Construction Law

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Procurement and the Duty of Good Faith

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I. INTRODUCTION

The substitution of competition for negotiation is the hallmark of the tendering method of procurement. In tendering law, procedural fairness and the duty of good faith are doctrinal developments essential to the integrity of the competitive process. Other procurement methods, including requests for proposals ("RFP"), may embed an element of negotiation in an otherwise competitive procurement process. Whether tendering law principles, including the duty of good faith, are engaged in an FWP or "hybrid" type of procurement process is an emerging issue for the construction industry and its legal advisors. This paper sets our some of the dominant tendering law principles which have emerged in the case law, and examines the question of whether the duty of good faith is reconcilable with an RFP or "hybrid" procurement process.

II. THE "TWO CONTRACT" MODEL OF TENDERING

The "two contract" model (Contract "A" and "B") was established by our Courts as an analytical framework for determining the legal rights and responsibilities of the parties in a tendering process. It provides that, upon the submission of a tender in compliance with the requirements of the tender call, a *process* contract (Contract "A") - the "Bid Contract" - may come into existence between the tenderer and the party calling for tenders ("owner") if the parties intended to enter into contractual relations upon the submission of the tender. Individual bid contracts come into existence between the owner and each compliant tenderer. Upon the acceptance of a tender, a second contract (Contract "B") - the Construction Contract - arises (*Queen in Right of Ontario v. Ron Engineering and Construction (Eastern) Ltd.,* [I981] 1 S.C.R. 111; *M. J. B. Enterprises Ltd. v. Defence Construction (1951) Ltd.,* (1999), 44 C.L.R. (2d) 163; and *Martel Building Ltd. v. R.,* [2000] 2 S.C.R. 860.

A. THE FORMATION OF THE BID CONTRACT

Whether or not a bid contract arises upon the submission of a compliant tender, depends on whether, objectively viewed, the parties can be taken objectively to have intended to enter into contractual relations upon its submission. Contractual intention will be determined upon a contextual consideration of the terms and conditions upon which tenders were invited and submitted, i.e. with reference to the tender documents. It is the existence of contractual intention that distinguishes an invitation to tender from a mere "invitation to treat", which by definition does not give rise to a bid contract. Objective indicia of an intention to enter into contractual relations - the bid contract - include (1) a formal process; (2) requirements for the submission and evaluation of tenders; (3) the irrevocability of tenders; (4) the provision of bid security; and (5) documents setting out terms and conditions for the submission, evaluation and acceptance of tenders, e.g. instruction to tenderers, the tender form, a model construction contract, design documents, etc.

The tender call is, in legal terms, the owner's offer to receive and consider tenders according to the terms and conditions of the tender call. The submission of a compliant tender is the act of acceptance of the offer and is good consideration for the owner's offer *(M.J.B. Enterprises, supra,* at p. 173). This is to be distinguished from an "invitation to treat" by the owner where the only offer, in law, is that of the invitee, and it is only upon the invitor's acceptance of that offer that a contractual relationship arises.

1. Substantial Compliance

A tender, submitted other than in compliance with the terms and conditions of the tender call does not give rise to a bid contract. The tender documents, including the instructions to tenderers, comprise the owner's offer to consider a tender, only if the tender is valid, i.e. compliant. An invalid or non-compliant tender may be one which is (1) not submitted on time; (2) is conditional or contained qualifications; (3) fails to provide information required, e.g. list of trades; (4) fails to include the requisite bid security; (5) is not submitted on the required tender form, (6) contains material alterations in the tender form; or (7) is uncertain as to a material term, e.g. price *(M.J.B. Enterprises, supra,* at p.177; *Smith Bros.* & *Wilson (B.C.) Ltd.* v. *British Columbia Hydro and Power Authority* (1997), 33 C.L.R. (2d) 64 (B.C.S.C.); *Vachon Construction Ltd.* v. *Cariboo (Regional District)* (1996), 28 C.L.R. (2d) 145 (B.C.C.A.); and *McMaster University* v. *Wilchar Construction Ltd.,* [l971] 3 O.R. 801 (H.C.), aff'd (1973), 69 D.L.R. (3d) 400 (Ont. C.A.).)

The test applied by the Courts, is one of "substantial" compliance. Thus, technical deficiencies, which would not operate to undermine the integrity of the tendering process, have been held not to invalidate a tender. Such deficiencies, include the omission of a surety's seal on a bid bond *(M.J. Peddlesden Ltd.* v. *Liddell Construction Ltd.* (1981), 32 B.C.L.R. 392 (S.C.)); the omission or misstatement of information otherwise incorporated by reference, or contained, in the tender documents *(Her Majesty the Queen in Right of the Province of British Columbia* v. *S.C.I. Shares* & *Constructors Inc. and Peter Kiewit* & *Sons Co. Ltd.* (1993), 22 B.C.A.C. 89; *J. Oviatt Contracting Ltd.* v. *Kitimat General Hospital Society* (2002) 16 C.L.R. (3d) 111 (B.C.C.A.); *Foundation Building West Inc.* v. *City of Vancouver* (1995) 22 C.L.R. (2d) 94 (B.C.S.C.), and *Bradscot (M.C.L.) Ltd.* v. *Hamilton- Wentworth Catholic District School Board* (1999), 44 C.L.R. (2d) 1).

