THE SIGNIFICANCE OF THE TENDERING CONTRACT ON THE OPPORTUNITIES FOR CLIENTS TO ENCOURAGE CONTRACTOR-LED INNOVATION

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Abstract

During the tendering process for most major construction contracts there is the opportunity for bidders to suggest alternative innovative solutions. Clearly clients are keen to take advantage of these opportunities, and equally contractors want to use their expertise to establish competitive advantage. Both parties may very well benefit from the encouragement of such innovation and the availability of cheaper methods of construction than have been contemplated by the tendering authority.

However recent developments in common law have raised doubts about the ability of owners to seek alternative tenders without placing themselves at risk of litigation. This common law has recognised the existence of the so-called ‘tendering contract’ or ‘process contract’. Since the tendering process is inherently price competitive, the application of the tendering contract concept is likely to severely inhibit the opportunity for alternative tenders.

The ‘tendering contract’ is automatically brought into being upon the timely submission of a conforming tender. This is contrary to the traditional view that an invitation to tender was considered to be no more than an invitation to treat, therefore submission of a tender creates obligations for neither party. Under the ‘tendering contract’, the owner becomes obliged to treat all tenderers equally and fairly.

This paper is primarily based on the literature review. The aim of this paper is to highlight the problems with the competitive tendering process in relation to contractor-led innovation and explore ways in which owners can develop procurement procedures that will allow and encourage innovation from contractors.

A slide presentation accompanies the paper (please refer to the original website).
PROBLEMS WITH COMPETITIVE TENDERING

The traditional tendering process was designed to produce direct price competition for a specified product. Evaluation of tenders could only be confined to price alone by creating a system in which price is the only criterion that could vary while design and technical content are the same for each competing tender. Albeit the contract period is stipulated as constant, owners often encourage tenderers to submit a second tender which offers an alternative price for an alternative time performance. Tenderers would achieve this by reworking their tender programme, finding the optimum contract period, and adjusting the tender price accordingly (Craig 1999b). Each tenderer would compete to find novel ways of organising the work method that would allow not only the minimum construction cost but also maximum profit margin within the price proposed. However, this process is always confined by the boundary of the owner’s design. In this way, the successful tenderer’s scope to be innovative is very limited.

When evaluating alternative tenders, the owner is confronted with the duty of equal treatment and fairness to all tenderers. If one is to be preferred on an alternative tender, which is not a conforming tender in terms of the original invitation, how can all tenderers be treated equally and fairly (Craig 1997c)? Any individualism exhibited on the part of a tenderer outside the permitted scope of price and time must disqualify that tender from the owner’s consideration because it does not conform to the invitation. Therefore, the traditional tendering process prevents, restricts or even discourages contractor-led innovation (Craig 1999b).

Songer and Ibbs (1995) believed that the use of design-and-build (design-and-construct) procurement method would encourage innovation in the building process. This procurement method imposes single point responsibility on contractor for the complete building and its tendering process differ from that of the traditional procurement method in that it must be capable of evaluating design as well as production capability, time and price, all on a competitive basis. This is not easy. Competitive design is not easy to evaluate in the context of tendering. The objectivity appears to be replaced by subjectivity in picking the winner, and the apparent integrity of the bidding process is lost, unless very clear criteria are established at the outset for evaluation of competing designs (Craig 1997c). This also means to say that the tender process rules must be designed as such that it encourages contractor-led innovation, yet at the same time places some limit on the scope for such innovation. The limits must be such that the project delivered is still the project for which tenders were invited (Craig 1999b). Songer and Ibbs, with respect to this aspect, asserted that one concern of public agencies is how to allow for innovation while maintaining appropriate control of certain design aspects of the project. Determining an appropriate balance of innovation and control in design and adequately communicating the desired balance to potential design-and-build tenderers provides a significant challenge to public sector agencies.
THE ‘TENDERING CONTRACT’

Developments in the law relating to tenders traditionally treated an ‘invitation to tender’ or a ‘request for tenders’ as no more than an invitation to treat, an indication that the owner was ready to do business – something prior to and short of an offer (Poole 1998). In other words, an invitation to treat was not an offer to make a contract with any person who might act on the invitation, but merely a first step in negotiation which may, or may not, lead to a contract. When each tenderer submitted its tender in the prescribed form, it amounted to an offer which could be regarded as an offer to make a contract. If the offer met with unequivocal acceptance, contractual obligation arose between the owner and the successful tenderer (Craig 1999b, Poole 1998).

