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Negotiations and the Bid Process: Midwest to Martel

I. Midwest

Background

Some believe that the bid process developed in *R v. Engineering and Construction (Eastern) Ltd.* (1979), 24 OR (2d) 332, Rev'd, [1981] 1 SCR 111 ("Ron") merely describes an offer with white walls and wire wheels. In *Midwest Management (1987) Ltd. vs. B.C. Gas Utility Ltd.*, the Court of Appeal for British Columbia ("BCCA") re-confirmed that a valid ("compliant") bid is an entirely different vehicle than an offer.

In 1989, BC Gas Utility Ltd. ("BC") invited six contractors to bid for a pipeline. Midwest Management (1987) Ltd. ("Midwest") submitted a bid.

The bidding documents included the following:

> "The Tender Documents are to be completed exactly…
>
> …. If Tenderer wishes to make exceptions, it may do so in a Statement of Discrepancies and Omissions,
>
> Transmittal letters from Tenderers which contain qualifications…. shall be deemed not to be part of or supercede the Tender, ….".

The bid documents included a "privilege clause" that gave BC enormous leeway in bid evaluation. The pertinent element of the privilege clause reads:

> "Should the OWNER not receive any tender satisfactory to the OWNER in its sole and absolute discretion, the OWNER reserves the right to re-tender the Project, or negotiate a contract for the whole or any part of the Project with any one or more persons whatsoever, including one or more of the Tenderers."

Midwest sent a letter with its bid stating that its price excluded dewatering. It proposed dewatering at cost-plus.

Then, BC and Midwest began negotiations which ended with rejection of the Midwest bid. Midwest believed that the principal reason for rejection was its union affiliations, a topic not discussed in the negotiations.

Motion To Dismiss

Midwest sued for breach of contract (Contract A as defined in Ron). Midwest also claimed BC breached a duty of fairness ***independent of Contract A*** by not disclosing its union concern.

In May of 1999 (yes 1999), BC moved to dismiss Midwest's action. BC argued that there was never a Contract A – therefore no breach. It also argued there was no "free standing" duty of fairness at law.

Mr. Justice Paris dismissed the breach of contract claim. The Midwest bid did not create Contract A because the qualification – dewatering – made it "non-compliant". He considered *Ron* and a 1999 Supreme Court of Canada decision, *MJB Enterprises Ltd. vs. Defence Construction (1951) Ltd. (1994),* 164 AR 399, Aff'd. (1997), 196 AR 124, Rev'd, [1999] 1 SCR 619. *MJB* affirmed *Ron* and ruled that a "non-compliant" bid means no Contract A.

With no Contract A, Mr. Justice Paris held there could be no contract based duty of fairness owed to Midwest. The negotiations between Midwest and BC could not resuscitate what had never breathed.

The Contract A analysis was hip deep in case law. But, for the "free-standing" duty of fairness, there was no support.

To obtain summary judgment, BC had to demonstrate there was no real issue for the trial judge to consider. Mr. Justice Paris decided the Midwest fairness claim was not necessarily "doomed". Midwest had half a case for trial – or so it thought.

Court Of Appeal

BC appealed the survival of the "freestanding" duty of fairness. Midwest cross-appealed the finding of no Contract A.

The BCCA confirmed there was no Contract A. The negotiations after the fact cannot bootstrap a "non-compliant" bid.

The BCCA found the notion of "freestanding" duty of fairness unappealing. Mr. Justice Finch wrote for the BCCA:

> "…Counsel did not refer us to any authority where such a duty has been held to exist. Such a duty is quite inconsistent with an adversarial competitive tendering process. To find such a duty would cause great uncertainty in this area of the law."

Goodbye Midwest!

Why Is A ("compliant") Bid More Than An Offer?

The Contract A/Contract B model described in Ron is two processes at once. When the owner seeks bids, it extends both an ***offer*** and an ***invitation.*** The *offer* is to enter Contract A (a process contract) with bidders who accept the offer by submitting a "compliant" bid. The ***invitation*** is to submit a price (the bidder's offer) for Contract B – the job.

Midwest did not accept the BC ***offer*** to enter Contract A. Midwest responded to the ***invitation*** by submitting an ***offer*** for something different than Contract B – same work; different commercial terms.

