THE DUTY OF FAIRNESS, PRIVILEGE CLAUSES, AND NEGOTIATION IN TENDERING, REQUEST FOR PROPOSAL AND “HYBRID” PROCUREMENT PROCESSES

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Introduction

An owner contemplating procurement of services (whether construction services or otherwise) has a variety of procurement processes to choose from, ranging from requests for proposals (RFP) to invitations to tender, with a variety of so-called “hybrid” procurement processes in between. The interest of the owner is generally in preserving some degree of flexibility in the selection of the winning proposal or bid, rather than being obligated to accept the lowest price regardless of other relevant considerations. The situation represents a potential minefield for owners. The lowest price proponent in an RFP process can be expected to say that its proposal ought to be accepted. Where the procurement process imposes restrictions on the form of bids, as is the case in tendering processes, the lowest compliant bidder will be clamouring that its bid ought to be accepted. All compliant tenderers can be expected to say that accepting a non-compliant bid would represent a breach of their bid contracts with the owner. Non-compliant bidders may be waiting until all bids are opened before revoking their bids.

This paper is directed to owners contemplating the selection of one of a number of procurement process types. It addresses the duty of fairness, and the extent to which the law permits an owner:

To accept either a compliant bid other than the lowest compliant bid or a non-compliant bid in a tendering situation;

To accept proposals other than the lowest price proposal in a request for proposals, or “hybrid” procurement process; and

To negotiate with proponents or bidders in any procurement process.

This paper highlights the importance of a well crafted “privilege clause” and being clear in the procurement documents as to the ground rules that will be followed in the assessment of tenders or proposals.

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Tensions in the Tendering Process

The tendering process is normally a competitive bidding process in which the offerors (the contractors) tender their offer to the offeree (the owner). It usually commences when an owner, or someone on the owner’s behalf, issues a tender package to prospective tenderers, normally general contractors. The package is usually tailored to the particular project and contains a description of the scope of the work, the terms and conditions (or form) of the contract to be executed, the design, and the detailed specifications. It also specifies the particulars for submission of tenders and whether bid deposits or bonds are required. The tender package usually contains a “privilege clause” to the effect that the lowest or any tender will not necessarily be accepted.

The attraction of a tendering process, especially for a public owner, is its ability to induce fair competition among tenderers. As long as the tender package is clear and complete, it will produce a range of contract prices for consideration that accurately reflects current market conditions. Moreover, the extra cost of the tendering process to an owner is usually small since virtually all of the documents in the tender package can be used in the final contract package, which is necessary in any event.

The tendering process is attractive to tenderers as well. When the tender call is an “open” one, contractors who wish to expand their scope of operations, either in size or type of work, or who wish to work for new owners, are allowed to tender. According to the British Columbia Construction Association (BCCA) and to many consultants and owners, if a tenderer is able to obtain a bid bond then the tenderer is a “qualified” tenderer. This puts the tenderer on an equal footing with other qualified tenderers. Implicit in the process is an absence of favouritism: the tenderer is willing to incur the considerable expense necessary to prepare a competitive bid because the tenderer knows favouritism or secret preferences will not operate against the tenderer.

In every tendering situation, however, there is a tension between the interests of the owner and the tenderers. The owner generally desires to retain some flexibility and is uneasy about setting in motion a process that prevents the owner from reserving the right to make the final decision. The owner strives to be in charge of the final decision and normally wishes to retain some ability to react to unexpected tender results or to unexpected tenderers, who the owner does not believe can complete the work on time and/or within the contract price. Occasionally, owners may even be tempted to use the tendering process for undisclosed purposes: for example, to set a budget instead of making a contract, or to pursue political policies which give consideration to factors other than price.

On the other hand, tenderers are concerned that favouritism not be shown other tenderers, that arbitrary or capricious decisions not be made by the owner and that owners do not take advantage of innocent errors in their bids. Tenderers are willing to accept reasonable levels of competition provided the “rules of the game” are, for obvious reasons, clearly spelled out at the outset. Since preparing a tender can consume a great deal of time, effort, and expense, tenderers do not want to waste their resources tendering when they have little or no chance of success.
Legal disputes that arise from the tendering process are generally the result of these tensions. Whether resolving the problem of a bid that contains a mistake, or of the competing interests of bidders and owners, the law of tendering is an attempt by the courts to reconcile the expectations of all parties with generally accepted standards of commercial morality.