The issue of compliance and the existence of an enforceable bid contract may be challenged by either the owner or a tenderer *(Derby Holdings Ltd. v. Wright Construction Western Inc.* (2002), 17 C.L.R. (3d) 64 (Sask. Q.B.)).

Generally, the instructions to tenderers will contain special terms which permit an owner to waive minor irregularities in a tender form. Whether such terms can be applied to validate an otherwise non-compliant tender will depend upon the nature of the non-compliance and the particular language of the provision. Typically, these special terms are not drafted in such a manner that they are capable of operating, in law, to render an otherwise non-compliant tender, valid and capable of lawful acceptance by the owner. Their reach is dependent upon the drafter.

2. Mistaken Tenders

Tenders which contain patent errors or omissions (i.e. errors or omissions on the face of the tender) respecting an essential requirement of the tender call, have been held to be invalid, and incapable of lawful acceptance or unilateral "correction" by the owner (*Vachon Construction Ltd., supra*; *McMaster University, supra*; and *Best Cleaners & Contractors Ltd. v. Canada*, [l985] 2 F.C. 293 (C.A.)). However, an error in the tender which is not patent, but merely relates to the underlying economics of the tender, may still give rise to an enforceable bid contract (*Ron Engineering, supra*; *Beaurivage & Methot Inc. et al. v. Corporation de l'Hopital de Sainte-Sacrement* (1986), 21 C.L.R. 263 (Que. C.A.); and *Pasedena (Town) v. Meld Enterprises Ltd*. (1992), 1 C.L.R. (2d) 251 (Nfld. S.C.)).

B. THE TERMS OF THE BID CONTRACT

The terms of the bid contract are both express and implied.

1. Express Terms

The express terms and conditions of the bid contract are contained in the tender documents, including (1) instructions to tenderers; (2) tender form; (3) the form of construction contract to be awarded; (4) drawings, specifications, consultants' reports (geotechnical, environmental, etc.); and (5) other information required to be provided with the tender.

The instructions to tenderers generally incorporate a form of "privilege clause" which provides that the owner is not required to accept the lowest or any tender. Further, in order to provide the owner with some flexibility in overlooking non-essential irregularities in the tender submittals, the instructions to tenderers typically provide that the owner may waive technical irregularities, omissions, etc. in the tender form. The case law has yet to fully develop on whether this latter type of clause may be resorted to in curing defects that otherwise would invalidate a tender.

2. Implied Terms

A bid contract will, in most instances, be held to contain an implied term that the owner will only accept a compliant tender (*M.J.B. Enterprises, supra,* at p.175) and will invariably contain an implied term that the owner must act fairly and in good faith in the tendering process. The duty is one of procedural good faith (*Chinook Aggregates v. Abbotsford, (Municipal District)* (1989), 35 C.L.R. 241 (B.C.C.A.), *Kencor Holdings Ltd. v. Saskatchewan* [1991], 6 W.W.R. 717 (Sask. Q.B.) and, *George Wimpey Canada Ltd. v. Hamilton- Wentworth, supra*).

It is generally accepted that terms may be judicially implied in commercial contracts (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 is necessary to give business efficacy to the contract or which otherwise meets the "officious bystander" test (*Canadian Pacific Hotels Ltd. v. Bank of Montreal,* [l978] 1 S.C.R. 711).

In a standardized tendering context it has been recognized that there is a substantial overlap "involving custom or usage, the requirements of the tendering process, and the presumed intentions of the party" (*M.J.B. Enterprises, supra*, p. 174). The Court will not imply terms merely because they are "reasonable", but will focus on the intentions of the actual parties. Terms will not be implied which conflict with the express terms of the bid contract e.g. the privilege clause (*M.J.B. Enterprises, supra,* p. 179). As to the implication of terms based on "custom and use", or "custom in the trade", see *Hudson 's Building and Engineering Contracts*, 10th ed. (London: Sweet & Maxwell, 1970) at p. 53, and *Law of Contracts*, Cheshire & Fifoot, 10th ed. (London: Butterworths, 1981) at p. 106.