As a result, Midwest was merely a guy who had submitted an offer – one it wasn't invited to submit.

Absent Contract A, Midwest lost whatever protection that contract might extend to it. For example, absent language to the contrary, an implied obligation of fairness is a well honoured term of Contract A. Whether a duty of fairness could have survived this privilege clause is moot. The failure of Contract A to arise stops that enquiry – cold.

Bid evaluation within Contract A is like boxing ***after*** the Marquis of Queensberry rules - still a rough sport but with a code of conduct. When Midwest entered negotiations, it entered a "no holds barred" contest with few rules – fairness isn't one.

The reasons of Mr. Justice Finch above might bear a one word adjustment. What the BCCA appears to be saying is more like:

> "Such a duty is quite inconsistent with an adversarial competitive ***negotiation*** process."

II. Martel

On November 30th, 2000, thirty-three days after *Midwest,* the Supreme Court of Canada ("SCC") dealt with a negotiation/bidding case where the negotiations came ***before*** the bid process.

In *Martel Building Ltd. v. Canada* 2000 SCC 60, Martel tried unsuccessfully to negotiate a lease renewal with its tenant, the Crown. That failure resulted in the Crown calling bids for its space needs. Martel was unsuccessful with its bid and sued the Crown for breaching a duty of care during negotiations and for unfairness in the bid process.

The Negotiations Before Bidding

SCC held that the landlord/tenant relationship created a duty of care which the Crown breached by negotiating negligently. Usually, after such a finding, the wronged party wins if it proves that the breach caused its damage – for Martel lost rent. That prospect raised serious policy questions for the SCC. What standards of behaviour should be imposed on parties to commercial negotiations? How far should the law go to compensate a party which has suffered a loss not arising from personal injury or property damage ("pure economic loss")?

The SCC considered five different scenarios and concluded – on policy grounds – that it would neither recognize the duty of care nor compensate Martel's kind of "pure economic loss". One of the five illustrations the Court chose paints a picture which transcends Martel and *Midwest* (paragraph 67);

> "It would defeat the essence of negotiation and hobble the marketplace to extend a duty of care to the conduct of negotiations, and to label a party's failure to disclose its bottom line, its motives or its final position as negligent. Such a conclusion would of necessity force the disclosure of privately acquired information and the dissipation of any competitive advantage derived from it, all of which is incompatible with the activity of negotiating and bargaining."

In *Midwest,* the complaint was about ***unfair*** bargaining after a tender process where Midwest was non-compliant. In the lower courts Martel claimed that the Crown failed to bargain in ***good faith.*** Martel did not argue good faith in the SCC but that Court dealt with it anyway in the following statement (paragraph 73):

> "As a final note, we recognize that Martel's claim resembles the assertion of a duty to bargain in good faith. The breach of such a duty was alleged in the Federal Court, but not before this Court. As noted by the courts below, a duty to bargain in good faith has not been recognized to date in Canadian law. These reasons are restricted to whether or not the tort of negligence should be extended to include negotiation. Whether or not negotiations are to be governed by a duty of good faith is a question for another time."

The decisions in *Midwest* and *Martel* pertaining to negotiation suggest that good faith/fairness in negotiation looks dead if not quite buried.

Fairness In Bidding

When Martel moved on to consider the bidding process, it finally approved what Provincial Courts of Appeal and the Federal Court of Appeal have been saying for over a decade. Absent contrary language in the bid documents, Contract A includes an implied duty on the part of owners to treat bidders fairly, expressed as follows:

> "A privilege clause reserving the right not to accept the lowest or any bids does not exclude the obligation to treat all bidders fairly…. (paragraph 89).
>
> While the Lease Tender Document affords the Department wide discretion, this discretion must nevertheless be qualified to the extent that all bidders must be treated equally and fairly. Neither the privilege clause nor the other terms of Contract A nullify this duty. As explained above, an implied contractual duty is necessary to promote and protect the integrity of the tender system." (Paragraph 92)

At last!