**Contract A/Contract B Analysis**

In *The Queen (Ont.) v. Ron Engineering*, [1981] 1 S.C.R. 111, the Supreme Court of Canada developed the Contract A/Contract B analysis in dealing with tendering. Prior to *Ron Engineering*, tenders were seen to be offers to owners where no contract arose unless the tender was accepted. Ron Engineering had tendered a construction project and made an error of $750,058 in its tender. The Province of Ontario accepted the tender and when Ron Engineering refused to execute a construction contract, the tender deposit of $150,000 submitted by Ron Engineering was forfeited to the Province. The Supreme Court of Canada upheld the forfeiture of the deposit.

The Court described the Contract A/Contract B analysis at pages 122-123:

> The tender submitted by the respondent brought contract A into life. This is sometimes described in law as a unilateral contract, that is to say a contract which results from an act made in response to an offer, as for example in the simplest terms, “I will pay you a dollar if you will cut my lawn”. No obligation to cut the lawn exists in law and the obligation to pay the dollar comes into being upon the performance of the invited act. Here the call for tenders created no obligation in the respondent or in anyone else in or out of the construction world. When a member of the construction industry responds to the call for tenders, as the respondent has done here, that response takes the form of the submission of a tender, or a bid as it is sometimes called. The significance of the bid in law is that it at once becomes irrevocable if filed in conformity with the terms and conditions under which the call for tenders was made and if such terms so provide. There is no disagreement between the parties here about the form and procedure in which the tender was submitted by the respondent and that it complied with the terms and conditions of the all for tenders. Consequently, contract A came into being. The principal term of contract A is the irrevocability of the bid, and the corollary term is the obligation in both parties to enter into a contract (contract B) upon the acceptance of the tender. Other terms include the qualified obligations of the owner to accept the lowest tender, and the degree of this obligation is controlled by the terms and conditions established in the call for tenders.
After *Ron Engineering*, numerous courts in Canada applied the Contract A/Contract B analysis. Three principles emerged from the application of *Ron Engineering*:

1. Only a compliant tender could be accepted by an owner;
2. The lowest compliant tender should be accepted; and
3. The owner owed bidding contractors a duty of fairness in analyzing the tender bids.

An example of the application of this analysis is *Sound Contracting Ltd. v. Nanaimo (City)* (1997), 42 B.C.L.R. (3d) 324 (S.C.), in which Downs J. properly summarized the law at that time:

> [57] In the case at bar the City mistakenly applied an undisclosed criterion to Sound’s bid which I found was a breach of Contract A. Had the City evaluated the tenders properly and had it decided Sound was the low bidder, it still had the option of not accepting any tender. If it were to accept any of the bids it would have had to accept Sound’s, because I find, aside from the cost analysis, Sound was otherwise qualified to perform the work in accordance with the City’s criteria (again, whether or not the City correctly concluded an independent engineer was required for Sound).

The legacy of *Ron Engineering* was that the courts sought to resolve tendering disputes in ways that address not only the interests of immediate parties, but also those that protect and effectuate the tendering system itself. Although not always expressly referred to, the requirement for good faith underlies nearly every tendering decision in the post-*Ron Engineering* period.

Owners were protected from contractors who allege mistakes as an excuse to revoke or revise their bids upwards when they find everyone else has bid substantially higher. In turn, the courts developed and imposed an obligation on owners to ensure that all bids will be given fair consideration. In short, the Contract A/Contract B analysis in *Ron Engineering* recognized that for the bidding system to be respected, it must be seen to be in accordance with established rules and both owners and contractors must exercise good faith. In the words of the Supreme Court of Canada in *Ron Engineering*, the courts will protect “the integrity of the bidding system … where under the law of contracts it is possible so to do.”
M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd.

In M.J.B., the Supreme Court of Canada modified the law of tender. In that case, the owner, Defence Construction (1951) Ltd., had included a so-called “privilege clause” in the invitation for tender that provided “the lowest or any tender shall necessarily be accepted”.

The lowest bidder in that case complained that Defence Construction (1951) Ltd. had accepted a higher non-compliant bid, thereby breaching the duty in Contract A to accept only the compliant lowest tender. While the Supreme Court of Canada accepted the proposition that the privilege clause required acceptance of only a compliant tender, the Court said at p. 644:

[48] Therefore I conclude that the privilege clause is compatible with the obligation to accept only a compliant bid. As should be clear from this discussion, however, the privilege clause is incompatible with an obligation to accept only the lowest compliant bid. With respect to this latter proposition, the privilege clause must prevail.