III. THE BID CONTRACT - RIGHTS AND RESPONSIBILITIES

A. THE OWNER

1. The Duty of Good Faith

The duty of procedural good faith, owed by the owner to tenderers, has its origins in the bid contract. There is no "free standing" duty of good faith, which exists independent of the bid contract (*Midwest Management (1987) Ltd. v. B. C. Gas Utility Ltd*. (2000), 5 C.L.R. (3d) 140 (B.C.C.A.)). The law implies an obligation of fairness on the part of the owner to treat all tenderers fairly and equally, without the application of hidden preferences, undisclosed noncustomary bid evaluation criteria, or conduct in the nature of bid shopping or which gives a tenderer an unfair competitive advantage over others (*Martel Building v. R., supra*, at p. 194; *Chinook Aggregates Ltd., supra*; *Fred Welsh Ltd. v. B.G.M. Construction Ltd.,* [l996] 10 W. W.R. 400 (B.C.S.C.); *George Wimpey Canada Ltd., supra*; *Martsellos Services Ltd. v. Arctic College* (1994), 12 C.L.R. (2d) 208, and *Kencor Holdings Ltd., supra*).

It has been held that the Courts will not lightly substitute their own judgments on whether a tender ought to have been accepted for those of the owners, or assume bad faith in the absence of convincing proof (*B.A. Blacktop, supra; Kamloops v. British Columbia (Ministry of Transportation and Highways)* (1988), 27 B.C.L.R. (2d) 230 (B.C.S.C.); *Hughes Land Co. Inc. v. Manitoba (Ministry of Government Services)* (1991), 72 Man. R. (2d) 215 (Man. Q.B.) and *Sound Contracting Ltd. v. Nanaimo (City)* (2000), 2 C.L.R. (3d), p. 1. Courts have recognized that tenderers are willing to accept some of the risk of the process, providing that the "rules of the 'game" are spelled out (*Fred Welsh Ltd. v. B. G.M. Construction Ltd*., [1996] 10 W.W.R. 400 (B.C.S.C.)).

2. Acceptance / Non-Acceptance of a Tender and the Privilege Clause

In evaluating and accepting or rejecting a tender, the owner is required to comply with the terms of its individual bid contracts and its overarching duty of procedural good faith. Where the privilege clause forms a term of the bid contract, the owner is under no contractual duty to award the construction contract to a particular tenderer (*M.J.B. Enterprises, supra*). The privilege clause will not however, operate to permit an owner to act other than in accordance with the duty of good faith (*Chinook Aggregates Ltd., supra*) and neither will provisions giving the owner the right to waive irregularities have this result.

The Court will not imply a term, based on custom and industry, or otherwise, that the owner must accept the lowest tender, in the face of a privilege clause (*M.J.B. Enterprises, supra*). The privilege clause, simpliciter, will not permit an owner to accept other than a compliant tender (*M.J.B. Enterprises, supra, at p. 179*). There is no incompatibility between the privilege clause and an owner's duty not to accept non-compliant tenders.

The mere rejection of the lowest tender does not imply that the owner acted without good faith, or on the basis of some impermissible undisclosed bid evaluation criterion. The privilege clause operates to permit the owner to take a "nuanced view of 'cost' than the prices quoted in the tenders" (*M.J.B. Enterprises, supra*, at p. 46). I. Goldsmith in *Goldsmith on Canadian Building Contracts* (4th ed. 1988) at p. 1-20, summarizes the importance to the owner of retaining a discretion not to accept the lowest nominal tender price:

> "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 ...."

Thus, if an owner, acting in good faith, concludes that the lowest tender price does not truly reflect the anticipated cost to the owner of the work, the owner will not be in breach of its bid contract not by accepting the lowest tender. The owner should be prepared however, to justify its decision according to "objective reasons for concluding that better value may be obtained by accepting a higher bid" (*Sound Contracting Ltd. v. Nanaimo, supra*, at p. 5). Some of the economic factors which an owner may properly take into account in rejecting the lowest tender, include:

(1) additional contract administration costs anticipated as a result of the tender's previous performance on other projects (*Sound Contracting Ltd. v. Nanaimo, supra*);

(2) the tenderer's lack of actual direct experience in performance of the work (*Westport Construction Ltd. v. Burnaby (City)* (1997), 39 C.L.R. (2d) 106 (B.C.S.C.));

(3) the potential for cost increases (*J. Oviatt Contracting, supra*);

(4) the application of alternative unit pricing (*Sound Contracting Ltd. v. Campbell River (District)* (2001), 8 C.L.R. (3d) 75 (B.C.S.C.)); and

(5) anticipated cost overruns due to past incidents of inadequate site supervision and construction errors *(W.I.B. Co. Construction Ltd. v. Central Okanagan School District No. 23* (1998), 41 C.L.R. (2d) 93 (B.C.S.C.)).

Absent a breach of the duty of good faith, the Courts will be disinclined to substitute its own analysis for that of the owner in determining which tenderer provided "the greatest value based on quality, service and price" to the owner (*Sound Contracting Ltd. v. Nanaimo, supra*, at p.5). The owner is under no obligation to advise the unsuccessful tenderer of the reasons for its rejection (*Cegeco Construction Ltee. v. Ouimet* (1991), 50 C.L.R. 171 (Fed. T.D.), and *Westport Construction, supra*).

