated bidder conforming to the basic technical requirements shall be considered by the employer.

In many cases, the reason for asking for alternative bids is to try to obtain the most cost-effective price for the work to be done. In such circumstances, it does not make sense to only refer to alternative bid prices after the lowest compliant tenderer has been awarded the contract. As such, local governments may wish to leave open the option of examining all the alternative prices as they relate to the original bid and to those alternate prices.

G. CONCLUSION - APPLICATION OF PRESENT DAY LAW TO A MUNICIPAL TENDERING PROCESS

So how does all this applicable case law affect local governments when calling for tenders on projects?

1. Local government bodies should be aware that contractual rights arise from the tendering process itself prior to the award of the contract. Certain obligations will be placed on both the local government and the contractors relating to Contract A (the tender).
2. In administering the tendering process and preparing the tender documents, the local government will be held to an obligation of fairness such that they treat all tenderers equally and fairly with respect to the tender process. (unless they expressly exclude such an obligation in the terms of the tender documents).
3. The decision of the Supreme Court in *MJB* that irrevocability of a tender is not a precondition to the existence of Contract A has far-reaching consequences to the local

government. This applies to more than just construction contracts. While no case law has yet determined this legal position, the findings in *MJB* potentially expand the number of scenarios to which the rights and responsibilities of contractors can arise under Contract A (i.e. request for proposals and expressions of interest).

4. While local governments are entitled to word their privilege clause as broadly as they deem appropriate, the implementation of that privilege clause falls under the obligation to act fairly and equally among all the tenderers.

5. No matter how fairly and equally the privilege clause may be administered it will not operate to allow the local government to choose a non-compliant tenderer over a compliant tenderer. This affects the ability of the local government to choose or accept tenders. In the past, local governments had privilege clauses that combined with related provisions in the tender documents allowed the local government to reject a tender that contained errors or qualifications but also permitted the owner to waive those irregularities if they so chose. Following *MJB*, such irregularities may be viewed as non-compliant tenders and as such, notwithstanding the privilege clause and related provisions, the local government would not be permitted to choose that tender, as it would be non-compliant.

6. The damages that will now be awarded against local governments for breach of the tender process are significantly more than what had previously been experienced. Damages may now be calculated on the basis of lost profit on the actual contract (Contract B) rather than the expenses incurred by the tenderer on the tender contract (Contract A).

7. All the cases cited in this paper do make note in their decisions that the express terms of the tendering documents govern. Therefore, if tendered documents contain privilege clauses and related terms that are express and clear in their intent and that are applied equally to all tenderers, then it is open to the local governments to structure their tender packages in such a way that allows them the greatest latitude in criteria for choosing the successful tenderer.