THE LAW OF TENDERING

by

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I. Introduction

Few areas of law have evolved as rapidly over the last decade as the law of tendering. In this article I will examine how this evolution has affected two questions which commonly arise during the tendering process:

a. When does a binding contract arise?

b. Is there a duty to treat bidders fairly?

The law of tendering is a branch of contract law, and is generally governed by the same principles. The most important principle is that the wording of a contract defines the parties' rights and obligations. In a tendering dispute, this wording is found in the tender documents. While it is possible to generalise from the cases considered below, one must carefully review the relevant documentation and factual background of a tender call before coming to any conclusions. Different language may give rise to different results.

II. When Does a Binding Contract Arise?

A. The Traditional Approach

In order to appreciate why the law of tendering has changed so dramatically it is necessary to understand some fundamentals of contract law. Three things are required in order for a contract to arise:

1. an *offer*,

2. an unconditional *acceptance* of that offer which is *communicated* to the other party while its offer is still valid, and

3. an exchange of something of value, known as *consideration*.

Traditionally, the law considered an Invitation to Tender to be a request for bidders to make an offer in the form of a tender. A binding contract did not arise until the owner accepted a bid. The consideration was the owner's contractual promise to pay the contractor the amount of its bid in exchange for the contractor's promise to do the work described in the tender documents.

B. General Contractor Bids

In 1981 the Supreme Court of Canada decided that this traditional approach to tendering was all wrong. In *The Queen v. Ron Engineering & Construction (Eastern) Ltd.*[1] that Court considered a call for tenders for the construction of a water and sewage treatment plant. When the tenders were opened Ron Engineering's bid of $2,748,000 was $632,000 lower than the second lowest bidder. Approximately one hour later Ron Engineering sent the Ministry a telex advising that its bid mistakenly omitted a cost of $750,058 for its own forces, and requesting that it be allowed to withdraw its bid without forfeiting its deposit of $150,000. The owner responded by presenting Ron Engineering with the construction contract for execution. Ron Engineering refused to sign, and sued the Ministry for the return of its deposit.

Ron Engineering based its case on the traditional law of tendering. It argued that an owner could not lawfully accept an offer that it knew contained an error. Since a binding contract could not arise, the owner was required to return the bid deposit.

The Supreme Court of Canada rejected this argument. It held that tendering involves *two* separate agreements, "Contract A" and "Contract B". Contract B is straightforward - it is the construction contract entered into between the owner and the successful bidder.

What was more controversial was the Court's description of Contract A. The Court concluded that an invitation to tender is properly understood as an offer, rather than an invitation to make an offer. Contract A arises when a contractor accepts this offer by submitting a bid. The terms of Contract A are set out in the tender documents.

In the *Ron Engineering* decision, those terms specified that bids were irrevocable for 60 days. By withdrawing its tender Ron Engineering breached Contract A and forfeited its deposit.

C. Subcontractor Bids

1. The Law in British Columbia

The leading British Columbia decision on subcontractor bids is the 1981 Supreme Court decision of *Peddlesden Ltd. v. Liddell Construction Ltd.*[2] Peddlesden submitted a bid through a bid depository for masonry work on a school. The depository required subcontractor bids to be irrevocable for 30 days. Liddell Construction nominated Peddlesden as the masonry subcontractor in its bid to the owner, and was awarded the

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1 (1981), 119 D.L.R. (3d) 267.

2 (1981), 32 B.C.L.R. 392 (B.C.S.C.).

head contract. A few days later, after the Peddlesden bid expired, Liddell sent a letter of intent informing Peddlesden that it was awarded the subcontract.

Shortly afterwards Liddell sent a second letter informing Peddlesden that it would not get the masonry subcontract because its bid bond had not been sealed, as required by the bond. Peddlesden immediately offered to correct this omission, and the bonding company confirmed that it would accept the bond once sealed. Peddlesden had failed to properly execute its bid bond on four previous occasions. Deciding to take a stand, Liddell completed the masonry work on a cost-plus basis with another subcontractor who had not bid on the job. Peddlesden sued for damages.

At trial, Liddell Construction relied on the well established legal principle that a binding contract does not come into existence until one party notifies the other that its offer has been accepted. Liddell's letter of intent notified Peddlesden that its bid had been accepted *after Peddlesden's bid expired*. Liddell argued that its acceptance of Peddlesden's offer was ineffective.