In the face of a privilege clause, the owner is under no contractual obligation to award the construction contract to the lowest or any tenderer (*Sound Contracting Ltd. v. Hood, Point Improvement District* (2000), 1 C.L.R. (3d) 76 (B.C.S.C.)). However, the privilege clause does not operate to allow an owner to introduce and apply undisclosed evaluation criteria. For example, when tenderers are pre-qualified without ranking, their qualifications cease to be valid evaluation criteria and, accordingly, the reintroduction of these criteria as a basis for an award to other than the lowest tenderer may attract liability to the owner (*Brunet & Associates Inc. v. 154469 Ontario Inc.* (2002) 19 CLR (3d) 173 (0nt.S.Ct.J.).

3. The Owner's Duty to Subcontractors

No contractual relations arise between an owner and a subcontractor whose bid is incorporated in the general contractor's tender to the owner (*Twin City Mechanical v. Bradsol (1967) Ltd.* (1999), 43 C.L.R. (2d) 275 (Ont. C.A.), and *Ken Toby Ltd. v. British Columbia Buildings Corp*. (1999), 45 C.L.R. (2d) 141 (B.C.C.A.)). However, in the context of a procurement process which stipulates for the obtaining of trade bids to the general contractor through the Bid Depository system, it has been suggested in *obiter* that "the owners duty to all subcontractors is to take reasonable steps to ensure the integrity of the Bid Depository process" (*Ken Toby Ltd., supra*, at p. 155). At present, the case authority has not gone so far as to decide that a tortuous duty of care is owed by the owner to a non-privity subcontractor (*Martel Building Ltd., supra*, at p. 202). The existence of a legally recognized duty of care owed by an owner to a non-privity subcontractor awaits further judicial treatment. Presumably, the Courts will be somewhat reluctant to extend duties to non-privity subcontractors, to avoid the prospect of overlapping lost profit claims by general contractors and subcontractors.

B. THE TENDERER

1. Duties Owed to the Owner

The duties owed by a tenderer to the owner are circumscribed by the terms of the bid contract. Thus, for example, (1) in the face of a clause providing that its tender remains irrevocable, the tenderer may not withdraw its tender during the period of irrevocability, and (2) so long as its tender is capable of lawful acceptance by the owner, it will be liable for the owner's losses in the event it declines to enter into the construction contract, upon award (*Ron Engineering, supra*; *Calgary (City) v. Northern Construction Co., Division of Morrison-Knudsen Co*. (1985), 19 C.L.R. 287 (Alta. C.A.), aff'd, [l987] 2 S.C.R. 757 (S.C.C.), and *Derby Holdings Ltd., supra*).

It is submitted that there is no reason in principle why a tenderer would not be held to a reciprocal duty of good faith to refrain from e.g. bid rigging, although the case law is so far silent on the point.

2. Duties Owed to Subcontract Tenderers

The two contract model has been applied in the context of the tendering relations between a general contractor and a subcontractor, whose price is utilized, or who has been nominated, by the general contractor in its tender to the owner.

The same approach to bid contract formation applies as between the subcontractor tenderer and the general contractor (*Naylor Group Inc. v. Ellis-Don Construction Ltd.* (2001), 10 C.L.R. (3d) 1). For example, a subcontractor's tender to the general contractor, will remain irrevocable for the duration of the general contractor's tender, in accordance with the tender documents (*Northern Construction Co. Ltd. v. Gloge Heating and Plumbing Ltd*. (1986), 27 D.L.R. (4th) 264 (Alta. C.A.)).

When all that is carried in the general contractor's tender is the subcontractor's price, upon the award of the construction contract to the general contractor, the successful tender is under no obligation to award the subcontract to the subcontractor *(Vipond Automatic Sprinkler Co.* v. *E.S. Fox Ltd*. (1996), 27 C.L.R. (2d) 3 11 (Ont. Gen. Div.), *Ron Brown Ltd.* v. *Johanson,* [l990] 22

A.C.W.S. (3d) 783 (B.C.S.C.); *Bate Equipment Ltd.* v. *Ellis-Don Ltd.* (1992), 2 C.L.R. (2d) 157 (Alta. Q.B.), and *Derrick Concrete Cutting and Coring Ltd.* v. *Central Oil Field Service Ltd.* (1994), 17 *C.L.R.* (2d) 120 (Alta. Q.B.)). Where the subcontractor is actually nominated in the general contractor's tender, the subcontractor may, or may not, be entitled to the award of the subcontract upon the acceptance of the general contractor's tender by the owner.

