

NAVIGATING THE TENDER PROCESS

This paper was originally published in the New Zealand Law Journal in 2000 and canvasses a number of legal and practical aspects of the tender process, including: the application of the Fair Trading Act 1986; the nature of contractual obligations; potential remedies for aggrieved tenderers; aspects of tender negotiation and reaching agreement; estoppel; and the selection of tender processes.

A tendering procedure ... is heavily weighted in favour of the invitor. He can invite tenders from as many or as few parties as he chooses. He need not tell any of them who else, or how many others, he has invited. The invitee may often ... be put to considerable labour and expense in preparing a tender, ordinarily without recompense if he is unsuccessful ... The invitor does not commit himself to proceed with the project, whatever it is; he need not accept the highest tender; he need not accept any tender; he need not give reasons to justify his acceptance or rejection of any tender received ...

... [Where a clear procedure is prescribed] the invitee is in my judgement protected at least to this extent: if he submits a conforming tender before the deadline he is entitled, not as a matter of mere expectation but of contractual right, to be sure that his tender will [be] considered in conjunction with other conforming tenders or at least that his tender will be considered if others are.

Bingham J in
Blackpool & Fylde Aero Club v
Blackpool Borough Council [1990] 3 All ER 25
at p30.

Introduction

The judgment of the English Court of Appeal in the *Blackpool & Fylde Aero Club case (Blackpool)* marks the beginning, at least in the UK, of an important line of cases, which have been followed in New Zealand.

Invitors are now having their behaviour examined more closely, and some of the cosy dealings with tenderers are being struck down, with justification.

It is the very nature of a tender process that all parties are in competition with each other and, within certain bounds, each is fully entitled to act in their own interests. The tenderers compete not only with each other, but also with the invitor to protect their profit. The successful tenderer scoops the pot, leaving nothing for those whose bids were unsuccessful. Increasingly, tenderers have shown an unwillingness to play the game, either by simply ignoring the rules or by challenging the process. This is almost certainly as a result of the cost and uncertainty that is inherent in any competitive process.

In many contractual situations, the adversarial relationship continues beyond award of the contract, all too frequently to the cost of the project. There are many construction projects where the contractor lost any prospect of a profit in the first few months after award, and proceeded to lose his shirt on the rest. There is no benefit to either party to a contract to see the other go out of business. In order to help avoid this, inviters and tenderers should both be aware of the legal and practical considerations relevant to tender processes.

Fair Trading Act 1986

It is worth canvassing the protection afforded to tenderers by the Fair Trading Act 1986 (FTA).

Section 9 of the FTA states that:

No person shall, in trade, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.

There are certain principles relating to section 9 that are clearly established:

- (a) Generally, the conduct must contain or convey a misrepresentation (*Bonz Group Pty Ltd v Cooke* [1994] 3 NZLR 216; *Levi Strauss & Co v Kimbyr Investments Ltd* [1994] 1 NZLR 332). One can engage, however, in conduct of a *misleading or deceptive* character by mere refusal or omission to act. Silence, through half truth, or omission to mention a subsequent material change, depending on circumstances, can suffice (*RhonePoulenc Agrochimie SA v UIM Chemical Services Pty Ltd* (1986) 68 ALR 77; *Smythe v Bayleys Real Estate* (1993) 5 TCLR 454).
- (b) Actual intention to mislead or deceive is not necessary (*Taylor Bros Ltd v Taylors Group Ltd* [1988] 2 NZLR 1; *Bonz Group Pty Ltd v Cooke* [1994] 3 NZLR 216). Whether an action is misleading or deceptive is a question of fact, determined objectively in all the circumstances (*Savill v NZI Finance Ltd* [1990] 3 NZLR 135).
- (c) Causation must be established. There must be a nexus between the conduct and the loss or damage alleged (*Savill v NZI Finance Ltd* [1990] 3 NZLR 135).

The leading case on the potential application of section 9 of the FTA to the tender process is *Gregory v Rangitikei District Council* [1995] 2 NZLR 208 (*Gregory*).

Gregory concerned the sale of a property by the Rangitikei District Council. The Council had invited offers by tender for the property. The plaintiff had earlier expressed interest in the property and he submitted a tender. Roberts, another prospective purchaser, also lodged a bid. The plaintiff was the highest bidder, but neither tender reached the reserve.