The Court rejected this argument. It held that a contractor is obliged to use a subcontractor if:

1. the contractor nominates the subcontractor in its bid to the owner,

2. the owner accepts the general contractor's bid, and

3. the general contractor's bid is accepted before the subcontractor's bid expires.

The timing of Liddell's letter of intent was therefore irrelevant.

The Court upheld Peddlesden's claim and ordered Liddell Construction to pay Peddlesden's profit and overhead. Profit was calculated at 15% and overhead at 10% of the labour and material costs in Peddlesden's estimate sheets.

2. The Law in Ontario

The reasoning in *Peddlesden* has been criticised by judges in other provinces. In *Scott Steel (Ottawa) Ltd. v. R.J. Nicol Construction (1975) Ltd.*[3] an Ontario Court considered a telephone bid by a structural steel subcontractor. R.J. Nicol nominated Scott Steel in its bid to the owner, and was awarded the head contract. After learning that Scott Steel might not be able to meet the owner's schedule, R.J. Nicol awarded the job to another subtrade. R.J. Nicol did not advise Scott Steel that it would be awarded the steel contract at any time during these discussions.

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[3] (1993), 10 C.L.R. (2d) 128 (Ont. Div. Ct.).

Relying on *Peddlesden,* Scott Steel argued that a binding subcontract arose as soon as R.J. Nicol's bid was accepted by the owner. The Ontario Court disagreed:

> I see no reason why the normal rules relating to acceptance should be departed from as was done in *Peddlesden*.... [N]othing in the bidding process would be affected if the contractor was not bound in a contractual relationship with a subtrade until he himself has the contract with the owner *and he subsequently communicates his acceptance of the subcontractor's bid*.

Since R.J. Nicol never told Scott Steel that it would get the subcontract, the Court dismissed Scott Steel's claim.

3. The Future of Subcontractor Bids

The precise moment at which a binding subcontract comes into existence has therefore not been clearly settled. The *Peddlesden* decision concluded that the general contractor is bound to use nominated subcontractors as soon as its bid is accepted by the owner. The *Scott Steel* case held that a nominated subtrade has a binding agreement only if the general contractor confirms that the subcontractor will get the work.

To understand how this discrepancy is likely to be resolved we need to consider how the judicial system operates. Trial Judges are generally required to follow the reasoning of other decisions in their own province, unless the facts in the two cases are significantly different. Decisions from other provinces do not carry the same weight. A Trial Judge is free to reject them if their reasoning is not persuasive. Court of Appeal Judges, on the other hand, are not required to follow any trial decision. The Court of Appeal interprets the law in whatever manner it considers to be correct, even if this means overruling a trial level decision in its own province.

Peddlesden is a British Columbia decision and *Scott Steel* is from Ontario. A British Columbia Trial Judge is therefore likely to follow *Peddlesden*. If the case is appealed, however, it is difficult to predict how the Court of Appeal will resolve this complex issue. While *Peddlesden* has the upper hand for the time being, it is still too early to call the final decision.

II. The Duty of Fairness

A. General Contractor Bids

1. Ensuring Fairness for the General Contractor

The *Ron Engineering* decision set the stage for another case that has had a significant impact on tendering practices in this Province.

Chinook Aggregates Ltd. v. Abbotsford[4] involved a call for tenders on a gravel crushing contract. The Invitation to Tender contained the standard privilege clause stating that "the lowest or any tender will not necessarily be accepted." Chinook Aggregates submitted the lowest bid. However, Abbotsford awarded the contract to a local contractor, in accordance with its policy of awarding contracts to local contractors whose bids were within 10% of the lowest bid. This policy was not disclosed in the tender documents or elsewhere, for the obvious reason that Abbotsford did not want local contractors to relax their competitive pricing.

Chinook Aggregates challenged the award. It argued that Contract A included not only the terms expressly set out in the Invitation to Tender, but also certain *implied terms*. These implied terms incorporate into Contract A tendering practices so widely followed by the construction industry that they "go without saying". Chinook Aggregates claimed that one well recognised practice is that contracts are awarded to the lowest qualified bidder. An owner who follows an undisclosed policy of favouring local contractors disregards this practice and breaches an implied term of Contract A. Abbotsford replied that a term that it would award the contract to the lowest qualified bidder could not be implied into its tender documents because of the privilege clause, which notified bidders that the industry practice would not necessarily be followed.