It has been held that a nominated subcontractor's tender will be deemed to have been accepted by the general contractor, upon the owner's award of the construction contract to the latter (*M.J. Peddlesden Ltd., supra).* This is the "deemed acceptance" rule. However, modern form construction contracts which allow the owner to object "for reasonable cause" to a proposed subcontractor, have lead to a different result. Where the form of construction contract incorporated in tender documents, provides for the substitution of a subcontractor, at the instance of the owner based on "reasonable cause", those terms are inconsistent with the "deemed acceptance" rule. In such circumstance, a subcontractor-contractor bid contract may come into existence, a term of which requires the successful contractor to award the subcontract to a nominated subcontractor absent any "reasonable objection" by the owner *(Naylor Group Inc., supra,* at p. 18; and *Scott Steel (Ottawa) Ltd.* v. *R.J. Nicol Construction (1975) Ltd.* (1993), 15 C.L.R. (2d) 10 (Ont. Div. Ct.).

Where the tender documents prescribe the use of the local Bid Depository rules, those requirements will be held to apply to the tendering process *(Moncton Plumbing and Supply Co. Ltd.* v. *Brunswick Construction Ltd. et al.* (1983), *3* C.L.R. 166 (N.B.Q.B.)).

Where a general contractor mistakenly carries a nominated subcontractor's price, different than that submitted by the subcontractor, no legal duties arise between them *(Co West Gypsum* & *Painting Ltd.* v. *Apacon Contracting (1981) Ltd.* (1992), *B.C.L.R.* (2d) 107 (Alta. C.A.). However, the contractor will be held to be bound to perform the work according to the mistaken price which it carried in its tender *(Quantum Homes Ltd. et al,* v. *The Guarantee Co. of North America* (1991), 41 C.L.R. 70).

A subcontractor which refuses to perform its subcontract work, in accordance with its tender, will be liable to the general contractor for the additional costs incurred by the latter to perform that component of the work. *(St. Lawrence Cement Inc.* v. *Farry Grading* & *Excavating Ltd.* (1989), *32* C.L.R. 185).

C. THE CONSULTANT

Frequently, the owner's consultant will not only prepare the tender documents, but will play a central role in evaluating and making recommendations on the award of the construction contract. The owner may incur liability as a result of actions by its consultant, which offend the owner's legal duties to the tenderers.

There is no obligation on either the consultant or the owner however, to (1) advise the tenderer of any concerns with respect to the tender, the tenderer's qualifications, etc. (*Cegeco Construction Ltee., supra*); or (2) to indicate in the tender documents what weight will be attached to particular evaluation criteria (*Acme Building and Construction Ltd. v. Newcastle (Town)* (1992), 2 C.L.R. (2d) 308 (Ont. C.A.)).

The consultant will not be held to be negligent at the instance of an unsuccessful tenderer for failing to exhaust all avenues of investigation into the tenderer's qualifications (*W.I.B. Co. Construction, supra*). No tort of inducing a breach of contract is committed by a consultant in evaluating and recommending the award of a tender, where the consultant was under a legally recognized duty to provide that advice to its client (*Spectra Architectural Group Ltd. v. Eldred Sollows Consulting Ltd*. (1991), 7 C.C.L.T. (2d) 169 (Alta. Master), and *W.I.B. Construction, supra*).

A consultant, in preparing tender documents and acting throughout the procurement process, will assume legal duties owed to its client - the owner or tendering authority. The nature and scope of those duties are generally circumscribed by its contractual arrangements with its client and applicable professional standards and practices. The consultant is often the instrumentality by which the owner acts in the procurement process and is relied upon by the owner to act in a manner consistent with the owner's legal duties to the tenderer.

The influence of well defined legal duties and applied generally accepted professional standards should generally, tend to reduce the prospect of consultants' liability. However, to the extent that the full measure of the owner's duties arising out of a "hybrid" procurement process is uncertain, the consultant's legal risks are correspondingly enhanced.

IV. DAMAGES FOR BREACH OF THE BID CONTRACT

A. THE OWNER'S LIABILITY

Having established a breach of its bid contract, the tenderer must establish its entitlement to damages by establishing a lost opportunity to obtain the construction contract. Whether, the unsuccessful tenderer would have been awarded the construction contract, had the owner not breached its bid contract is a matter of fact in each case. (*Maritime Excavators (1994) Ltd. v. Nova Scotia (Attorney General*) (2000), 2 C.L.R. (3d) 84 (N.S.S.C.), and *Thompson Bros. (Construction) Ltd. v. Wetaskiwin* (1997), 205 A.R. 185 (Alta. Q.B.). See also *Chaplin v. Hicks*, [l911] 2 K.B. 786 (C.A.)).

The proper assessment of damages requires a determination in each case of (1) the likelihood that the tenderer would have been awarded the construction contract had the owner fulfilled its bid contractual duties; and (2) the value of the loss of the benefit of the construction contract (*Houweling Nurseries Ltd. v. Fissons Western Corp.* (1988), 49 D.L.R. (4th) 205 (B.C.C.A.)).

In most, but not all, cases, the value of the tenderers lost opportunity will equate to its tender price less the proven costs of executing and completing the work, i.e. the loss of profit (*M.J.B. Enterprises Ltd., supra*, at p.650; and *Naylor Group Inc., supra*, at p.24). Evidence that the tender price was unreasonable, e.g. based on an erroneous bid estimate, may reduce the assessed damages.