The Application of Tendering Law to Requests for Proposals and “Hybrid” Procurement Processes

An RFP process is generally considered to be the procurement process that allows the owner the greatest amount of flexibility. The decision of the BC Supreme Court in Tercon Construction Ltd. v. BC (MOTH) 2006 BCSC 499 suggested that tendering law may in some circumstances apply to procurement processes that are not, strictly speaking, a tendering process. The result is to limit the owner’s flexibility.

Tercon involved a process characterized as a request for proposals. Tercon sued the Ministry of Transportation and Highways (the “Ministry”) for failure to reject the first ranked proposal, which did not comply with one of the stated requirements of the RFP. Tercon alleged that its submission of a proposal to the Ministry resulted in a Contract “A” (i.e. a bid contract) between them, and had the Ministry complied with the terms of the contract, the plaintiff would have been ranked first and would have been awarded the contract. The court found in favour of Tercon.

Tercon illustrates that tendering law can apply in some instances to a procurement process considered by the owner to be an RFP process. However, it is important to recognize that the Tercon decision turned on the specific facts of that case. The procurement process undertaken by the owner in Tercon amounted in substance to a tendering process, and the decision is best characterized as an attempt by the courts to preclude an obvious subterfuge of the tendering process. Although the process used by the Ministry was referred to as an RFP process in the procurement documents, there were a number of features of the process that were very reminiscent of a formal tendering process:
The RFP required proposals to reflect design specifications set out in the RFP. The nature of the work and materials were specific, with “no fundamental details awaiting input from proponents”. A proposal would fail if it was not compliant with specifications;

A specific form of contract was attached, and a proponent was required to accept this form of contract substantially unaltered;

Although entitled “RFP”, the documentation did not say that this was not a tender call, nor did it include any provision making it clear that it was only an invitation to negotiate further with the Ministry;

Proposals were irrevocable for 60 days, which they could not have been had the owner intended to extend only an invitation to negotiate;

Proponents were required to post security and the security was lost if the agreement was not executed; and

The documents included a provision that required proponents to negotiate the final agreement in good faith, and this type of obligation could only arise by contract (there is otherwise no obligation at law to negotiate in good faith).

It is important to keep in mind that there is nothing inherently wrong with a process that incorporates any or all of the elements of the procurement process used in Tercon. The real issue is that the application of tendering law to what might be intended to be an RFP process can significantly reduce the owner’s flexibility. An owner can mitigate the risk of its RFP or “hybrid procurement” process being characterized as an invitation to tender by ensuring wherever possible that RFP documents:

Leave at least some of the essential specifications undefined, and thus open to initiatives by proponents;

Allow for meaningful negotiation;

State that they do not constitute a tender and do not represent an offer to create binding contractual relations upon the submission of a proposal; and

State that proposals are not irrevocable.

These steps will not eliminate the risk to owners that tendering law will apply, however. Procurement documents can be drafted to set out evaluation criteria, and include a privilege clause so that in the event tendering law were held to apply, the owner could maintain that it treated proponents fairly and complied with Contract “A”.

The Privilege Clause and Accepting a Higher Compliant Bid

*M.J.B.* signalled to owners the fundamental importance of a carefully crafted privilege clause in order to manage risk from the outset of the tendering process. In *M.J.B.*, the Supreme Court of Canada held (at p. 664) that the presence of a privilege clause in the Tender Documents that stated that “the lowest or any tender shall not necessarily be accepted” permits the owner to accept a compliant bid other than the lowest bid. Today, almost all contract tenders, RFP’s and “hybrid” procurement documents contain a privilege clause, and many use the same or similar wording to “the lowest or any tender shall not necessarily be accepted”.

An important aspect of this type of privilege clause is to permit the owner to decline to accept any tender based on reasonable and relevant grounds. As the court said in *Oviatt v. Kitimat Hospital Soc.*, 2000 BCSC 911, at para. 38; affd. 2002 BCCA 323: “…the Hospital could have awarded Contract B to any of the compliant bidders provided that its decision was made in good faith”.

The lowest tender will not necessarily result in the most affordable job and, in the presence of a privilege clause, the owner will be entitled to reject the lowest bid on the basis that other factors may result in a higher project cost. For example, in *Sound Contracting Ltd. v. City of Nanaimo*, 2000 BCCA 312, Sound was the low bidder on a project. Nanaimo did not award the contract to Sound because past litigation with Sound led Nanaimo to conclude that contracting with Sound would increase Nanaimo’s costs due to the extra supervision and risk of litigation. The privilege clause provided:

> The Owner reserves the right to reject any or all tenders; the lowest will not necessarily be accepted.

