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Making Sense of the Recent Case Law

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I. WHAT IS TENDERING?

Tendering is the alternative to simple negotiation of a construction contract. Tendering is a formalized negotiation process which imposes procedural rules and time limits on the receipt and evaluation of bids and the award of the construction contract or subcontract by the party seeking tenders ("the tendering authority").

II. CONTRACT A/CONTRACT B

Since the decision of the Supreme Court of Canada in *R.* v. *Ron Engineering* & C*onstruction (Eastern) Ltd.* (198l), 119 D.L.R. (3rd) 267, Canadian law has identified that the tendering process entails two contracts:

1. Contract A, which is created upon a bidder's submission of its tender, which exists between the tendering authority and each bidder, and the terms of which are the provisions of the tender documents; and

2. Contract B, which is the construction contract awarded by the tendering authority to the successful bidder.

The existence of the tendering Contract A gives rise to contractual rights and responsibilities between the tendering authority and the tenderers with respect to the procedures of the tendering process. This means that wrongful conduct of participants on either side of a tender can result in their liability to pay damages for breach of contract to a participant on the other side of the tender.

The formalities of the process restrict the freedom of action of the parties on both sides, imposing on tendering authorities duties to act in accordance with the requirements which they have set out in their tender documents and on tendering contractors/subcontractors the inability to revoke their bids, if valid.

In response, tendering authorities proactively attempt through the wording of the tender document provisions to maximize their flexibility to accept or reject bids, while tenderers sometimes seek to avoid the effect of irrevocability after the fact, by attempting to establish that their tenders are legally incapable of acceptance.

III. CASE LAW AFTER RON ENGINEERING

Since *Ron Engineering,* Canadian tendering law has continued to develop, with the rights and responsibilities of the tendering authority and the bidder changing with new approaches to the Contract A/Contract B analysis:

1. *Chinook Aggregates Ltd. v. Abbotsford (Municipal District)* (1990), 35 C.L.R. 241 (British Columbia Court of Appeal) - As an implied term of Contract A, a tendering owner/contractor owes a duty of fairness to all bidders.

2. *M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd.* (1999), 44 C.L.R. (2d) 163 (Supreme Court of Canada) - Despite the inclusion in tender documents of a "privilege" clause to the effect that the lowest or any tender will not necessarily be accepted and other provisions which attempt to reserve to the owner the discretion to waive tender irregularities, a tender which does not comply with the requirements of the tender documents is incapable of acceptance by the owner. Privilege clauses only operate to preserve to the tendering authority the right to choose among fully compliant tenders.

   The Court stated its concept of the balance of tendering rights and responsibilities as follows at page 178:

   > "The rationale for the tendering process . . . is to replace negotiation with competition. This competition entails certain risks for the appellant. The appellant must expend effort and incur expense in preparing its tender in accordance with strict specifications and may nonetheless not be awarded Contract B. It must submit its Bid Security which, although it is returned if the tender is not accepted, is a significant amount of money to raise and have tied up for the period of time between the submission of the tender and the decision regarding Contract B...this procedure is 'heavily weighted in favour of the invitor.' It appears obvious to me that exposing oneself to such risks makes little sense if the respondent is allowed, in effect, to circumscribe this process and accept a non-compliant bid. Therefore I find it reasonable, on the basis of the presumed intentions of the parties, to find an implied term that only a compliant bid would be accepted."

3. *Graham Industrial Services Ltd. v. Greater Vancouver Water District*, 2004 BCCA 5 (British Columbia Court of Appeal) - The dividing line for the operation of the tendering authority's privilege clause discretion is "material" compliance with tender document requirements, not absolute compliance. This approach was less onerous on tendering authorities than that indicated by *MJB. Enterprises*, but still significantly limited their discretion.

4. *Kinetic Construction Ltd. v. Regional District of Comox-Strathcona*, 2004 BCCA 485 (British Columbia Court of Appeal) - In a reversal of its own recent approach in *Graham*, the Court found that a strongly worded privilege clause provision successfully reserved the owner's right to accept even what had been determined to be a materially non-compliant tender. That acceptance was found

not to be a breach of the owner's Contract A with the lowest price compliant bidder, since the terms of the Contract A between them included the owner's right to waive non-compliance with the tender requirements.