In determining the quantum of damages, in each case, the actual conditions and costs that would have been incurred by the unsuccessful tenderer (had it performed the work), will be inquired into in order to determine what its "lost profits" would have been had it performed the construction contract. This process involves an evaluation, in money terms, of future possibilities and chances (*Naylor Group Inc., supra*, at p.25). The contractor will be required to mitigate its damages according to the normal principles governing recoverability of damages.

By appropriately drafted tender documents, the owner may exclude or limit its liability for damages for breach of the bid contract. It is not uncommon for tender documents to contain terms and conditions exempting the owner from damages or losses arising directly or indirectly out of its breach of the bid contract, or other tortious acts or omissions by the owner, its consultant or employees. In some instances, damages are sought to be limited to the tenderers costs of preparing and submitting its tender.

These clauses will be applied *contra proferentem*, and must be carefully drafted by the owner to attain their intended legal effect. Their commercial effect, in most cases, is to increase tendering prices due to the rather one-sided allocation of procurement risk.

B. THE TENDERER'S LIABILITY

Where a tenderer breaches its bid contract by declining to enter into the construction contract following the award, it may become liable for the difference between its tender price, and the next lowest tender price of the contractor who subsequently performs the work (*Calgary v. Northern Construction Co., supra*). Depending on the terms of the bid contract, the tender deposit may be forfeited as "liquidated damages". The owner's costs of retendering may be recoverable. The provisions of a standard form Bid Bond provide that the surety will pay this amount up to the limit of the penal limit of the bond.

The owner's duty to mitigate damages does not extent to accepting a mistaken tender even when it is lower than the next higher tender price *(Vaughan (Town) v. Alta Surety Company Ltd.* (1991), 42 C.L.R. 305 (Ont. H.C.)).

V. "HYBRID" PROCUREMENT AND THE DUTY OF GOOD FAITH

Tendering law has evolved in the context of a "traditional" tendering process involving ascertained project work, a settled form of construction contract and a well defined competitive process. The "finish line" in the competition, was ascertainable, and common to all tenderers. It remains unanswered whether, and to what extent, established tendering law principles may be applied to "hybrid" procurement models involving elements of both competition and negotiation. These "hybrid" types of procurement methods are becoming more common, particularly in cases of staged construction projects and design-build project delivery models.

Normally, an owner will seek to avoid the legal constraints of a true tendering process, by characterizing the procurement as a "request for proposals" ("RFP") or a "request for quotations" ("RFQ") process. An owner may even stipulate in procurement documents that the process is "not a tendering process" and that no legal relations are intended to arise prior to the award of the construction contract. Whatever label the owner may seek to use in characterizing a procurement process, it is clear that the Courts will look to the substance of the transaction in the context of the terms and conditions of the procurement documents *(Hughes Land Co.* v. *Manitoba* (1998), 13 1 Man. R. (2d) 202 (C.A.))

For present purposes it is accepted that a "true" RFP is one which invites proponents to enter into negotiations for a construction contract and evinces the owner's intention to consider proposals and, if it wishes, to enter into negotiations with one or more of the proponents. There is, in such a case, no intention on the part of the owner to create binding contractual relations with one or more proponents, at any time prior to entering into the construction contract. In tendering law

terms, this "true" RFP does not give rise to a bid contract: *(Powder Mountain Resorts Ltd.* v. *British Columbia,* [l999] 11 W.W.R. 168 (B.C.S.C.), aff'd [2001] B.C.J. No. 2172 (C.A.); *Mellco Developments Ltd. v. The City of Portage La Prairie* (October 1,2002) unreported, (Man. C.A.), (application for leave to appeal to S.C.C. pending); *Cable Assembly Systems Ltd. v. Dufferin-Peel Roman Catholic Separate School Board* (2000), 1 C.L.R. (3d) 143 (Ont. S.C.J.); and *Silver Lake Farms Inc.* v. *Saskatchewan* (2001), 46 R.P.R. (3d) 66) (Sask. Q.B.).

The legal principles which apply to the twin extremes of a "true" RFP, and a "true" tender call, have developed, for the most part, in cases where the procurement process was readily characterized as one or the other. However, there are procurement procedures that fall within a continuum between these two extremes. Consider, for illustration purposes, a "hybrid" procurement process which combines the following elements:

(1) The issuance of an RFP document which includes Instructions to Proposers providing for the irrevocability of proposals, milestones for the submission, opening and award of proposals, a form of "privilege clause", proposal evaluation criteria, a form of proposal, performance based (non-prescriptive) technical construction requirements, and the essential articles of a form of construction contract, (and, possibly, a proposal security requirement).

(2) A structured process for the delivery of two proposals by a proponent; firstly, a technical proposal in which the proponent describes its design approach, building size, layout and configurations, proposals for methods for the delivery of contract administration and construction services (including alternatives), etc; secondly, a price proposal.