The Council had stated in a letter to Roberts (written a considerable time earlier) that it would offer the property to Roberts if it were to be sold. The Council considered that this imposed a moral duty on it to negotiate with Roberts. Gregory, who had been the highest bidder, on being informed of his lack of success in the tender, sought to negotiate with the Council but the invitation was not taken up. The Council also concealed the fact that it

was engaged in negotiations with Roberts. The property was subsequently sold to Roberts.

On learning of the sale, Gregory issued proceedings against the Council on a number of grounds, including the FTA and in contract. Gregory succeeded in his claim that the Council had breached section 9 of the FTA (although the quantum of damages was not addressed). Having created a clear public impression that it would sell, if at all, by tender, it was misleading and deceptive for the Council to proceed to sell by private treaty without disclosure to other tenderers. The Court held that the Council should have notified those concerned that its intentions had changed. It also found that letters sent to Gregory by the Council contained express and plain untruths and that this was also misleading and deceptive conduct.

Having found that section 9 applies, what remedies are available? The Court has discretion under section 41 of the FTA to restrain an invitor from engaging in conduct that constitutes or would constitute a breach of section 9. In practice, however, the contract will usually have been awarded to another party before a tenderer realises that it has a claim against the invitor. Damages will be a more appropriate remedy in these situations.

A party that *has suffered, or is likely to suffer, loss or damage* by a breach of section 9 is entitled to seek a court order for compensation (under section 43(1)). Damages under the FTA are discretionary and the Court may award the *amount of the loss or damage* (under section 43(2)(d)). Damages will be assessed having regard to the statutory scheme created by the Act and compensation will be directed at the loss caused by the misleading conduct (see *Cox & Coxon Limited v Leipst* [1999] 2 NZLR 15).

For damages to be available for the full amount of the loss, there must be a causative link between the deceptive conduct and the loss. In *Gregory*, the necessary causative link was established because the misleading statement deflected the aggrieved tenderer from further negotiation and caused him to wait. He then lost the opportunity to purchase. In particular, it deflected him from offering considerably more than his opening tender price, and a price which more likely than not would have procured eventual sale to him.

One final note on the FTA, claims under section 9 and in contract are not mutually exclusive. Aggrieved tenderers should consider seeking a remedy under both heads if possible.

The Nature of Claims in Contract

In practice, the boundary between express and implied terms tends to be merged by the courts and decisions are often based on a combination of the two. One of the leading New Zealand cases on contractual obligations in the context of tender processes is the well known case of *Pratt Contractors Limited v Palmerston North CC* [1995] 1 NZLR 469 (*Pratt*).

The plaintiff claimed damages for failure to be awarded the contract to build a traffic flyover. Tenderers had been required to pre-register and to pay a non-refundable \$100 deposit on registration. When the detailed tender was lodged, each tenderer was required to succeed in a pass/fail method of evaluation. The tender was then to be awarded to the

lowest tenderer. Four tenders were considered. The plaintiff was the lowest tenderer and accordingly expected to be awarded the contract.

Another tenderer had, with his conforming tender, forwarded an alternative tender which he claimed would result in a \$250,000 saving. That alternative tender was accepted by the Council, notwithstanding that non-conforming tenders were prohibited by the invitation documents.

Obligations were found to exist on the basis of an express promise in the tender documents:

The Principal shall only enter into a contract for the non-excluded tender with the lowest price.

In light of the express promise, Gallen J found that the Council had breached contractual obligations owed to Pratt when it accepted the non-conforming tender. The Court found an express unilateral contract based on an offer which was accepted by submission of the tender fulfilling the criteria.

Gallen J made this finding notwithstanding that the tender advertisement and detailed instructions on tendering contained the now standard phrase that *the Principal is not bound to accept the lowest or any tender he may receive*. Those provisions simply meant that it was open to the Council not to award the contract at all; however, if it chose to award the contract, it had to do so in accordance with its stated procedures.

It should be noted, however, that these same words were fatal to the claimant's contractual argument in Gregory, which was delivered by McGechan J only a matter of days after Gallen J's decision in Pratt. At best, this illustrates that each case will depend on its own facts and on the particular words used. It also shows that there is some room for flexibility of legal argument.