On Appeal, the Court rejected Abbotsford's argument. It held:[5]

> ... it is inherent in the tendering process that the owner is inviting bidders to put in their lowest bid and that the bidders will respond accordingly. If the owner attaches an undisclosed term that is inconsistent with that tendering process, a term that the lowest qualified bid will be accepted will be implied in order to give effect to that process.

By awarding the contract to a local bidder, Abbotsford "was in breach of a duty to treat all bidders fairly and not to give any of them an unfair advantage over the others."[6]

2. Ensuring Flexibility for the Owner

The *Chinook Aggregates* decision gave rise to a difficult question: if an owner has to award the contract to the lowest qualified bidder even where it has given notice that the lowest bid will not necessarily be accepted, can it ever pass over the lowest bidder in favour of another contractor? Can an owner ever award the contract to a builder with greater experience or financial capability than the lowest bidder?

Recent decisions establish that an owner is not always bound to award a contract to the lowest bidder. What has not been conclusively answered, however, is when an owner is free to reject the lowest bid.

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4 (1987), 28 C.L.R. 290 (B.C.S.C.), appeal dismissed (1989), 35 C.L.R. 241 (C.A.).

5 *Chinook Aggregates*, at p.249.

6 *Chinook Aggregates*, at p.248.

The thrust of recent cases is that the courts will require the owner to award the contract to the lowest qualified bidder *only where such an implied term is necessary to ensure fairness in the bidding process*. For example, in the recent case of *Martselos Services Ltd. v. Arctic College*[7], the Northwest Territories Court of Appeal carefully reviewed *Chinook Aggregates* and the other decisions which have considered the effect of privilege clauses. It concluded:[8]

> Practice and custom have been held to override the privilege clause only in specific cases with special circumstances. Those circumstances have been where the owner has relied on undisclosed criteria, or where the owner takes into account irrelevant or extraneous considerations, or where there are specific provisions in the tender specifications that are inconsistent with the general privilege clause, or where the tendering process was a sham.

These cases suggest that an owner is free to reject the lowest bidder, when the criteria on which it relies are set out in its tender documentation. If an owner wishes to consider a contractor's experience, for example, the tender documents should ask contractors to specify their experience with projects of a similar nature and size. Any other criteria considered by the owner should also be set out.

By disclosing its standards, an owner should be free to select the type of contractor it wants without violating the duty to treat all bidders fairly.

B. Subcontractor Bids

Bid depository rules usually contain a privilege clause stating that "the lowest or any bid will not necessarily be accepted." As we have seen, it is now well recognised that these clauses do not allow an owner to act arbitrarily in awarding a contract. Are subcontractors also entitled to be treated fairly by general contractors? The cases have considered this issue in the course of answering three questions:

1. Is bid shopping legal?

2. Can the general contractor renegotiate subcontractor bids after it is awarded the contract?

3. Can a general contractor be prevented from relying on a privilege clause to reject the lowest bid?

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[7] [1994] 3 W.W.R. 73 (N.W.T.C.A.), leave to appeal to the Supreme Court of Canada refused on September 1, 1994.

[8] At p.82.

1. Bid Shopping

In *Ron Brown Ltd. v. Dwain Johansen*[9] the British Columbia Supreme Court considered the legality of bid shopping by Johansen, the successful bidder on the head contract for a sewage treatment plant. Ron Brown submitted the lowest mechanical bid to Johansen. Johansen in turn used Brown's bid to prepare its own bid to the owner. However, Johansen failed to nominate Brown as the mechanical subcontractor, or to indicate that Johansen intended to do the mechanical work himself. Johansen was awarded the head contract and completed the mechanical work with his own forces. Brown sued for its loss of profits.

The Judge relied on the earlier decision of *Peddlesden Ltd. v. Liddell Construction Ltd.*, which established that a contractor whose bid has been accepted is obligated to use its nominated subcontractors. The Judge confirmed that Johansen would have been legally liable if he had nominated Brown. But the Court refused to extend this principle further. Johansen was not obligated to use Brown simply because he took advantage of Brown's bid. The Court recognised that the industry disapproved of bid shopping. However, the Judge refused to find that this questionable business practice was necessarily against the law.