IV. GRAHAM INDUSTRIAL VS. KINETIC CONSTRUCTION

Thus, the two opposing approaches applied in recent years by British Columbia courts have been:

1. Non-compliance with the tender requirements, or at least "material" non-compliance, makes impossible the formation of a Contract A between the tendering authority and the non-compliant tenderer, with the result that the privilege clauses of the tender documents allowing the tendering authority's waiver of "irregularity" cannot be invoked by the tendering authority to accept that tender.

2. If clearly drafted, privilege clauses allow the tendering authority to waive non-compliance and form a Contract A with a non-compliant bidder since, under the tendering authority's separate Contract A with every other bidder, the owner is only doing what it said it might do by waiving the irregularity.

The cases before *Kinetic* focused on distinguishing between non-waivable material non-compliances with tender document requirements and waivable non-material non-compliances. A common thread in the case authorities was that the certainty of tender price and other fundamental requirements such as the provision of tender and contract security would generally be deemed to be material and not waivable, regardless of the strength of privilege clause provisions, in contrast to more procedural non-compliances, such as a failure to list all intended subcontractors.

The result in *Kinetic* depended on the owner's use of very strong privilege clause wording in the tender documents considered in that case.

V. POINT/COUNTERPOINT

A. *GRAHAM INDUSTRIAL* IS RIGHT

1. The decision in *Graham Industrial* is consistent with the Supreme Court of Canada's approach in *Ron Engineering*:

> "In his reasons, Estey J. noted that the rights of the parties, as set out in the terms and conditions of the tender documents, crystallize at the time a tender that is capable of acceptance is submitted...:

'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.'

It follows from this reasoning that if a bid is not filed ' in conformity with the terms and conditions under which the call for tenders was made', the rights of the owner under Contract A...do not arise. Indeed, Estey J. suggested ... that Contract A, and the parties' rights under the terms of Contract A, would not come into existence where the bid fails materially to comply with the tender specifications ..." (Paras. 18- 19)

and that Court's subsequent decisions:

"The principles underlying the law of tendering articulated by the Supreme Court of Canada support the view that the Discretion Clause cannot be used to effect the creation of Contract A." (Para. 25)

2. *Graham Industrial* is logical in its application of an objective requirement to the creation of Contract A:

"It is the submission of a compliant tender which establishes the legal relationship, Contract A, between the parties... Since the Discretion Clause does not operate before Contract A is formed, the determination of whether a bid is capable of acceptance in law must be based on an objective standard.

...Although the court examined the effect of the privilege clauses at issue in *M.J.B. Enterprises* and *Martel Building* as matters of interpretation, in both of those cases the clauses related to the owner's exercise of discretion after Contract A arose. In neither case did the court address the ability of the owner to dictate subjectively when Contract A would arise through a discretionary term in the tender documents." (Paras. 21-22)

3. *Graham Industrial* is reasonable in holding tendering authorities to the mandatory requirements of their own tender documents:

"In my view, giving the Discretion Clause the effect for which the Water District contends would allow the Water District and other owners to circumscribe the tendering process. The mandatory requirements of the instructions to the tenderers would be

> completely negated if the Water District had the right to exercise its discretion to waive any defect or non-compliance by deeming material omissions to be non-material...
>
> ...no bidder would participate in a tendering process in which the owner had the unreviewable, subjective right to deem patently non-compliant bid to be compliant bids. The effect of such a provision would return the construction industry to the *pre-Ron Engineering* days where negotiation on undisclosed terms, rather than competition on specified terms, governed the tendering process." (Paras. 27-28)

4. *Graham Industrial* is consistent with applicable and desirable public policy principles:

> "The conclusion that the Discretion Clause cannot operate to bring a noncompliant bid into existence and thereby create Contract A does not introduce uncertainty into the tendering process. Rather, it enhances certainty. It ensures that the owner will only exercise its decision-making discretion in respect of bids that are materially compliant. It also ensures that all contractors can be confident that their bids will receive fair consideration and be neither accepted nor rejected for arbitrary reasons. In these respects, I consider that my conclusion protects the integrity of the tendering process." (Para. 29)

B. *KINETIC* IS RIGHT

1. The decision in *Kinetic* is consistent with the Supreme Court of Canada's approach in *Ron Engineering:*

> "I share the view expressed by the Court of Appeal that the integrity of the bidding system must be protected where under the law of contracts it is possible so to do."
>
> "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 the 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 call 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."