(3) A formal proposal evaluation process in which the owner can deal individually with proponents to clarify deficiencies or non-conformities in the technical proposals, suspected mistakes, and alternatives.

(4) A formal process providing for the owner's option to accept an initial proposal, or alternatively, enter into negotiations with one or more of short-listed proponents falling within an owner-determined competitive range, with a view to obtaining changes in the terms of technical and price proposal(s).

(5) Following negotiations with one or more of the proponents, provision for the submission by one or more of the short-listed proponents of a "Best and Final Offer" ("BAFO").

(6) Procedures for the owner's evaluation and selection of a BAFO which it considers in its discretion to be technically acceptable and financially achievable, without further negotiations with the preferred proponent.

(7) Provision for the award of the construction contract to a proponent submitting a BAFO and a corresponding requirement that, upon selection, that proponent must enter into the construction contract.

It can be seen that this "hybrid" procurement process combines features which are both typical of, and atypical of, a "true" tendering process. The question emerges in the context of this kind of procurement process, whether, bid contractual relations, and the derivative duty of procedural fairness and "good faith" ever arise, and, if so, (i) at what stage does it arise, and (ii) what is the nature and scope of the duty.

In one decided case, involving a "hybrid" procurement process (in which the terms of the BAFO was not thereafter negotiable), it was held that a bid contract arose upon the submission of the BAFO, but not earlier in the negotiation stage of the procurement process: (*Hughes Aircraft Systems International v. Air Services Australia* (1997), 146 A.L.R. 1 (Australia Full C.T.) ref'd to in *M.J.B. Enterprises, supra*, at p. 172). Prior to the BAFO stage, in the example above, it seems unlikely, however, that traditional tendering law principles would play a role in defining the legal relations between the parties. To begin with, the recognition of a pre-BAFO bid contract would invoke recognition of the owner's duty of good faith in dealing with all proponents. Of course this is highly problematic in the context of multi-party negotiations antecedent to a BAFO.

The duty to bargain in good faith, absent the existence of a bid contract, is not yet recognized in Canadian law (*Martel Building Ltd. v. R*., at p. 19 1). In this regard, the reasons of Lord Ackner in *Walford and others v. Miles and others,* [l992] 2 A.C. 128 (H.L.), approved in *Cedar Group Inc. v. Stelco Inc.,* [l995] O.J. No. 3998 (Q.L.) (Gen. Div.) at para. 4, aff'd [l996] 0,J. No. 3974 (Q.L.) illustrates the difficulties that would ensue if tendering law principles were to be impressed upon a negotiated procurement process:

> "The reason why an agreement to negotiate, like an agreement to agree, is unenforceable, is simply because it lacks the necessary certainty. The same does not apply to an agreement to use best endeavours. ... How can a court be expected to decide whether, *subjectively*, a proper reason existed for the termination of negotiations? The answer suggested depends upon whether the negotiations have been determined "in good faith". However the concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations. ....- how is a vendor ever to know that he is entitled to withdraw from further negotiations? How is the court to police such an "agreement"? A duty to negotiate in good faith is as unworkable in practice as it is inherently inconsistent with the position of a negotiating party. ... Accordingly a bare agreement to negotiate has no legal content."

The same policy considerations that animated the decision in *Martel Building Ltd. v. R., supra*, where the Supreme Court found against a tortious duty of care between parties to a negotiated procurement process, would militate against the recognition of pre-BAFO bid contractual relations in the above "hybrid" procurement process because,

(1) the primary goal of a party in negotiations is to achieve, at the expense of another, the most advantageous financial bargain;

(2) extending a duty of good faith within the negotiation process would discourage economically efficient conduct and defeat the essence of negotiation;

(3) extending the duty of good faith in negotiations would impress the Courts with a significant regulatory or oversight function, involving an examination of the minutae of the bargaining process; and

(4) extending the duty of good faith into the negotiation process would encourage a multiplicity of litigation.

It must be considered however that, in the context of a highly structured and well defined "hybrid" procurement process, a Court might possibly recognize the existence of a qualified obligation in the owner to act in a manner compatible with the integrity and openness of the process in order to prevent the owner from unilaterally and unfairly departing from the procedures it put in place. Whether the benefits of doing so would outweigh the practical and legal implications that would result, is arguable. To date, there is one case that has gone so far as to suggest, albeit in obiter, that a stand-alone duty of good faith may arise in a non-tendering procurement context. In *Mellco Developments, supra*, the Manitoba Court of Appeal Court posed, and then answered, the following question in the affirmative (at paras. 79-81):

> "Can a bidding process that is something less than one intended to involve the formation of Contracts A and B invoke the obligation of fair bargaining in good faith that is now firmly established in formal tendering cases?"