Recently, the modern view turns this theory upside down. There exists what is known as the ‘two contract’ analysis involving the emergence of the ‘tendering contract’. The invitation to tender is now in some circumstances to be treated as an offer to make a contract which a tenderer accepts when it submits a conforming tender (Craig 1999a). The owner makes an offer to each tenderer which might be worded as follows:

“If you submit a tender in response to my invitation and which complies with the stipulations made, I will consider that tender ...” (Craig 2000, p.93).

There is no obligation at all at this point on the side of the tenderers, but if a conforming tender is submitted, a contract is formed between owner and tenderer which has been described here as the ‘tendering contract’ or described elsewhere as a ‘pre-award contract’ or ‘process contract’. This contract is quite distinct from the contract eventually entered into with the successful tenderer, called the main contract. Obligations of a contractual nature therefore arise between the owner and each tenderer who has submitted a proposal. Just as the tender contract places obligations on the owner, each tender also imposes obligations on the tenderer. Once the tender has been submitted to the owner, meaning the tender or first contract has been formed, the owner becomes obliged to each tenderer to perform its side of bargain, which at this stage is an obligation to consider all conforming tenders. By the same token, tenderers become obliged to not simply withdraw their tender, the tender will remain open for a stipulated period of time. Under the ‘two contract’ principle, a tenderer who makes a mistake may find that the tender is accepted with no opportunity to escape even if there is an error in tender compilation (Craig 1999a).
For the sake of clarity, it may be stated that the submission of a conforming tender in response to an invitation can create contractual obligations for both parties. In the case: *Ontario (The Crown) v. Ron Engineering & Construction Eastern Ltd. (1981)*, the Court of Canada held that a contract was brought into being automatically upon the submission of a responsive tender by each tenderer. Having established that a ‘tendering contract’ exists, it is then important to constitute what the terms of that contract. The terms are derived from the tender conditions, the ‘tender code’, and other relevant material such as legislation and correspondence (Craig 1999b). All or some of the provisions of the ‘tender code’ may be incorporated in the ‘tendering contract’ by reference and/or by implication. Terms may be implied to the effect that the owner must consider all conforming tenders, must treat all tenderers equally and fairly, and must award only a contract for the project tendered for and not for something different (Craig 2000).

**GUIDANCE ON CONTRACTOR SELECTION**

**The Significance of Probity in Tendering**

Probity (or procedural integrity) is defined in various dictionaries as “moral excellence, integrity, uprightness, conscientiousness, honesty, sincerity and as confirmed integrity”. In the tendering context, it generally depends upon confidentiality of documentation and decision making, objective and consistent assessment at each phase of decision making and resolution of any possible, perceived or actual conflicts of interest (Johnstone and Clark 1997). Thus, one of the primary objectives of probity in tendering is to maintain the integrity of the bidding process. The Canadian court in the *Ron Engineering* case (1981) referred to this as the obligation of owners to treat all tenderers equally and fairly, that contract award criteria are established in advance and known to all parties, thus creating a transparent award process (see Craig 1999a).

Johnstone (1997) asserts that transparency in the entire contracting out process is essential so that potential contractors and members of the public can have confidence in the outcomes. If integrity and impartiality are not evident, tenderers may be reluctant to make a bid, the formulation of which requires significant amount of time and resources. In that case, competition is likely to be lessened and the best value for money may not be achieved.

In principle, recent development in common law attempts to maintain some integrity in the tendering process by recognising the existence of the parties’ obligations to one another so that the owner is restrained in how tenders are assessed and the award of contracts made. In other words, owner cannot simply reject or accept tenders as it pleases, or cannot negotiate with one or more tenderers to produce satisfactory deal. As mentioned previously, the contractual obligation between the parties is referred to as the ‘tendering contract’. Breach of the ‘tendering contract’ entitles the injured party to the normal remedy of damages (Craig 1997c). Probity in the tendering process ensures that fair and equal treatment to all tenderers is put in place and maintained so that no term of the ‘tendering contract’ is likely to be breached. According to Johnstone (1997), common probity objectives are:
• to ensure all respondents are assessed objectively and consistently and in accordance with the published documentation (transparency of process)
• to ensure integrity in all evaluation and selection process
• to ensure all confidential information is secured
• to address any potential, perceived or actual conflicts of interest
• to promote defensibility of process.