Whether or not there is an express contract will very much depend on the wording of the tender documents in any particular case. If an implied contract can be established, however, the intention of the parties will be assumed.

Historically, the law did not recognise an implied contractual relationship between the invitor and tenderers in a tender process. This began to change with the landmark Blackpool case, decided by the English Court of Appeal in 1990 (see the quote at the head of this paper).

In Blackpool, the Court held that any tender process necessarily involves two contracts:

- (a) a contract relating to the conduct of the tender itself; and
- (b) a contract relating to the subject matter of the tender, following award.

The Court in Blackpool dealt with the tender as a matter of contract implied from circumstance and commercial necessity. The consideration for the first contract is said to flow from the knowledge that a bidder will be committed to time, trouble and expense in preparing and lodging a bid. Although there is scope for academic debate on whether or not this can properly be deemed consideration in terms of pure contract law, the reality is

that the Blackpool case has been followed in New Zealand and other jurisdictions on a number of occasions and it is now good law in this country.

The *two-contract* approach in Blackpool was first applied here in the Pratt case (discussed above). Despite his finding that there was an express unilateral contract, Gallen J relied heavily on the Blackpool case in his judgment. He also identified a number of factors which weighed in favour of finding a contractual intent, including the payment of a non-refundable deposit and the detail of the instructions given to prospective tenderers.

The issue was considered again in *Pratt Contractors Limited v Transit New Zealand Limited* (CP221/97, HC, Wellington, delivered 6 September 2000) (*Transit*). In that case, Transit sought tenders for a contract realigning State Highway 1 at Vinegar Hill, near Hunterville. The plaintiff was the lowest tenderer of the eight received. After a two month period in which the plaintiff was asked to establish its ability to do the work, it became apparent that the tender validity period was about to expire. Transit asked the tenderers to confirm their tenders. Two tenderers refused and sought a re-letting. Transit then terminated the tender round and began a second round. The plaintiff, at the prompting of a tender evaluation team member increased its price, whilst another tenderer after similar prompting, reduced its price. The tenderer was subsequently awarded the contract.

The plaintiff alleged breach of contract on the basis of bias and unfairness in evaluating the tenders, misevaluation of the tenders and wrongful disclosure of price prior to completion of the evaluation of non-price attributes. The Court held that Transit was liable for breach of contract. It affirmed the contractual nature of the tender process, stating (at paragraph 104):

There is no dispute in the present case that the tendering process is a process contract, and subject to the duties and obligations imposed by its terms and conditions, and also subject to a general implied obligation to act in good faith. It is clear that the common law envisages that tenders will be evaluated in a fair, transparent and commercially competitive way.

The Court held that the first tender round was so tainted by the real risk of bias that it was irrelevant that Transit had the right to reject all tenders. Members of the tender evaluation team had been involved in previous dealings with the plaintiff that had resulted in a dispute. The history of their relationship dictated that any situation of possible bias or antipathy be dealt with squarely and in advance of the evaluation commencing. Past experience on the part of the evaluators is a desirable factor, but Transit should have alerted the evaluation team from the outset that apparent bias was a live issue so as to put them on notice of the need to disqualify themselves or guard against it, and to be very open in their dealings.

The Transit case highlights the fact that inviters must be proactive in ensuring that the tender evaluation is made impartially and in accordance with the tender procedure. A duty to conduct the tender evaluation fairly is implied into the contract, and the consequences of a failure to meet this obligation can be severe.¹

¹ The finding of the High Court was subsequently overturned by the Court of Appeal, but not on the stated grounds.

Remedies for Breach of a Contractual Obligation

To have the Court require the tenders to be reconsidered and then have them rejected after the event would be cold comfort for all tenderers. The Court's wide discretion under the Contractual Remedies Act 1979 to award such damages as it considers just in the circumstances does provide a real opportunity for compensation.

In some cases, it may be appropriate to unwind the tender process and start again, as in the Blackpool case where the Council was ordered to re-tender the airfield concession. The Court may also award the cost of preparing the tender. In New Zealand the Courts have gone further, however, than might reasonably be expected bearing in mind the nature of the contract.