In *Mellco Developments*, the Court reasoned on the facts before it, that a Request For Proposal process, which involved a negotiation component, fell within a "continuum":

> "I agree with counsel for the plaintiffs that the question of the duty to negotiation in good faith with respect to bids (be they a tender or proposal), is a form of continuum. At one end are the formal tender cases invoking the principles of *Ron Engineering*. At the other end are cases where, for example, an owner requests a simple quote. There is obviously a lot of territory between these two extremes. The fact situation before us falls somewhere in between the two extremes. On the one hand, there is a detailed request for proposals mandating that they must contain a security deposit and remain open for a length of time. Conversely, the RFP does not create Contracts A or B and envisions continuing negotiations with the 'lead proponent' that submits 'the most attractive proposal'.
>
> Within the continuum, in the instant case, there was, in my opinion, an obligation on the part of the city to conduct itself fairly and in good faith. Without some fairness in the system, proponents could incur significant expenses in preparing futile bids which could ultimately lead to a negation of the process. In circumstances such as those before us, there must be enough fairness and equality in the procedures to ensure its integrity and openness." (*Mellco Developments, supra*, per Scott C.J.M. at paras. 80 and 81)

The Court in *Mellco Developments*, concluded that the source of the duty of good faith and fairness lay in the parties' reasonable expectations of the procurement process, and that it was not necessary to the existence of the duty, that a bid contract - Contract A - ever came into existence. In this regard, the decision of the Manitoba Court of Appeal contrasts sharply with that of the British Columbia Court of Appeal in *Midwest Management, supra*. Unless the quality and content of a duty of fairness and good faith were qualified, it is difficult to envision their application in the context of a negotiated procurement process without offending the policy considerations outlined in *Martel Building, supra*. It remains to be seen whether the reasoning in *Mellco Developments* will be applied and explained in future cases.

If contractual or other duties were recognized in a "hybrid" procurement process, the question of damages for breach by the owner of its obligations would be problematic. While no broad duty of good faith, or duty to negotiate in good faith, may be recognized, nevertheless some more qualified duty to treat proponents fairly and equally - from a procedural standpoint only – may nevertheless be viewed by some as compatible with the negotiation process in a "hybrid" RFP context.

In the above example of a "hybrid" procurement process, if qualified duties, akin to those in a true tendering context, were recognized, the assessment of damages for breach of a pre-BAFO contractual duty would itself involve significant legal and factual difficulties in assessing the existence and value of the party's lost opportunity to negotiate an agreement, the terms of which were uncertain. Traditionally the Courts have declined to enforce agreements to enter into other agreements, the terms of which are uncertain. At best (and this would by no means be free from analytical difficulties) the measure of damages in a claim by a disappointed proponent might be equated with (i) its costs incurred in the procurement process, which are "thrown away", or (ii) the heavily discounted value of its loss of opportunity to obtain the construction contract. (*Bate Equipment Ltd. v. Ellis-Don Ltd*. (1992), 2 C.L.R. (2d) 157 (Alta. Q.B.); see also, *Bowlay Logging Ltd. v. Domtar Ltd*. (1978), 87 D.L.R. (3d) 325 (B.C.S.C.)). The former measure of damages recognizes the tenderer's "reliance interest" in the owner abiding by the process rules it established, and the latter recognizes the tenderers "expectation interest" - the traditional approach to damages for breach of contract (*Hadley v. Baxendale* (1854), 156 E.R. 145 ; *Keneric Tractor Sales Ltd. v. Langille*, [I987] 2 S.C.R. 440; *Webb & Knapp (Can.) Ltd. v. Edmonton (City),* [1970] S.C.R. 588 and *Houweling Nurseries Ltd. v. Fissons Western Corp., supra*.

Assessing damages (on the theory that a reciprocal duty of good faith was owed by the proponent to the owner, and was breached), would correspondingly involve analytical and practical difficulties. In either case, the Court would be required to enter into a speculative inquiry into the outcomes of an incomplete negotiation and an "apples and oranges" cost comparison of different construction contracts - the one actually awarded, and the one that might have been awarded to the proponent in breach. In one recent case the Court concluded that the measure of damages for the breach of a contract which embedded an unfulfilled negotiation process, was determinable according to the contractor's pre-estimated profit *(Knappett Construction Limited v. Axor Engineering Construction Group Inc.* 2003 B.C.S.C. 73**,** app. pending).

VI. CONCLUSION

In principle, there is no legal impediment to a "hybrid" procurement process. However, the introduction of the duty of fairness and good faith in the negotiation stages of the process would lead to substantial uncertainty and difficulties in application. It is arguable that the introduction of a stand-alone duty of fairness and good faith in a negotiated procurement is neither desirable nor compatible with existing tendering law and contract law principles. Resort to an "expectations" based duty of good faith and fairness, independent of subsisting contractual duties, is bound to lead to uncertainty in the construction industry.

Although the legal framework for analyzing the rights and responsibilities of parties to a traditional tendering process are relatively settled in Canadian law, nevertheless the application of tendering principles to new and evolving procurement methodologies will continue to be of interest to the construction industry and the legal profession, alike.