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Trying to Figure Out the Law of Tendering

There was a lot of discussion about the law of tender after the Supreme Court of Canada's decision in *MJB Enterprises v. Defence Construction.* The hope is that after a judgment of the Supreme Court of Canada is made, the law in that area is clarified so that business people can make appropriate business decisions and know where and when to draw the line. The truth is that the law of tender was complicated by the decision of the Supreme Court of Canada in *Ron Engineering* and there are still many, many unanswered questions in the wake of *MJB Enterprises.*

On May 17, 2000, the British Columbia Court of Appeal issued its decision in the *Sound Contracting Ltd. v. Nanaimo (City)* case. Sound Contracting had been the low bidder on a number of projects for Nanaimo. When the "Hammond Bay" project was sent out for tender, Sound Contracting submitted a bid. One year before the Hammond Bay tender, Sound Contracting was involved in a dispute with Nanaimo that was determined by arbitration. The Arbitrator awarded Sound Contracting 29% of the value of deleted work for that project, requiring an additional payment to Sound Contracting of $22,600.00.

Nanaimo had previously always accepted the lowest tender. In the Hammond Bay tender package Nanaimo included the following terms:

> *Article 18. Tender Rejection*
>
> *The Owner reserves the right to reject any or all tenders; the lowest will not necessarily be accepted.*
>
> *The City of Nanaimo reserves the right to waive informalities in or reject any or all tenders or accept the Tender deemed most favourable in the interests of the City of Nanaimo.*
>
> *Article 19. Award*
>
> *Awards shall be made on tenders that will give the greatest value based on quality, service and price. Preference shall be given to local suppliers where quality, service and price are equivalent.*

Sound Contracting submitted the lowest tender for the Hammond Bay project at $540,639.00. The second lowest tender was $573,329.91. When Nanaimo analyzed the results of the bids, it determined that although the dollar amount of Nanaimo's bid was the lowest of the bids received, in the long run, Sound Contracting's bid would cost more because of "extra on-site supervision, the risk of under-running another contract because of anticipated work deletions due to budget constraints, and the likely costs of legal, staff and arbitration expenses."

Nanaimo's City Administrator wrote the following report about Sound Contracting's bid:

> *It is staff's conclusion that to award the tender to the low bidder, Sound Contracting, would result in a cost to the City in excess of the second low bid… Most significantly, if the contract were awarded to Sound it would be imperative based on the City's past experiences with this particular contractor, that an independent, qualified inspector be hired to supervise the work on a daily basis. This would add to the project costs…*

As a result of the above analysis, Nanaimo awarded the Hammond Bay project to the second lowest bidder and Sound Contracting sued Nanaimo. At trial, the Judge found that Nanaimo had used undisclosed criteria to adjust the Sound Contracting bid and awarded Sound Contracting damages for lost profits.

Nanaimo appealed the trial decision and the British Columbia Court of Appeal considered the case in light of the *MJB Enterprises* case, which had been decided by the Supreme Court of Canada after the trial Judge's decision. The Court of Appeal quoted the following passage from the *MJB Enterprises* case:

> *Therefore even where, as in this case, almost nothing separates the tenderers except the different prices they submit, the rejection of the lowest bid would not imply that a tender could be accepted on the basis of some undisclosed criterion. The discretion to accept not necessarily the lowest bid, retained by the owner through*

the privilege clause, is a discretion to take a more nuanced view of "cost" than the prices quoted in the tenders…

Although the Court of Appeal in the *Sound Contracting* case expressed some reservations, it found that the consideration of Sound Contracting's previous claim against Nanaimo was not an undisclosed criteria, but an "objective" reason for not awarding to the lowest bidder:

On the basis of the clarification of the law in M.J.B. *I am constrained to hold that in this case, the privilege clauses in the request for tenders releases Nanaimo from the obligation to award the work to the lowest bidder if there are valid, objective reasons for concluding that better value may be obtained by accepting a higher bid.*

I confess that I find this somewhat worrisome as it creates an opportunity for arbitrariness in the operation of the bidding system. It must be recognized that a compliant tender establishes a legal relationship between the parties conditioned only by the privilege clause. The privative clause gives the owner a discretion and that discretion must surely be exercised fairly and objectively. The legal relationship just described provides the basis for a court challenge by unsuccessful compliant bidders of an award to a higher bidder. While I would not attempt to establish a comprehensive enumeration of salient factors that would support a successful action, it may possibly be summarized by reference to the essential requirements of objective fairness and good faith.