In Pratt, the Court awarded \$17,822 for the cost of tendering and \$200,000 for lost profit on the project. In Transit, the quantum of damages was not considered in the substantive decision (and no decision on quantum has been issued by the Court at the date of writing of this paper), but the Court held that the loss and damage suffered by the plaintiff as a result of the breaches of contract were:

- (a) the cost of being involved in the tendering process;
- (b) the loss of profit that would have been made; and
- (c) consequential losses as the result of being unable to continue trading.

This apparent willingness to award damages for lost profit, on the contract as a whole is surprising considering that it is the contract relating to the tender procedure that has been broken, not the main contract following award. Applying Blackpool, unless there is a clear statement in the invitation to tender that, having evaluated all tenders in accordance with a prescribed procedure (for example, a weight-adjusted methodology), the lowest tender will be accepted, the contract can only be that the invitor will consider all conforming tenders in accordance with the procedure.

Most projects will have a budget, and other strict requirements to be met, before the contract will be awarded. It may be that, having negotiated all tenders received into a conforming or acceptable format, the invitor decides not to proceed with the project. This is not unusual, and should not be open to a claim in damages for lost profit on the whole project. Considering a tender is one thing. Awarding damages on the assumption that the contract would be awarded to the thwarted tenderer is quite another. An ill-treated tenderer may not have had the contract awarded to it for any number of valid reasons and awarding lost profit is therefore a relatively speculative exercise. Calculating the appropriate quantum of damages for lost profit also requires a significant degree of crystal ball gazing.

It is worth noting that in the Pratt case, Pratt also claimed damages for loss on the basis of being deprived of the opportunity of obtaining future contracts, but the Court held that this was too speculative and remote. In effect, Pratt was in a 'catch 22' situation typical of the tender process. Pratt was unlikely to win future contracts unless it could gain experience by successfully completing a prestigious contract such as the one at hand. Accordingly, Pratt priced to win. The competitive nature of the tendering process is such that a 'winning' price may be so low as to cause the contractor to make a loss on the project. A

loss on a single project can be enough to put smaller or less experienced contractors out of business altogether.

Any claim for lost profit on the contract at hand must be speculative by its nature, not just where profit on future contracts is being considered. Not only might the aggrieved contractor not have been awarded the contract at all, it may well have made a loss even if it had been awarded the contract.

Tender Negotiations and Reaching Agreement

Negotiating during a tender process is not without risk. At its most simplistic, the invitation to tender document is an invitation to treat (albeit creating a separate contract); the tender is hopefully an offer, capable of acceptance within a prescribed time; and the acceptance creates a binding contract.

Making a counter-offer will have the effect of negating the original tender, if it is not done carefully. This is not such a problem if the tenderer is asked to confirm that the tender remains open for acceptance on the revised basis.

Leaving aside our pre-contract contract there is a common misconception that negotiations can never create binding legal obligations before the parties have signed a formal document. This is a matter of assessing the intention of the parties. Where the signing of a formal document is envisaged, there is a presumption that the parties did not intend to be bound until the formal documentation has been prepared and signed. This presumption can, however, be rebutted.

The critical question in determining whether or not a contract has been formed during negotiations is whether the parties intended to enter an agreement with immediate effect to bind them. Where a binding agreement has been made but the document not yet signed, the Courts will treat the first agreement as a contractually binding provisional agreement which is later replaced by the formal document (*Reid Motors Ltd v Wood* [1978] 1 NZLR 319).

It is well established that *agreements to agree* or *contracts to negotiate* are generally unenforceable because of a lack of certainty about what is being agreed (*Walford v Miles* [1992] 2 AC 128). If the intention of the parties is that each party would be free to accept or reject a future agreement, then the agreement will not be binding.

However, an agreement will not be invalid for uncertainty if it contains provisions or machinery or formula by which any matters left unresolved are to be determined (*Attorney General v Barker Bros* [1976] 2 NZLR 495). Similarly, a Heads of Agreement (HoA) can be a valid and binding contract, as illustrated in the recent case of *Fletcher Challenge Energy Ltd v Electricity Corporation of NZ Ltd* (2000) 6 NZBLC 103-073 (*Fletcher*).