2. The decision in *Kinetic* is consistent with the Supreme Court of Canada's approach in *M.J. B. Enterprises*:

"41 The rationale for the tendering process, as can be seen from these documents, is to replace negotiation with competition. This competition entails certain risks for the appellant. The appellant must expend effort and incur expense in preparing its tender in accordance with strict specifications and may nonetheless not be awarded Contract B. It must submit its bid security which, although it is returned if the tender is not accepted, is a significant amount of money to raise and have tied up for the period of time between the submission of the tender and the decision regarding Contract B. As Bingham L.J. stated in *Blackpool and Fylde Aero Club Ltd*., supra, at p. 30, with respect to a similar tendering process, this procedure is 'heavily weighted in favour of the invitor'. It appears obvious to me that exposing oneself to such risks makes little sense if the respondent is allowed, in effect, to circumscribe this process and accept a noncompliant bid. Therefore I find it reasonable, on the basis of the presumed intentions of the parties, to find an implied term that only a compliant bid would be accepted."

"45 I do not find that the privilege clause overrode the obligation to accept only compliant bids, because on the contrary, there is a compatibility between the privilege clause and this obligation. I believe that the comments of I. Goldsmith, in Goldsmith on Canadian Building Contracts (4th ed. (loose-leaf), at p. 1-20, regarding the importance of discretion in accepting a tender are particularly helpful in elucidating this compatibility:

> The purpose of the [tender] system is to provide competition, and thereby to reduce costs, although it by no means follows that the lowest tender will necessarily result in the cheapest job. Many a 'low' bidder has found that his prices have been too low and has ended up in financial difficulties, which have inevitably resulted in additional costs to the owner, whose right to recover them from the defaulting contractor is usually academic. Accordingly, the prudent owner will consider not only the amount of the bid, but also the experience and capability of the contractor, and whether the bid is realistic in the circumstances of the case. In order to eliminate unrealistic tenders, some public authorities and corporate owners require tenderers to be prequalified.

In other words, the decision to reject the 'low' bid may in fact be governed by the consideration of factors that impact upon the ultimate cost of the project."

Implied Term of Contract A

27 The second argument of the appellant is that there is an implied term in Contract A such that the lowest compliant bid must be accepted. The general principles for finding an implied contractual term were outlined by this Court in *Canadian Pacific Hotels Ltd. v. Bank of Montreal*, [1987] 1 S.C.R. 711. LeDain J., for the majority, held that terms may be implied in a contract: (1) based on custom or usage; (2) as the legal incidents of a particular class or kind of contract; or (3) based on the presumed intention of the parties where the implied term must be necessary 'to give business efficacy to a contract or as otherwise meeting the 'officious bystander' test as a term which the parties would say, if questioned, that they had obviously assumed' (p. 775). See also *Wallace v. United Grain Growers Ltd*, [l997] 3 S.C.R. 701, at para. 137, per McLachlin J., and *Machtinger v. HOJ Industries Ltd*., [l992] 1 S.C.R. 986, at p. 1008, per McLachlin J.

28 While in the case of a contract arising in the context of a standardized tendering process there may be substantial overlap involving custom or usage, the requirements of the tendering process, and the presumed intentions of the party, I conclude that,

in the circumstances of the present case, it is appropriate to find an implied term according to the presumed intentions of the parties.

29 As mentioned, LeDain J. stated in *Canadian Pacific Hotels Ltd., supra*, that a contractual term may be implied on the basis of presumed intentions of the parties where necessary to give business efficacy to the contract or where it meets the 'officious bystander' test. It is unclear whether these are to be understood as two separate tests but I need not determine that here. What is important in both formulations is a focus on the intentions of the actual parties. A court, when dealing with terms implied in fact, must be careful not to slide into determining the intentions of reasonable parties. This is why the implication of the term must have a certain degree of obviousness to it, and why, if there is evidence of a contrary intention, on the part of either party, an implied term may not be found on this basis. As G.H.L. Fridman states in The Law of Contract in Canada (3rd ed. 1994), at p. 476:

> In determining the intention of the parties, attention must be paid to the express terms of the contract in order to see whether the suggested implication is necessary and fits in with what has clearly been agreed upon, and the precise nature of what, if anything, should be implied.