In this case, the previous dealings between these parties provided the basis for the additional criteria addressed by Nanaimo. It is not for us to substitute our own analysis for that of the owner in whom the discretion to award the contract ultimately resides and whose staff, in my view, have not been shown to have acted unfairly or other than in good faith in determining which tender provided the "greatest value based on quality, service and price" to the City. Nor can it be said, in my view, that the consideration of past dealings between these parties constituted an undisclosed criterion. In fact, past dealings are probably the best indicator of how a proposed relationship will come to work out in practice. I would caution, however, that this discretion must not be exercised in such a way as to punish or to get even for past differences. Whenever the low bidder is not the successful tenderer, any additional factors in the analysis will have to be shown to be reasonable and relevant. I conclude that sufficiently good reason has been shown in this case to sustain as appropriate the decision of Nanaimo to award this contract to the second lowest bidder.

Sound Contracting has sought leave to appeal this decision to the Supreme Court of Canada. Of course, there is no guarantee that the Supreme Court of Canada will hear the case, even if that Court thinks the decision is wrong.

The difficulty with some legal issues is that sometimes there is no clear answer for every factual situation. Clarity is something we strive for and look to the cases to provide. Certainly the Supreme Court of Canada in *MJB Enterprises* contemplated that there would be some cases where the lowest bid would not be accepted and the owner could rely on the privilege clause and award the project to the second lowest bidder without running afoul of the requirement that there be no undisclosed criterion. However, the British Columbia Court of Appeal's decision in the Sound Contracting case is disturbing as it permits consideration of a contractor's past claims history as an acceptable criterion upon which to evaluate a bid even where that criteria is not disclosed in the bid process.

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Arbitration of Construction Disputes

Arbitration can be a very expensive method of dispute resolution, and its outcome can have serious repercussions, so it is important that parties to construction contracts consider the issue.

Many standard form construction contracts, such as the 1994 CCDC-2 Stipulated Price Contract, now contain some form of arbitration clause. Given the perception that arbitration is a quicker, less formal and more flexible method of determining disputes, it is not uncommon to see individualized construction contracts containing some form of arbitration clause. Some require the parties to arbitrate all disputes, while some leave arbitration as an option.

Parties should bear in mind that in most cases, the arbitrator's decision is binding. Unless the arbitration clause states otherwise, appeals are restricted by the *Arbitration Act, 1991* to errors of law only, and permission of the court is required. If the arbitration agreement provides, for instance, that the arbitrator's award is "final and binding", courts will treat this as a prohibition against any appeal, and the dissatisfied party is left with an application to set aside the award, which may well be more difficult to obtain than an appeal. Also, Courts generally defer to the arbitrator's decisions, many of whom will have some expertise on the matters at issue which judges recognize.

If speed in resolving the dispute is not a crucial or determining factor (and for many payors on the contract, it is not), then consideration should be given whether to allow arbitration at all. It may not be in your best interests. Also, if arbitration is required, careful consideration should be given to whether, and if so, what types of appeals should be provided for in the arbitration clause. A failure to consider the issue of appeal may leave a dissatisfied party with no recourse to have the award

reviewed by a court, and stuck with a decision it feels is simply wrong.

It should also be remembered that with arbitration, unlike the courts, the parties have to pay for the arbitrator (including for preparation time and pre-hearing motions), the place of the arbitration, and the reporter who will make a transcript of the evidence, if required, in addition to their lawyers' and experts' costs. Also, parties should not automatically assume that the hearing itself will be any quicker, less costly, or significantly less formal than court proceedings. Lawyers require just as much preparation for an arbtration as for trial, and, if the circumstances require it, may insist on agreement to a comprehensive set of procedural rules which will have to be developed and agreed to.

Arbitration is a popular alternative to litigation, but parties negotiating construction contracts should seriously consider the advisability of arbitration at an early stage, before the dispute has already arisen, and also whether the arbitrator's award, for better or for worse, should really be "final and binding".

