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The 'Privilege Clause' in construction tender documents – Supreme Court of Canada decision in M.J.B. Enterprises v. Defence Construction Ltd.

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This much–awaited decision has come down. It always was a simple case. The Supreme Court of Canada confirmed what we already knew, from Ron Engineering, and shed some light on the "privilege clause" (that is, the clause that states that *"the lowest or any tender shall not necessarily be accepted"*).

Following are key excerpts from Judge Iacobucci's well written decision:

> "The central issue in this appeal is whether the inclusion of a "privilege clause" in the tender documents allows the person calling for tenders (the "owner") to disregard the lowest bid in favour of any other tender, including a non–compliant one."

> "[Defence Construction] invited tenders for the construction of a pump house, the installation of a water distribution system and the dismantling of a water tank on the Canadian Forces Base in Suffield, Alberta. Four tenders were received, including one from [MJB]. The contract was awarded to Sorochan Enterprises Ltd., the lowest tenderer, and the work was carried out. [MJB] was the second lowest tenderer."

"Sorochan was only the lowest bidder because it failed to accept, and incorporate into its bid, the risk of knowing how much … fill would be required. As the Court of Appeal outlined, this risk was assigned to the contractor. Therefore Sorochan's bid was based upon different specifications. Indeed, it is conceded that the Sorochan bid was non–compliant."

{Quoting from Ron Engineering} "The principal term of contract A is the irrevocability of the bid, and the corollary term is the obligation in both parties to enter into a contract (contract B) upon the acceptance of the tender. Other terms include the qualified obligations of the owner to accept the lowest tender, and the degree of this obligation is controlled by the terms and conditions established in the call for tenders."

"What is important, therefore, is that the submission of a tender in response to an invitation to tender may give rise to contractual obligations, quite apart from the obligations associated with the construction contract to be entered into upon the acceptance of a tender, depending upon whether the parties intend to initiate contractual relations by the submission of a bid. If such a contract arises, its terms are governed by the terms and conditions of the tender call."

"Although [Defence Construction] has not disputed the trial judge's finding that the Sorochan tender was non-compliant, [Defence Construction] argues that the privilege clause gave it the discretion to award the contract to anyone, including a non–compliant bid, or to not award the contract at all, subject only to a duty to treat all tenderers fairly. It argues that because it accepted the Sorochan tender with the good faith belief that it was a compliant bid, it did not breach its duty of fairness."

"I do not find that the privilege clause overrode the obligation to accept only compliant bids."

Simple as that. The bid was non–compliant. The court held that the privilege clause does not allow the owner to accept a non–compliant bid.

Based on the Supreme Court of Canada's reasoning over 18 pages, what can we take from the decision?

1. *Contract A / Contract B* The analysis represented by Ron Engineering has been re–affirmed.
2. *The privilege clause means that you can accept another bid, if you have valid reasons* The validity of the privilege clause was supported by the Supreme Court of Canada, in these words:

> "I conclude that the privilege clause is compatible with the obligation to accept only a compliant bid [and] the privilege clause is incompatible with an obligation to accept only the lowest compliant bid."

> "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."

> "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."

What about all those cases that limit the effect of the privilege clause? The Supreme Court of Canada neatly addressed these, as follows:

> "[Defence Construction] submits that the majority of Canadian jurisprudence supports the proposition that the person calling for tenders should award Contract B to the lowest valid tender despite the presence of a privilege clause like the one in issue in this appeal. … I have reviewed the cases submitted to this Court and find that they do not stand for the proposition that the lowest valid tender must be accepted. Those cases that in fact deal with the interpretation of the privilege clause in the context of a finding that Contract A arose between the parties are instead generally consistent with the analysis outlined above."
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> "For example, a number of lower court decisions have held that an owner cannot rely on a privilege clause when it has not made express all the operative terms of the invitation to tender: [long list of cases]. Similarly, a privilege clause has been held not to allow bid shopping or procedures akin to bid shopping:[another list of cases]."

In other words, in a case such as Chinook Aggregates, where the District of Abbotsford did not disclose its "local preference", they could not rely on the privilege clause. And the owner can't use the privilege clause to bid shop. Also, now, based on MJB, it is clear that an owner cannot rely on the privilege clause to select a bidder that is clearly and materially non–compliant.

1. *Freedom to contract* What is set out in the tender documents will govern, according to usual contract law principles, including the principles that govern whether a term will be implied into the contract.

In the MJB case, the court determined that: *"For [Defence Construction] to accept a non–compliant bid would be contrary to the express indication in the Instructions to Tenderers and contrary to the entire tenor of the Tender Form"*. There was no express right to waive non–compliance. As noted above, the Court stated a number of times that the terms and conditions of the tender call will govern. It is reasonable to infer that if the owner expressly allowed itself the right to

waive an irregularity or error or non-compliance, the owner could have done so – it would become a term of "Contract A".

If the owner were to say, in the tender documents: "*our paramount duty and objective is to achieve good value for the owner, and we will select the bidder based on that result, even if non–compliant*", that would not be a case of relying on the privilege clause – rather, that would be a case of relying on an express provision allowing the owner to waive non–compliance.

Out of fairness to the contractor, any court would be circumspect in allowing an owner to waive an irregularity or error or non–compliance, based on any such provision. At the same time, owners might want to try to give themselves some flexibility, in this regard, by an appropriate provision in the tender documents. Often bids are non–compliant in a minor respect, and often bids are non–compliant in a material, but not necessarily critical, item. How far to go in allowing flexibility for the owner depends on the contracting philosophy or approach of the owner – which entails legal and non–legal considerations. More on that in the next issue.

If the case is simple, as stated above, then why did it go so far as the Supreme Court of Canada? Perhaps because Judge Rowbotham, at the Alberta Supreme Court level, initially held that the submission of a tender does not create a contract, and that therefore there could be no breach of contract; and then subsequently (in dismissing an application for Leave to Reargue), he acknowledged that he had made an error in holding that no Contract A had been formed. Then, the Alberta Court of Appeal held that the privilege clause "is a complete answer to MJB's action", but, curiously, held that MJB should be reimbursed for the costs of preparing its rejected tender. What a mess! The Supreme Court of Canada set it straight.

Next issue, a discussion of the relative merits of different philosophies adopted by tendering bodies, as to the degree of flexibility to build in to the tender documents.