The *Ron Brown* decision is an example of how conduct which is considered unfair by business standards may not necessarily be unlawful.

2. Renegotiating the Bid

In today's highly competitive industry, it is not unusual for bidders to be asked to lower their price or to revise their bid after tenders are opened. The cases demonstrate that everyone must tread very carefully during these negotiations.

(a) Negotiations Between the Subcontractor and General Contractor

An example of the trouble that contractors can get into is found in *Protec Installations Ltd. v. Aberdeen Construction Ltd.*[10], which considered a call for tenders for the electrical work on the Parker Place Mall in Richmond. The owner and general contractor were related companies. The Instructions to Bidders contained the standard privilege clause.

Protec's bid of $631,335 was over $60,000 lower than the second lowest bid from Lilly Electric (1973) Ltd. After discovering that it was not the lowest bidder, Lilly telephoned the owner and offered to do the job for $5,000 less than Protec. After further negotiations, Lilly entered into an agreement to do the work for $618,709. Although there was some dispute

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[9] (Unreported, April 10, 1990, B.C.S.C.).

[10] (1993), 6 C.L.R. (2d) 143 (B.C.S.C.).

among the witnesses, the Court accepted Protec's evidence that it was excluded from the post-tender negotiations.

The Court found that there was no valid commercial reason for excluding Protec from these negotiations, and that the general contractor had not conducted the bidding process in good faith. This violated its duty to treat all bidders fairly and to not give any of them an unfair advantage over the others. Protec was granted judgement against Aberdeen Construction, with damages to be calculated at a later date.

(b) Negotiations Between the General Contractor and the Owner

In *Westgate Mechanical Contractors v. PCL Construction Ltd.*[11] the Court considered the consequences of post-tender negotiations between the owner and the general contractor.

Westgate submitted a telephone bid to PCL for mechanical work on a highrise office building in Vancouver. The owner refused to accept any of the bids and instead entered into negotiations with the general contractors. These negotiations led to an agreement between the owner and PCL which reduced the price in PCL's original tender by 1% ($285,000), and shortened the construction schedule by 5% (from 19 to 18 months). Westgate was not consulted during this process. PCL asked Westgate to reduce its price by 3-4%, or approximately $120,000. Westgate refused. Westgate argued, relying on the earlier decision in *Peddlesden Ltd. v. Liddell Construction Ltd.*, that it had a binding agreement because it had been nominated by the successful general contractor.

The legal issue at trial and on appeal was whether PCL's original bid had been rejected by the owner, or whether the bid had merely been amended. If the bid had been rejected then the tendering process had been terminated by the owner and Westgate could not claim that it had any rights under PCL's bid. If the bid had simply been amended, on the other hand, then PCL's original bid was the foundation for PCL's contract with the owner, and PCL would be obliged to work with Westgate and the other subcontractors nominated in that bid.

The evidence established that the owner had rejected all of the original bids, and had entered into direct negotiations with PCL. Once the bids were rejected PCL's bid ceased to have any legal effect. PCL's bid no longer formed the basis of a binding commitment to the owner or to any of PCL's subtrades. Westgate's action was dismissed.

The Court in *Dave's Plumbing & Heating (1962) Ltd. v. Voth Brothers Construction (1974) Ltd.*[12] came to a different conclusion. Dave's Plumbing submitted a bid to Voth for the mechanical portion of a contract to build a railway diesel shop. The bid depository rules provided:

> Tenders shall not be altered or amended in any way after Bid Depository closing time.

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[11] (1989), 33 C.L.R. 265 (B.C.C.A.).

[12] (1986), 21 C.L.R. 276 (B.C.S.C.).

Voth nominated Dave's Plumbing in Voth's bid to BCR. All of the bids exceeded BCR's budget and it asked the general contractors to submit cost saving proposals. Voth in turn began negotiations with Dave's Plumbing and Westgate Mechanical, which had submitted the second lowest bid. On May 15, 1984 BCR sent Voth a letter stating:

> This will confirm acceptance of your tender dated April 27, 1984 ....

Further negotiations followed between Voth and Dave's Plumbing, but eventually Voth awarded the mechanical contract to Westgate.