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Bill 69 and Bill 139 Introduce Changes to Construction Industry Labour Relations

The provincial government has introduced two Bills that specifically impact upon labour relations within the construction industry.

Bill 69

Bill 69 was originally introduced in the Legislature on April 25, 2000. The progress of the Bill was delayed considerably after second reading. The government announced in October that it would be withdrawing the legislation due to a lack of consensus, particularly among ICI trade unions, and that it would be proceeding with new legislation in its stead. However, the government has recently decided to proceed with the Bill to Committee. The Bill was passed following third reading on November 28, given Royal Assent on December 4, and was proclaimed into force on December 16, 2000 (with the exception of one section, yet to be proclaimed). The key features of the Bill include:

1. Local Bargaining Reform in the ICI Sector

The Bill contains provisions allowing certain designated employer bargaining associations to seek local variances to provincial ICI collective agreements. The purpose of these provisions is to allow for greater competition between unionized and non-union contractors in areas where non-union companies currently have a competitive advantage. Under the scheme of the legislation, disputes as to the concessions required in the applicable collective agreement will be settled by interest arbitration. Interest arbitration has seldom been used in the construction industry to settle contract disputes.

2. GTA Residential Bargaining

Residential bargaining across Ontario is largely conducted by unions on an "employer by employer" basis. Bill 69 proposes to change this within the Greater Toronto Area ("GTA") by organizing employers under a single agreement for each trade (following the model of provincial bargaining in the ICI sector). Agreements would follow the 3 year pattern of ICI agreements beginning in April 2001. The intent of these provisions is to avoid staggered bargaining amongst the trades, which can result in the industry being shut down by a strike in a single trade (e.g. the drywall strike).

3. Flexible Recognition/Bargaining Rights Rules

The Bill provides for the possibility that unions in the ICI sector may abandon part of their bargaining rights in relation to an employer. This provision is intended to allow more flexibility in fashioning voluntary recognition agreements (perhaps making them more palatable where their geographic scope may be limited). Further, these provisions may afford greater strength to "estoppel" defences raised in some construction industry grievance arbitrations.

4. Flexibility Regarding Local Hiring in the ICI Sector

The Bill provides for default ratios in transferring existing members to new work jurisdictions in Ontario (up to 40%), and also provides for flexibility in hiring "name hires" rather than seeking union referees (up to 75%). These percentages are subject to bargaining between the authorized bargaining authorities, but cannot be made the subject of a strike by a union.

5. Related Employer/Sale of Business Reform

Under proposed changes to the Act, the Labour Relations Board will no longer be able to consider the family relationship between principles of different companies in determining "related employer" and "sale of business" provisions of the Act. In some cases, the Board had considered these relationships in determining whether two companies were under "common direction or control".

Bill 139

This Bill was introduced at first reading on November 2, 2000, passed on third reading on December 20, 2000 and was proclaimed into force December 30, 2000. The Bill touches on a number of aspects of the *Labour Relations Act.* However, only those aspects having particular impact on the construction industry are highlighted below:

1. Project Agreements

The project agreement provisions are amended to permit applications with respect to multiple projects and are also amended to permit

applications to add further projects to existing project agreements. Further, the "certification/voluntary recognition protection" afforded to employers who hire members of unions under a project agreement (where that union has no bargaining rights with that employer) is now extended to any work on the project falling ***outside*** of the construction industry (s. 163.1(16)) (for example, maintenance work).

2. Non-Construction Employers

The definition of a "non-construction employer" is amended from the current "not engaged in a business in the construction industry" to the proposed "does no work in the construction industry for which the employer expects compensation from an unrelated person". This change significantly broadens the class of employers who could make an application to terminate bargaining rights under this section.

3. Section 8.1, Relationship of Construction Provisions to Remainder of Act

Various sections of the construction provisions of the Act are amended with the intent of reversing the result in *Bayview-Wellington,* which had held that s. 8.1 (requiring the appearance of 40 % membership in order for a union to get a certification vote) did not apply in the construction industry.

4. Sector Determinations

The Board may now apply a "consultation" approach to sector determination hearings (no need to hold hearing). The Board may now issue interim orders in sector determination cases.

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Note:

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If you would like additional information or have any questions on the matters discussed above, please contact the author or any member of our group.

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