In *Fletcher*, Fletcher Challenge and ECNZ entered into a three-and-a-half page HoA for the supply of gas worth up to \$1.8 billion. The HoA included a clause which stated that the parties were to *use all reasonable endeavours to agree a full sale and purchase agreement within three months of the date of this agreement*. Full agreement was not reached and Fletcher Challenge brought proceedings claiming that ECNZ was in breach of its *reasonable endeavours* obligations.

The Court had to decide whether or not the HoA was a binding and enforceable contract and whether the *reasonable endeavours* clause was binding in law. On an objective analysis the Court held that the parties intended to be bound, taking the following factors into account:

- (a) the importance and complexity of the transaction;
- (b) the degree of formality/informality and the terminology of the agreement (eg was there a signed agreement, an exchange of correspondence or only an oral exchange);
- (c) the amount of detail settled by the agreement;
- (d) the parties' previous dealings and their conduct at the time of and following the agreement;
- (e) actions taken in reliance upon or part performance of the agreement; and
- (f) the fact that the agreement is one of a series of inter-related agreements between the parties.

On the question of whether or not the terms of the HoA were sufficiently certain, the Court held that the HoA contained all of the terms necessary to make it workable. It rejected ECNZ's argument that the HoA was incomplete in that it lacked agreement on essential terms. Where a particular term is specified as *to be agreed* it will often simply be an indication of the parties' understanding that the term is capable of being agreed in the future and that it is their intention to do so, not that there is to be no contract until such agreement is reached. The Court held that the *all reasonable endeavours* clause was sufficiently clear and certain to be legally enforceable and that ECNZ had breached its duty under that clause.

The Fletcher case illustrates that there are circumstances in which parties can be required to enter into a more detailed agreement pursuant to an earlier agreement. During tender negotiations, a tenderer may, for example, offer an attractive long-term maintenance arrangement as an additional benefit to the invitor in exchange for awarding the contract to that tenderer. The specific terms of that arrangement may be set aside to be agreed at a later date. If it is found that the parties intended to enter into a binding agreement, the Courts will do their best to give effect to the agreement (*Queensland Electricity Generating Board v New Hope Collieries Pty Ltd* [1989] 1 Lloyd's Rep 205).

Estoppel

The courts have also been willing to find equitable obligations of good faith in certain types of contractual situations, particularly those that involve a degree of trust or reliance.

In the landmark case of *Waltons Stores (interstate) Limited v Maher* (1988) 164 CLR 387 (*Waltons Stores*), the terms of a contract for the construction and leasing of a new building were substantially settled, but both parties understood that the contract would not have binding effect until a formal exchange of documents had taken place. Waltons' solicitors sent a draft contract to Maher's solicitors and in a subsequent telephone conversation, the solicitors for both parties agreed on certain amendments. The solicitor for Waltons

indicated that the amendments were subject to client approval and sent an amended draft later that day along with a covering letter which stated *we shall let you know tomorrow if any amendments are not agreed to.*

Waltons did not make contact with Maher for a further two months, at which time they wrote to say that they did not intend to proceed with the contract. By this time, Maher had already completed 40% of the building. Maher had forwarded a signed copy of the amended contract to Waltons a few days after the telephone conversation and, not having heard anything further to contradict Waltons' earlier encouraging statements, had proceeded with the works.

Waltons were aware that Maher was proceeding with the works. On appeal, the High Court of Australia did not accept Waltons' reliance on strict legal principles of contract. It held that the defendant had represented by conduct that it would enter into a lease and it was therefore estopped from denying that such an obligation existed.

For equitable estoppel to be successful, the plaintiff must have relied on the defendant's representation to its detriment and the defendant must have committed some form of unconscionable conduct. In *Waltons Stores*, the detriment was that construction work on the property in question had already begun. The Court suggested that unconscionability may exist where the detriment has been suffered by the plaintiff in circumstances where there was a *relationship of responsibility* between the parties. The factors which will be relevant in finding such a relationship will be the conduct of the party in creating or encouraging the belief that a promise would be fulfilled, the reliance on this by the other party, and knowledge of that reliance.

Selecting a Tendering Process

Aside from considering legal rights and remedies when tender processes have led to disputes, it is important to consider the practical measures that can be taken to benefit both parties and to help prevent disputes from arising in the first place.

