The Revay Report

Volume 15
Number 3
October 1996

Published by
Revay and Associates
Limited

Construction Economist
and
Management Consultants

by
Stephen G. Revay

We frequently receive suggestions for topics to be discussed in the Revay Report and, as far as we are able to, comply with the requests of our readers. This issue is no different.

With the last issue of the Revay Report, we enclosed a questionnaire inquiring about the implications of the 1981 decision of the Supreme Court of Canada in the ***Ron Engineering*** *case. An analysis of the responses is included herein on pages 3 and 4.*

It appears from the responses to the questionnaire that many industry practitioners either know little about the impact of the ***Ron Engineering*** *decision or consider it a mere nuisance without realizing its importance in respect of the tendering process. This Report attempts to give our readers some pointers.*

But is it possible, as Paul Sandori suggests in his article, that public tendering as we know it today, is on its way out?

An international symposium held in Washington earlier this year discussed the future of the construction industry with a view to finding solutions for sustainable development.

Among the many recommendations arrived at by the end of the week-long symposium, one was entitled ***Developing Risk Guidelines for the Construction Industry Stakeholders****. It recommended a fairer way of buying construction services and reducing adversarial relationships among the participants. Perhaps that is what Mr. Justice Estey had in mind when he wrote the* ***Ron Engineering*** *decision.*

THE *RON ENGINEERING* DECISION: FIFTEEN YEARS OLD AND STILL IMMATURE

This year, construction lawyers are (or should be) celebrating the fifteenth anniversary of the decision of the Supreme Court of Canada in *Ron Engineering & Construction (Eastern) Ltd. v. The Queen*. With a stroke of his pen, Mr. Justice Estey turned the law of bidding and tendering on its head.

He also created a great deal of work for law firms and courts trying to resolve the resulting legal tangles.

That is not all: Justice Estey also created, out of thin air, tens of thousands of contracts—bidding contracts—that even the parties to these contracts did not know existed. The bonding companies which had issued the contractors' bid bonds discovered that, from one day to the next, the contractor could no longer withdraw a mistaken bid.

Your lawyer will explain in detail how this magic was accomplished. It is important to know, because the disputes are continuing and some of the main issues are still not resolved. The following is a brief review of the essential points and an examination of the decision's impact on the construction industry.

Contract A/Contract B. Ron Engineering, a general contractor, made an error in its tender. It tried to withdraw but the owner decided to retain Ron's tender deposit of $150,000. The resulting fight went all the way up to the Supreme Court of Canada which ruled in favour of the owner.

A contract results from an offer and the acceptance of that offer. Traditionally, a call for tenders by an owner was considered an invitation to contractors to make offers. A tender was an offer. The owner, by accepting one of those offers, would create a binding contract.

The word "tender" was, and still is, synonymous with "offer" in all the dictionaries of the English language—but, since 1981, the word has meant "acceptance" in the Canadian construction industry because Mr. Justice Estey in *Ron Engineering* chose to make it mean that. Since Justice Estey's decision, the call for tenders by an owner is an **offer**.

> *"When I use a word," Humpty Dumpty said in a rather scornful tone, "it means just what I choose it to mean, neither more nor less."*
>
> *Lewis Carroll, "Through the Looking Glass" (1871)*

Tenderers, by submitting a tender, accept that offer and so, from that moment on and without any further formality, the owner and each of the tenderers are bound by a contract—**Contract A**.

The terms of Contract A are spelled out in the tender package so everything contained in it must be prepared bearing in mind that it may create binding obligations.

The main feature of Contract A is that the tenderer, in submitting a tender, agrees that it is irrevocable during the specified period.

The corollary obligation is that, once the owner has accepted the successful tender, the tenderer and the owner must enter into a construction contract. That is a separate contract—the so-called **Contract B**.

The same legal framework applies in cases involving subcontractor ten-

ders to general contractors. The general contractor asking for subtrade prices is making an offer; when a subcontractor submits a quote or tender, he is accepting the contractor's offer and they become locked in a Contract A (if and when the owner accepts the general contractor's own tender).

New Legal Framework. So, in 1981, literally from one day to another, a new way of doing business was imposed on a vast and complex industry, involving thousands of owners and tenderers. All of a sudden some of them had to struggle with a contract like no other contract they had experienced before, with obligations generally unknown even to lawyers.