The court held that this clause allowed Nanaimo to choose someone other than the lowest bidder based on “objective reasons”. The court held that Nanaimo’s consideration of past litigation with Sound was an objective reason and dismissed Sound’s action. The court said that Sound’s bid, although the lowest bid price, did not necessarily provide the "greatest value based on quality, service and price" to the City.

Sound’s reputation for extras also, in part, gave rise to its bid being rejected by another public authority. In *Sound Contracting Ltd. v. Hood Point Improvement District*, 2000 BCSC 438, the court summarily dismissed Sound’s claim. Citing a similar privilege clause the court held that the District retained a discretion to take a more “nuanced view of cost” than the prices quoted in the tenders.

Notwithstanding these decisions, the privilege clause does not permit consideration of irrelevant and unreasonable factors but requires the Owner to make its Contract B decision in good faith. Examples of factors that would not be in good faith would be to make the Contract B decision based on undisclosed criteria (*Oviatt*, at paras 52 – 54 (S.C.)) or to engage in bid shopping or bid
manipulation (Stanco Projects Ltd. v. HMTQ & Aplin & Martin Consultants Ltd., 2004 BCSC 1038, at paras. 95 – 103).

The Privilege Clause and Non-Compliant Bids

In M.J.B. the court held that accepting a non-compliant bid would represent a breach of a duty of fairness to other bidders. However, recent case law has clarified that a carefully crafted, unequivocal privilege clause may give the owner the necessary flexibility to accept a non-compliant tender as well as a higher compliant bid.

For instance, in Kinetic Construction Ltd. v. Regional District of Comox – Strathcona, 2003 BCSC 1673, Affd. 2004 BCCA 485, Kinetic was the low compliant bidder in respect of a sewage treatment plant contract. The contract was not awarded to Kinetic. The privilege clause provided:

> tenders which contain qualifying conditions or otherwise fail to conform to the instructions to tenderers may be disqualified or rejected. The owner may, however, in its sole discretion, reject or retain for its consideration tenders which are nonconforming because they do not contain the content or form required by the instructions to tenderers or for failure to comply with the process for submission set out in these instructions to tenderers

The issue in the case was whether or not this clause allowed the owner to accept a non-compliant bid over the lowest compliant tender. The court concluded that in light of the language of the privilege clause the owner was entitled to accept the non-compliant tender and did not breach its duties to compliant bidders in so doing.

It is important to recognize that, unlike a compliant bid, the bidder can revoke a non-compliant bid prior to acceptance. In Graham Industrial v. GVWD et al., 2003 BCSC 1735, Affd. 2004 BCCA 5, Graham sought to escape the acceptance of its tender by the GVWD after Graham learned of a fundamental error in the tender. The error led to a submission that was two million dollars too low. Graham wrote to the GVWD, revoking the tender. Graham’s bid was lower than the next lowest bid by about five million dollars but it was also non-compliant. The tender required a bid bond and consent of surety in favour of the GVWD, however, Graham’s bid included a bid bond and a consent of surety in favour of the GVRD not the GVWD. The very extensive privilege clause provided:

> 10.1 If a Tender contains a defect or fails in some way to comply with the requirements of the Tender Documents, which in the sole discretion of the Corporation is not material, the Corporation may waive the defect and accept the Tender.

13.1 The Tender submitted by the Tenderer shall be irrevocable and remain open for acceptance by the Corporation for a period of 60 days from the Tender Closing, whether another Tender has been accepted or not. If at any time after 60
days from the Tender Closing, the Tenderer has not revoked its Tender in writing, the Corporation may accept the Tender.

13.2 If a Tenderer, for any reason whatsoever, purports to revoke its Tender within 60 days from the Tender Closing, or if for any reason whatsoever a successful Tenderer does not execute and deliver the Agreement in accordance with Section 00100, Clause 16.1, the Corporation, without limiting any other remedy it may have under the Tender Documents or otherwise, shall be entitled to:

(1) exercise its rights under any Bid Bond and retain the amount payable to the Corporation under the Bid Bond as liquidated damages; or

(2) require the Tenderer to pay to the Corporation an amount equal to the difference between the Tender price of its Tender and any other Tender which is accepted by the Corporation, if such other Tender is for a greater price, plus the total of all costs, expenses and damages, including legal fees on a solicitor and own client basis, incurred by the Corporation as a result of or related to such revocation or failure by the Tenderer.

15.1 Notwithstanding any other provision in the Tender Documents, any practice or custom in the construction industry, or the procedures and guidelines recommended for use on publicly funded construction projects, the Corporation, in its sole discretion, shall have the unfettered right to:

(1) accept any Tender;

(2) reject any Tender;

(3) reject all Tenders;

(4) accept a Tender which is not the lowest Tender;

(5) reject a Tender even if it is the only Tender received by the Corporation;

(6) accept all or any part of a Tender; and

(7) award all or a portion of the Work to any Tenderer.

