

# Loss Control Bulletin

## Architects and Engineers

### Professional Liability Insurance

#### When Things Go Wrong in Tendering, Who Are You Going to Call?

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Much has been written about the law of tenders over the past quarter century since the decision in *Ron Engineering*<sup>1</sup>, and the case has since given birth to a library of legal cases interpreting tender documents and delineating what can or cannot be done during the tender process. It is critically important for consultants to have a basic working knowledge of the law of tenders as it has evolved, but it is equally important to know that when a problem arises during the tendering process, it is the legal profession and not the design profession to whom you and your clients must turn for guidance and counselling.

This Bulletin takes a brief look at how the law in this area has developed, and highlights some of the more important rules any consultant responsible for preparation of tender documents, or assessing tenders, should be aware of.

#### A. The Two Contract Model

In *Ron Engineering*, the Supreme Court of Canada introduced the “two contract” model into the law of tendering. Under this model, the tendering process consists of the formation of two separate contracts: Contract A and Contract B. Contract A, also known as the bid contract, governs the manner in which the tendering

process is to be conducted. Contract B is the substantive construction contract to perform the work that has been bid.

It is the instructions to tenderers and the tender form which establish the specific terms and conditions of Contract A. One of the terms of Contract A will be an obligation that the bidder is contractually bound to enter into the construction contract, Contract B, if the owner accepts its tender. Contract A comes to an end when an owner either 1) enters into the construction contract with one of the bidders; 2) rejects all of the bids; or 3) when the irrevocability period of the tenders (if applicable) expires.

#### B. The Importance of the Tender Conditions ... The Rules of the Game

The primary source of the express terms of the bid contract is the Instructions to Tenderers. Typically, this document will contain the fundamental terms of the tender call, including the irrevocability of the tender, the time of the tender close, the owner’s discretion to accept or reject bids (including privilege or discretion clauses) and procedural requirements relating to the tender form and bid security. Other express terms and conditions can be found in other documents comprising the tender package, including any Tender Addenda, drawings, specifications, engineer’s reports and the Tender Form. The bid contract may also incorporate, by specific reference in the tender package, standard industry rules.

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<sup>1</sup>*The Queen in Right of Ontario v. Ron Engineering and Construction (Eastern) Ltd.*, [1981] 1 S.C.R. 111

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Recognizing the effort expended and expense incurred by a contractor in preparing a bid, the Courts imply certain obligations on the owner under the bid contract, in order to maintain the integrity of the process. The Court has implied these terms based on 1) custom or usage in the industry; or 2) the presumed intention of the parties in order to give “business efficacy” to the contract. In particular, the Court has recognized the existence of an implied duty of fairness, commonly referred to as the duty of good faith, upon those calling for tenders in relation to their dealings with tenderers. The duty of good faith obligates owners to treat all bidders fairly and equally (without the application of hidden preferences or undisclosed bid evaluation criteria), to not conduct bid shopping and to not accept non-compliant bids. (In Quebec, such a duty has at times also been recognized on the basis of extra-contractual liability.)

### C. The Privilege Clause – Is the Owner Omnipotent?

In evaluating and accepting or rejecting a tender, the owner is required to comply with both the express terms of the bid contract as well as the implied overarching duty of procedural fairness and good faith. In nearly all cases, the Instructions to Tenderers will include a “privilege clause” which provides the tendering authority with broad discretion in relation to the acceptance or rejection of tenders. Although the privilege clause can take many forms, it usually reserves to the owner the discretion to accept or reject the lowest, or any, tender.

Where the privilege clause forms a term of the bid contract, the owner will generally not be required to award the construction contract to the lowest bidder. This enables an owner to take a more “nuanced” view of cost, relying on factors other than simply the tender price. For example, an owner is entitled to consider such things as the experience and capability of the contractor when assessing the relative strength of tenders.

Notwithstanding the existence of a privilege clause in the tender package, the Courts have

found that an owner does not have unfettered discretion when accepting and rejecting bids. Privilege clauses and discretion clauses will not displace the overarching duty of procedural good faith. Similarly, the discretion given to an owner by a privilege clause must be exercised “fairly and objectively.” Where an owner applies a “secret preference” in evaluating a tender or participates in bid shopping, it will likely be found to have breached the terms of the bid contract, notwithstanding the existence of a privilege clause.

The Courts have also found that a privilege clause does not enable an owner to award the construction contract to a tenderer whose bid is non-compliant.