It has cost the construction industry—and other industries—millions in money and lost time to establish and clarify the new rules in the courts. Hundreds of companies whose tendering problems made it necessary for the courts to examine and clarify *Ron Engineering* also paid the costs.

Yet ambiguities seem to be built into the Contract A/Contract B scheme and, after fifteen years, some basic questions have no clear-cut answers. For example:

- What happens when there is a mistake in a tender?
- What is the effect of the so-called privilege clause?
- What is the position of the subcontractor who is named in the general contractor's tender?

Mistake in Tender. In the old system, the contractor could withdraw a mistaken offer any time before the owner accepted it because before acceptance there was no contract. If the contractor made a mistake in the tender, this provided a painless way out. It also provided some great opportunities for playing games.

After *Ron Engineering*, however, opportunities for playing games may have been reduced, which is debatable, but a mistake can now be deadly for the contractor.

Contract A arises when the tender is submitted to the owner. At the time the owner decides which tender to accept, Contract A is already firmly in place and the tenderer is bound by his or her original tender (unless a mistake is clearly apparent "on the face of the tender").

This puts the contractor in a bit of a dilemma: if he executes Contract B, he can no longer raise the question of mistake in Contract A; on the other hand, if he fails to execute Contract B, he is in breach of Contract A. Damned if he does, damned if he does not. As a result, it is now practically impossible for the contractor to withdraw a mistaken tender.

The owner is not in a much happier position even though he can, theoretically, profit from the contractor's honest mistake. He is likely to end up in court.

The owner has a pretty good chance of being sued by the mistaken bidder if he does not let him correct the mistake, or by the next lowest bidder if he does.

If he awards the contract to the second lowest bidder, the owner will have to go through a court battle if he wishes to recover from the mistaken bidder the difference between the two bids.

Most owners are prepared to let the mistaken contractor off the hook anyway: it is to nobody's benefit to push a contractor into bankruptcy or have him teetering on the verge of bankruptcy during construction.

*We are grateful to **Michael Atkinson**, President of the Canadian Construction Association, **Keith Gillam** of Vanbots Construction Corp., **Don Cameron** of the Ontario General Contractors' Association and **Dennis Houle** of Houle Electric Limited for their comments. The Hon. **Wilfred J. Wallace** QC, formerly of the Court of Appeal of BC, kindly reviewed the text.*

Public owners are in a different boat. They feel obligated to preserve the "sanctity of the bidding process" at any price, and therefore end up in court more often. Some contractors feel that, squeezed by their shrinking budgets, public owners would be happy to accept a mistaken low bid even for other, less noble motives.

The Privilege Clause. This is a clause invariably found in the tender documents which says "lowest or any tender not necessarily accepted," or words to that effect.

In some provinces, notably British Columbia and Saskatchewan, regardless of how the privilege clause is worded, the courts have held that there is an implied term in Contract A that the parties would comply with industry "custom and usage," meaning primarily that the contract should be awarded to the lowest qualified tenderer.

In other provinces, such as Ontario and Alberta, the courts firmly maintain that no custom of the trade or implied term can change the explicit words of the privilege clause.

So, the answer to the question as to how far you can rely on the privilege clause depends, to a large extent, on where you go to court.

Named Subcontractor. A general contractor is normally required to name his subcontractors in his tender to the owner. Does the naming mean that the contractor has accepted the subcontractor's tender? What if the general contractor only incorporates the subcontractor's price into his tender to the owner, without naming him?

Once again, the answer seems to depend on the geographical location of the court. In British Columbia, the courts have held that the contractor is obligated to enter into a Contract B with the subcontractor whose quote he incorporated in his own tender. Why should the contractor have the freedom to choose a competitor of the named subcontractor, while the sub remains bound by Contract A?

The use of the subcontractor's price in the contractor's tender is the critical factor. Naming the sub is considered to be a mere acknowledgment of what has already taken place — acceptance of a particular subcontractor's tender.

On the other hand, some cases in other provinces, primarily Ontario and Alberta, suggest that the general contractor is not bound to a subcontractor until the contractor communicates to the sub that he has accepted his tender, typically after the owner has accepted the contractor's tender.