15.2 Awards shall be made on Tenders that in the Corporation’s sole discretion give the greatest value based on quality, service and price.

Both the Supreme Court and the Court of Appeal held that since the bid did not comply with the tender requirements it was non-compliant because the bid became irrevocable only “if filed in conformity with the terms and conditions under which the call for tenders was made”. The court
distinguished *Kinetic* in this case by finding that Graham had revoked its offer before it was accepted by the GVWD.

**Preserving the Ability to Negotiate With Bidders**

In the context of a traditional RFP, no bid contract (Contract “A”) is created upon the submission of a proposal - the RFP is really just an invitation to negotiate with proponents. Since, in tendering law, the duty of fairness is an implied term of the Contract “A”, the duty of fairness will not arise in an RFP where there has only been an invitation to negotiate with proponents. The court in *Tercon* noted that any requirement to negotiate in good faith is repugnant to the adversarial position of parties in a negotiation.

The absence of a “free standing”, non-contractual duty of fairness in tendering law (separate from the contractual duty of fairness arising under the Contract “A”) was illustrated in *Midwest Management (1987) Ltd./Monad Contractors Ltd. v. BC Gas Utility Ltd.*, 2000 BCCA 589. The invitation for tenders contained a very extensive privilege clause that gave the owner the right to accept or reject “any Tender which in the view of the OWNER is incomplete, obscure, or irregular, which has erasures or corrections in the documents, which contains exceptions or variations, which omits one or more prices, which contains prices the OWNER considers unbalanced, or which is accompanied by a Bid Bond or Consent of Surety issued by a surety not acceptable to the OWNER.” An unsuccessful non-compliant bidder argued that a privilege clause that gave the owner the ability to accept a non-compliant bid also carried with it a reciprocal duty of fairness (either contractual or otherwise) with respect to non-compliant bidders. The argument was unsuccessful. It would be anomalous if the owner were permitted to reject any compliant bid, but not a non-compliant one.

The primacy of contractual intent post- *M.J.B.*, which is illustrated starkly in *Kinetic* and *Graham*, has opened the doors for owners to provide for “hybrid” procurement processes that involve, for instance, irrevocability of proposals for a specified period of time (much like a tendering process), while still expressly retaining the right to negotiate with proponents. In *Tercon* the court held that there is no implied duty to negotiate in good faith in any Contract “A”, and no contractual duty to negotiate in good faith in contract unless the parties expressly agree to do so. However, the contractual duty of fairness arising out of Contract “A” will apply to require owners to apply the same evaluation criteria and processes to all proponents. The *Tercon* case underscored the importance for owners electing to use a “hybrid” procurement process of setting out in the procurement documents the criteria that will be used in evaluating proposals and when and how negotiations will occur, and with whom.

**Conclusion**

It is clear that the Supreme Court of Canada in *M.J.B.* thought it important to uphold basic freedom of contract principles in the tendering context and to prevent their erosion by implied concepts of fairness which were contrary to the Contract A express terms.
There are a variety of privilege clauses that can be used in RFP’s and invitations to tender, and each serves a slightly different purpose. An owner, in drafting procurement documents, should consider carefully the desirability of including the broadest possible privilege clause that would permit the acceptance of a non-compliant tender. On a given project or contract, such clauses may be very advantageous to the owner. But owners must recognize that the use of broad privilege clauses along the lines of those in *Kinetic* and *Graham* could result in bidders being motivated to submit bids which are non-compliant so that a contractor has an opportunity to revoke the bid prior to acceptance. After the tenders are open, a tender will just be an offer. In the long-term, bidders may conclude that it is a waste of their resources to prepare well-conceived bids with “sharpened pencils”; bidders will assume that the owner will negotiate with all bidders regardless.

The same considerations apply in the case of “hybrid” procurement processes that involve a degree of negotiation with proponents. On a given project or contract, such negotiation may be very advantageous to the owner. However, while owners may like the additional flexibility afforded by “hybrid” procurement processes that incorporate a degree of negotiation, potential proponents might be discouraged from submitting a proposal if the process is perceived (rightly or wrongly) as allowing an owner to “bid shop”. In the long-term, the use of such process on a regular basis might deter some qualified proponents.

At the end of the day, owners should resist the temptation to use a “one size fits all” approach to procurement, and carefully consider the pros and cons of a particular type of process in the context of each initiative or project being undertaken.