### D. When Is a Bid Non-Compliant?

A tender is valid or compliant only if it meets all of the requirements of the tender call, as set out in the tender documents. In each case, the Instructions to Tenderers and other documents comprising the tender call will have to be considered in order to determine whether or not a bid is compliant. When a bid contains a fatal error, this cannot be accepted because it is non-compliant. The situation, however, is less certain where a bid contains a minor error or irregularity.

Generally speaking, a tender which although valid on its face, contains a latent or hidden error (such as in the calculations or the economics leading to the bid price) or a technical irregularity (such as the omission of a surety’s seal on a bid bond) is nevertheless valid and capable of acceptance. The Court has explained that preserving the validity of bids that contain hidden errors or technical irregularities would not operate to undermine the integrity of the bidding process. On the other hand, a tender which contains a patent or obvious error, respecting an essential requirement of the tender, may be incapable of acceptance by the owner.

So, where the tender documents expressly reserve to the owner the discretion to waive defects and accept a non-compliant tender, the owner’s

discretion is not absolute. Even when that discretion is given by a privilege clause, an owner must exercise their discretion in good faith and in the manner which would withstand objective scrutiny in order to preserve the fairness of the tendering process. The only exception to this rule is where the tender documents themselves give the owners the discretion to award a contract to a non-compliant bidder.

#### **E. How Important Is the Owner's Budget?**

Can an owner elect to not award the construction contract if all bids exceed its budget? With the properly worded privilege clause, the answer is “yes.”

An owner who receives tenders, which although compliant exceed its budget, can rely on a properly worded privilege clause to reject all tenders to not award the contract to any bidder. As explained earlier, it is the Instructions to Tenderers and related documents which establish the terms and conditions of the bid contract. Where the tender package includes a clearly worded privilege clause, the owner will be under no contractual duty to award the construction contract to the lowest bidder, or to any bidder.

#### **E. Is Experience Important?**

In many cases, the lowest tender price will not offer the best overall value to an owner. For example, a project which begins with a competitive bid price can turn into a financial disaster for the owner if the successful bidder does not have the necessary skill or experience to complete the work properly and on schedule. At the very least, the matter is likely to result in costly, protracted litigation. The point was made by the Supreme Court of Canada in the *M.J.B. Enterprises* case this way:

“...(I)t 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 from 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.”

For this reason, it is important that the owner, when assessing the relative strength of competing bids, consider other factors, such as the skill, experience, financial resources and perhaps even the claims history of contractors. This evaluation can occur in one of two ways: 1) prior to the tender call during a “pre-qualification”; or 2) within the tendering process, during bid evaluation.

### **Summary**

The tendering process is an essential business tool for the construction industry. However, it remains a complex area of the law, and the subject of much litigation. To help consultants avoid costly litigation, here are some things to keep in mind.

1. In evaluating and accepting or rejecting a tender, the owner is required to comply with both the express terms of the bid contract as well as the implied overarching duty of procedural fairness and good faith.
2. Where a privilege clause is included in the Instructions to Tenderers, the owner will generally not be required to award the construction contract to the lowest bidder. The owner will be able to take a more “nuanced” view of cost, relying on factors such as the experience and capability of the contractor when assessing the relative strength of tenders.
3. The existence of a privilege clause in the tender package will not displace the overarching duty of procedural good faith that the Courts have found is an implied term of the bid contract. The discretion given to an owner by a privilege clause must be exercised “fairly and objectively.”
4. Even when there is a broadly worded privilege clause in the tender package, an owner may not award the construction contract to a tenderer whose bid is non-compliant.

5. A tender, which although valid on its face, contains a latent or hidden error or a technical irregularity, is nevertheless valid and capable of acceptance. A tender which contains a patent error which is obvious on the face of the bid or some other irregularity that does not substantially comply with the tender call is not capable of acceptance. The standard to be applied is one of *substantial compliance* rather than strict compliance.
6. An owner can rely on a properly worded privilege clause to reject compliant tenders and not award the contract to any bidder, if all bids exceed the owner's construction budget.
7. An owner that uses a pre-qualification process may be precluded from later rejecting a compliant tender during bid evaluation on the basis that the bidding contractor does not have the necessary skill, capacity or experience for the project.

So, if something goes wrong in the tendering process, who are you going to call? Hopefully, after reviewing these highlights of the law of tenders, you will be driven to the answer ... legal counsel experienced with this area of the law. It should not be you who provides your clients with advice on how to interpret the tender documents or how to assess a particular bid where a problem does arise. Your immediate advice to your client should be to retain independent legal counsel to give your client advice on the issue.



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Publication Mail Agreement  
No. 40005147