The courts in these provinces have held that neither the naming of the subcontractor in the contractor's tender nor carrying his quote required the general contractor to award the subcontract to the named sub.

Apparently, in those provinces where the courts take this approach, the practice of changing named subcontractors is becoming more and more common. Some observers attribute this fact to an erosion of tradition and ethics in the industry, which was only reinforced by the court rulings.

Uncertainty. These and other grey areas are unlikely to be clarified soon: who has the time and money to take such issues to the Supreme Court of Canada? In the meantime, judges will continue to cite *Ron Engineering* while reaching divergent decisions.

And then there are those decisions where the judge goes his or her own merry way without paying much attention to *Ron Engineering*.

Not long ago, the court in an Ontario case* decided that Contract A arises only when the owner accepts the contractor's tender. *"The mere act of submitting a tender cannot create such a contract; if it did, all responses to calls for tenders would give rise to absurd assertions of contractual rights,"* said the judge.

Yet that is exactly what *Ron Engineering* stands for: the owner has a Contract A with each of the tenderers **before** acceptance and this fact **does** lead to assertions of contractual rights, absurd or not.

Of course, if you are convinced that the judge is wrong, you can always appeal. You may even end up meeting the justices of the Supreme Court of Canada, if you can afford it.

Lesson for the future. It is quite possible that bidding and tendering has **no** future: the process may become virtually extinct some years from now.

A contractor summed up the practice in these words: *"It is a mug's game: if you don't win the work, you go out of business; if you win it, you make no profit and end up out of business."* The bankruptcy rate among general contractors in some provinces, notably Ontario, supports this comment.

Still, it is worthwhile to look at *Ron Engineering* because it holds lessons of general value. The underlying objective of the decision in *Ron Engineering* was, in the words of Justice Estey, to preserve the sanctity of the tendering process. The decision has certainly made tendering more rigid and more litigious. Has it also made the process fairer? Maybe so, but does the end justify the means?

The experience over the last fifteen years has shown that such major changes in the way the industry performs its basic operations should come from the industry itself or through legislation after extensive consultations with the industry.

They should not be imposed from outside by courts, however well-meaning the jurists, who have little knowledge or understanding of the workings of the industry. The changes should come in complete packages with clear instructions for the users, not in bits and pieces, over decades. The cost is simply too high in terms of money, time and injury to business.

There is also another cost inherent in *Ron Engineering*, a cost paid by the legal profession. Such decisions reinforce the feeling that the courts, like Humpty Dumpty, can make words mean just about anything they want them to mean. Hardly a reassuring feeling if you are facing a trial, either as lawyer or client.

Paul Sandori, V.P.
Toronto

Note: If you would like more information about *Ron Engineering*, we would be happy to send you a summary of the decision—just call our Toronto office at (416) 498-1303 or fax your request to (416) 491-0578 or e-mail to revay@ican.net.

* In *Megatech Ltd. v. Ottawa-Carleton*

RAL QUESTIONNAIRE

With the last issue of the Revay Report, we included a questionnaire which asked the following questions:

1 *Ron Engineering* splits the bidding process into two contracts: Contract A and Contract B. Is this concept clear to you?
2 Has splitting the bidding process into two contracts created a fairer system?
3 Is there less bid shopping now than before *Ron Engineering*?
4 Are owners in a stronger position than before?
5 Are contractors better off than before?
6 Are subcontractors better off ?

The alternative answers were "yes" "no" and "somewhat". We also asked for comments. The results of the survey are tabulated below. There was a total of 112 replies. Not everybody answered all questions so the "total" numbers in each row do not match the total number of questionnaires returned.

The survey is, of course, unscientific since the sample is too small and for many of the respondents we do not know whether they are owners, contractors or subcontractors. Nevertheless, the results are interesting.

A surprisingly low proportion of respondents answered "yes" to the first question: 53%. After fifteen years of bidding and tendering based on *Ron*, one would expect a higher percentage. A couple of lawyers answered "no" commenting that they understand very well what the decision implies but that the reasoning was, and still is, murky.