Dave's Plumbing sued. Relying on the *Peddlesden* decision, Dave's Plumbing argued that it was entitled to the work since it had been nominated in Voth's bid, which had been accepted by the owner. Voth replied that *Peddlesden* did not apply since the May 15, 1984 letter from BCR was not an *acceptance* of Voth's bid, but a *counter-offer* from the owner.

The Court disagreed with Voth. It held that the Owner had accepted Voth's bid. Dave's Plumbing was entitled to the mechanical work, and was awarded damages to be assessed at a later date.

(c) Changes in the Construction Contract

General contractors sometimes try to change the terms of a bid by presenting a subcontractor with a construction contract that does not conform to the tender documents.

An Alberta Court considered this situation in *Forest Contract Management Ltd. v. C & M Elevator Ltd.*[13] Forest requested bids for the supply and installation of two elevators. C & M submitted a telephone bid of $94,720 after receiving a quote from an elevator manufacturer. The construction contract which Forest presented for execution varied slightly from the specifications (it increased the price by $300, added a light and signal and introduced some supplemental conditions). C & M began its work but neglected to sign the contract.

After completing some of the preliminary work, C & M was informed that its elevator supplier had missed one elevator in its quote. C & M tried to get out of the contract by pointing to the discrepancies in the scope of work.

The Court rejected this argument. The Court held that C & M was bound by the terms of the contract once it commenced the work. If C & M wished to ensure that it would not be bound, C & M should have resolved any discrepancies prior to beginning the work.

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[13] (1988), 33 C.L.R. 118 (Alta. Q.B.).

3. Rejecting the Lowest Bidder

In *Ron Brown Ltd. v. Dwain Johansen*, considered above, the Court held that a general contractor's request for tenders is not governed by an implied term that the general contractor will nominate the lowest qualified bidder. This case suggests that a contractor is generally free to select any subcontractor, without regard to price.

A similar conclusion was reached in *Pro Star Mechanical Ltd. v. Sandbar Construction Ltd.*[14], where the Court relied on a privilege clause in the rules of the Victoria Bid Depository to uphold the contractor's position that it was not required to accept the lowest mechanical bid.

However, the Court in the *Pro Star Mechanical* decision went on to hold that the general contractor might not be able to rely on the privilege clause if the tendering process is tainted by collusion, secret agreements or other fraud. A similar conclusion was reached in the *Protec Installations Ltd. v. Aberdeen Construction Ltd.* decision, considered above, where the Court held that a general contractor, who had excluded the lowest bidder from post-tender negotiations, acted unfairly and was liable to that subcontractor.

These decisions indicate that, while a contractor is generally free to select any subcontract bid, this freedom is subject to an overriding duty to treat all subcontractors fairly.

III. Summary

The foregoing decisions permit us to draw the following conclusions:

1. In the case of a general contractor bid, Contract A arises when the general contractor submits a qualifying bid to the owner;

2. In the case of a subcontractor bid, a Trial Judge would likely conclude that Contract A arises when:

    a. the contractor nominates the subcontractor in its bid to the owner,

    b. the owner accepts the general contractor's bid, and

    c. the general contractor's bid is accepted before the subcontractor's bid expires. If the Judge's decision is appealed, however, Court of Appeal might follow the Ontario *Scott Steel* decision and conclude that a binding contract does not arise unless the general contractor notifies the subcontractor that the subcontractor's bid has been accepted.

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[14] (1992), 1 C.L.R. (2d) 310 (B.C.S.C.).

3. An owner owes general contractors a duty of fairness which prevents the owner from rejecting the lowest bidder, if doing so would result in unfairness such as fraud or collusion.

4. A general contractor owes subcontractors a legal duty of fairness which may:

   a. prevent it from excluding the subcontractor with the lowest bid from post-tender negotiations;

   b. prevent it from renegotiating a subcontractor's bid once its own bid is accepted by the owner;

   c. prevent it from rejecting the lowest subcontract bid in cases involving secret agreements, collusion or other serious instances of unfair conduct.

5. A subcontractor should ensure that its contract conforms to the tender documents before doing any work. If the subcontractor begins its work, it may be held to have waived any right to object to changes to the contract, even if the agreement has not been signed.

6. Not all unfair business practices are unlawful.

The application of these principles will depend on the tender documents and other surrounding circumstances of a particular case.

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