It is critical that the invitor identifies its expectations from the process before calling tenders, whether it is price, quality or performance. In this way, the tender process can be properly tailored for the project, and when the process is put under pressure by, for example an aggressive tenderer, recourse can be had to those initial principles for guidance. The selected procedure should be drafted with the knowledge that aggressive tenderers will appear, and the procedures should allow the invitor the flexibility to deal with them.

There are benefits of prescriptive processes, for example in those limited situations where there is no flexibility in design or any other matter where tenderers may be able to add value over and above the supply of a standard item of stock. In extreme cases, for example in some project financed or equity based transactions, the invitor may leave it to the bidding consortium to propose a contract structure. In most cases, however, the principal will have a good idea of what the contract will contain, and the form of contract should be prescribed.

It is worth noting that the case law relates to prescriptive tendering procedures which have not been followed. In most cases the tender process should retain the level of flexibility

needed to negotiate the best deal, within the bounds of the competence and authority of the people running the tender. No alternatives should be discouraged.

The selected tendering process sets the terms of the contract. As noted by McGechan J in *Gregory* (at 221):

Parties at arms' length may contract in a way which allows the arbitrary, abnormal or even downright stupid.

There is no requirement that the procedures themselves are fair or reasonable. It is a requirement that, having established a tender procedure, the invitor is bound to abide by it and apply it fairly. This is of course, overlaid by the provisions relating to misleading and deceptive conduct in s9 of the Fair Trading Act (discussed above).

Imposing unreasonable, opportunistic and overbearing tendering procedures and contract terms will depend on the principal's perceived position of strength and the extent to which there is any expectation of longer term relationships. These approaches almost always end in grief for both parties. An overly opportunistic commercial position procured during the competitive process will almost always adversely impact on contractual performance through quality, delay, under-resourcing or increased disputes.

There are number of ways to promote a successful tendering process:

- (a) The procedure should reassure tenderers that, even if the terms are tough, the procedures will be reasonably applied;
- (b) Sufficient time should be allowed for proper due diligence. Even with tough contracts, if the tenderer has the time to properly review the terms and to investigate the subject matter, then there is a better prospect of a realistic tender;
- (c) Set terms which reduce, as far as possible, the pricing for risk. It is tempting to load risk onto tenderers, in the hope that the invitor will get something *for free*. This is rarely the case. If the risk does not materialise, then a premium has been paid for certainty, but ultimately for no other reason. If the risk does materialise, there is no guarantee that the premium set will be sufficient to cover the risk and it will not stop the contractor from lodging a claim;
- (d) Identify the evaluation method with sufficient flexibility to ensure that the invitor retains control of the process. The process should be robust, and withstand scrutiny at all levels, however the final decision is the principal's, and this right should be protected.
- (e) The tender process should be reviewed and signed off by the invitor at senior levels internally before being issued to ensure that the integrity of the process is retained.

Conclusion

Tenderers involved in a tender process should expect to be treated in accordance with the tender procedure. This includes the right not to be misled or deceived by the invitor. If a

dispute over the award of a tender arises, an aggrieved tenderer may base a claim on a number of grounds including a claim under the FTA and breach of contract.

Once inviters have selected a tender process, they should stick to it. Like most contracts, it is not necessary for them to be *fair* or *reasonable* in their terms, but an appropriate allocation of risk and a fair and reasonable application of the procedures, during tendering and post award, will significantly reduce the risk of subsequent dispute.

Prospective inviters and tenderers must be aware of the opportunistic and competitive nature of the tender process. The process can sometimes favour rash or inexperienced tenderers that price to win by failing to factor adequate price protection against risk into their bids. It can also favour opportunistic tenderers that deliberately ignore risk at the tendering stage and seek to extract money from the invitor through claims for extra payment made during the works. Many tenderers find themselves in a catch 22 situation where they must price to win, but in so doing will end up making a loss and perhaps even go out of business.

The opportunistic nature of the process can be detrimental to both parties if it is not managed properly and it is in their mutual interests to prevent claims arising. Time is best spent for inviters early in the tender process. This includes the setting of priorities and risks for the project and getting the tenderers on board early as well. Inviters and tenderers alike must be aware of the pitfalls of tender processes if they are to successfully navigate their way towards a successfully completed project.