Some of those who answered "yes" may be a bit overconfident. From their answers to the rest of the questions and their comments it is fairly obvious that they have a very limited understanding, if at all. For example, some respondents believe that the *Ron* decision does not apply to subcontractors. They will have a rude awakening some day.

Continued on next page

	yes	%	no	%	some	%	total
1 Understand?	56	53%	22	21%	28	26%	106
2 Fairer?	18	16%	84	75%	10	9%	112
3 Bid shopping less?	4	4%	97	91%	6	6%	107
4 Owners?	54	55%	33	34%	11	11%	98
5 Contractors?	33	39%	42	50%	9	11%	84
6 Subs?	12	13%	78	85%	2	2%	92

It is interesting that several respondents replied "yes" to the question asking whether the system has become fairer, and "no" to the question whether there is less bid shopping now than before! Does this mean they consider bid shopping fair?

An overwhelming percentage of respondents believe that the *Ron* decision has done nothing to reduce bid shopping. Some feel that there is more bid shopping now than ever before and blame the recession. A fair number added comments which indicate a feeling of resignation with regard to this issue:

> *"There will always be bid shopping."*
>
> *"Bid shopping is rampant, pervasive and a cancer to the industry."*
>
> *"Most owners still seem to find a way to play one contractor against another."*

A significant percentage feel that owners are better off as a result of Ron than they were before. Judging by their comments, this is mainly because they feel that the owner may take advantage of honest error. A couple of typical comments:

> *"They have the money and the legal system on their side."*
>
> *"Less work, more aggressive options. Owners continue to tighten conditions."*

Quite a few of the respondents felt that contractors are better off than before. An even larger percentage felt that they are not better off with several comments blaming the danger of a mistake.

A typical comment on the positive side: *"Yes, low bidder gets the job."* Really? One respondent liked the *Ron* decision because it *"restricts preference awards by municipalities etc."*

Very few respondents felt that *Ron* did much for the subcontractors. One person put down "no" and referred us to his answer to the question on bid shopping, which was *"more than ever before."*

Several respondents commented: *"General contractors make less, and try and pass it down the line,"* or words to that effect. A fairly common complaint had to do with named subcontractors, with a typical comment: *"Recent cases say sub is not protected by mere listing on tender."*

The design professions add to the woes of the subs:

> *"Engineers & designers are placing more risk on the subcontractors and are not being challenged with qualifications in tenders as subs are being disqualified due to disclaimers."*

A common subcontractor complaint had to do with owners and general contractors exerting pressure on subs by pre-purchasing major equipment. As one sub put it:

> *"The sub becomes a labour broker. There is no margin on equipment so risk is that much greater."*

But at least one subcontractor knows how to play the *Ron Engineering* card right:

> *"We have avoided the loss of large subcontracts a couple of times by making the owners aware of Ron Engineering."*

The respondent neglected to say what exactly in *Ron Engineering* they made the owner aware of in order to save the subcontract.

There were some general comments that many of our readers will find only too true. For example, a respondent wrote:

> *"Most buyers and bidders don't even understand the fundamental concepts of the formation of a contract (offer & acceptance etc.) and consider the bidding process as a prelude to extensive negotiations... we normally stumble into the bidding process and careen through the award and subsequent contracting until something goes wrong... then everybody gets the law books out."*

A lawyer had some advice for owners interested in making the system work:

> *"Does Ron Engineering create a level playing field? No, as it leaves the door open for owners to create the rules to be followed. If the owners:*
>
> - *didn't bid shop (including post tender, pre-contract negotiations);*
> - *got out the criteria to be used in the award in detail;*
>
> *then the system would work. Absent that, it's a shot in the dark."*

Another lawyer commented on the way the court laid down the law:

> *"The artificial creation of Contract A is another example of the tendency of the Supreme Court to legislate rather than adjudicate ... [and] to tread into the areas which should properly belong to the provincial legislatures."*

We'll close with a quote from a respondent who put the entire situation in a nutshell: *"Too much fighting and not enough building!"* To that we can only add: amen.

The Revay Report is published by Revay and Associates Limited, a national firm of Construction Consultants and Claims Specialists, assisting owners and contractors in achieving profitable and trouble-free construction projects.

CONTACT INFORMATION

Please visit **www.revay.com** for more details.
To subscribe to the *Revay Report*, **click here**.