30 In this respect, I find it difficult to accept that the appellant, or any of the other contractors, would have submitted a tender unless it was understood by all involved that only a compliant tender would be accepted. However, I find no support for the proposition that, in the face of a privilege clause such as the one at issue in this case, the lowest compliant tender was to be accepted. A review of the tender documents, including the privilege clause, and the testimony of the respondent's witnesses at trial, indicates that, on the basis of the presumed intentions of the parties, it is reasonable to find an implied obligation to accept only a compliant tender. It is to a discussion of the tender documents, the effect of the privilege clause, and the testimony at trial to which I now turn.

3. The decision in *Kinetic* is consistent with the Supreme Court of Canada's approach in *Martel Building:*

> "88. In the circumstances of this case, we believe that implying a term to be fair and consistent in the assessment of the tender bids is justified based on the presumed intentions of the parties. Such

> implication is necessary to give business efficacy to the tendering process. As discussed above, this Court agreed to imply a term in *MJ.B. Enterprises* that only compliant bids would be accepted since it believed that it would make little sense to expose oneself to the risks associated with the tendering process if the tender calling authority was 'allowed, in effect, to circumscribe this process and accept a non-compliant bid' (para. 41). Similarly, in light of the costs and effort associated with preparing and submitting a bid, we find it difficult to believe that the respondent in this case, or any of the other three tenderers, would have submitted a bid unless it was understood by those involved that all bidders would be treated fairly and equally. This implication has a certain degree of obviousness to it to the extent that the parties, if questioned, would clearly agree that this obligation had been assumed. Implying an obligation to treat all bidders fairly and equally 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 expenses in preparing futile bids or ultimately avoid participating in the tender process."

4. *Kinetic* is consistent with the view of the Supreme Court of Canada that the "integrity of the bidding system must be protected where under the law of contracts it is possible so to do." Prior to *Ron Engineering*, procurement was a "free for all". Owners had the freedom to obtain prices from contractors and then use those prices to negotiate with others. There was no period of irrevocability and there was no bid security. In this scenario of unrestricted negotiations, contractors do not tend to give their best price first. An owner wanting the best price first will have to convince bidders that they will be treated fairly.

5. The Supreme Court of Canada has suggested that the intention of the tendering process is to replace negotiation with competition. The rules for that competition have been set down in *Ron Engineering* and subsequent cases. All the Supreme Court is really saying in these cases is that those who make the rules must follow them and that unless the rules very clearly allow the owner to do things which might affect the bidder's decision to bid, the price or any other aspect of the bid, there will be an implied term that the owner cannot do those things.

6. Understandably, owners have been reading the cases and attempting to draft Instructions to Bidders in such a way as to allow maximum discretion and flexibility. For example, owners may clearly give themselves wide latitude to negotiate or, in the case of *Kinetic*, to accept clearly non-compliant bids. However, when owners do make it clear that they are reserving their rights in this fashion, they must do so in the knowledge that the wider they make their

discretion, the closer they will return to the old days of the "free for all". Contractors will read the Instructions to Bidders and will be aware of the potential for "mischief". Their prices, should the choose to bid at all, will reflect the potential for "mischief". As well, the bids that they submit may very well be intentionally noncompliant.

C. *KINETIC* IS WRONG TO THE EXTENT THAT IT SUGGESTS THAT A CONTRACT A WAS FORMED WITH THE NON-COMPLIANT BIDDER

1. In *Kinetic*, no Contract A could have been formed as the bid was clearly not compliant. The B.C. Court of Appeal, in the subsequent *Silex* decision, made the following comments:

> "*Kinetic*, however, referred to the contract created by acceptance of the counter-offer as Contract A. With this I do not agree. Being an offer in terms somewhat different from those required by the Invitation to Tender, acceptance creates a contract different in some respects from a Contract A. Indeed, because Contract A would permit the owner to reject the bid according to the terms of the tender package, acceptance of a counter-offer may create a contract advanced one step from Contract A. Here, treating the non-compliant bid as a counter-offer, I conclude that it cannot be said, on any view of the facts, that it led to creation of Contract A, and that the counter-offer theory cannot found a claim in damages for breach of Contract A."

Although in *Kinetic* the Court mistakenly decided that a Contract A arose with the non-compliant bidder, the case was nonetheless rightly decided. All of the bidders who looked at the Instructions to Bidders would have been aware of the clear intention of the owner to consider and potentially accept non-compliant bids. In that knowledge, some bidders may have chosen not to bid. Others may have made compliant bids and increased their prices. It is possible that at least one decided to make a non-compliant bid. It looks like that one bidder, which by the way could have revoked its bid at any time, made the right decision.