Guidelines to Avoid Breach of the ‘Tendering Contract’ in the Competitive Bidding Process

On conclusion, Craig (1997a, 1997c) suggests some guidelines on how alternative tenders and tenders involving design proposals might be taken legitimately by the owner so as to avoid or minimise the likelihood of the clients placing themselves at risk of litigation due to a breach of the contractual obligations arising out of the ‘tendering contract’. They are specified as follows.

• Under the ‘tendering contract’ the owner is obliged to treat all tenders equally and fairly. All conforming tenders must therefore be considered.
• Acting in good faith, as a minimum, means not acting in bad faith. What are considered bad faith are:
  □ awarding something other than the main contract,
  □ failing to reject non-conforming tenders, or
  □ awarding the main contract on undisclosed criteria
• An effective ‘privilege clause’ which says something like “the lowest or any tender will not necessarily be accepted” will normally prevent an owner becoming obliged to accept any tender. All tenders may therefore be properly rejected. On the other hand, a term to the effect that a contract will be awarded to the lowest, or highest, bidder is enforceable. This implies that an owner cannot use the ‘privilege clause’ as an excuse for deviating from the contract evaluation and award criteria set down in the tender invitation or documents. Or, put it another way, the ‘privilege clause’ does not allow the owner to: (i) choose comparatively among the tenderers based on criteria that has not been disclosed to the tenderers; or (ii) to award to another tenderer or another person something other than the main contract.
• It would be a breach of the tendering obligation of equal and fair treatment for the owner to negotiate with one tenderer on terms which do not apply to other tenderers.
• Without the existence of the tender document’s terms within the ‘tendering contract’, there is no term which permits the owner to consider an alternative tender. There is no sufficiently identifiable established practice that would allow the court to imply a term to the ‘tendering contract’ to permit consideration of alternative tenders. Without clear words, they cannot be considered. In other words, an alternative tender must be put in terms which are sufficiently precise to enable acceptance by the owner.
• All tenderers are entitled to know the basis on which tenders will be evaluated and on which a contract-award decision will be made.
• If innovation from tenderers is required, an owner must expressly create the right for a tenderer to submit an alternative tender. If the right then exists, the owner is obliged to consider such proposals. Tenderers must be informed of criteria for evaluation of such alternative proposals.
• Tender conditions must define the scope of alternative tenders. That scope must be not too tight so as to restrict innovation, but not too wide so as to result in a proposal for a scheme quite different to the one originally tendered for.
• Tender conditions for projects involving design must include criteria for evaluating that design, as well as criteria for evaluating performance. The criteria must be made known to all tenderers.
Without such criteria, every tender becomes ‘alternative’ in as much as a contract award to one party is likely to be a breach of contract with another.

- It is a breach of the ‘tendering contract’ for the owner to award a contract to a tenderer who offers something different to what was asked for in the invitation to tender. There must be substantial compliance with the owner’s requirements before a bid can be considered as a conforming tender.
- When tenders involve design, it is accepted that tenderers must exercise substantial judgment in formulating their proposals. Tenders should not be rejected because of some minor departure from owner’s requirements. But errors in interpreting those requirements and the need for substantial redesign must result in rejection.

Furthermore, Johnstone (1997) adds

- Invitation document should be accessible to all potential bidders. They should be expressed in readily understood terms.
- It is easier to formulate appropriate selection criteria when the project specifications are developed first. The specifications should include the terms of reference, objectives and expected outcomes of the project. Clear specifications and selection criteria assist possible contractors to formulate bids appropriately.
- As bidders will have formulated their bids based on predetermined selection criteria, any deviations to those criteria should, at best, be avoided. In the situation where it is necessary to deviate from those criteria, all bidders should be notified. If necessary, all bidders should be given the opportunity and sufficient time to re-submit bids in light of the new information.
- A policy in relation to non-conforming bids should be formulated and documented in the invitation documentation.
- Often assessment of bids will involve a number of assessment panels. In this situation, there should be a separation of assessment panels. For example, a panel of experts may review financial viability whilst another will look at those same bids from a design perspective. Assessment panels would commonly not meet and would be quarantined through the evaluation period.
- Members of assessment panels should be selected on the basis of the specific expertise which is linked to selection criteria.
- Justification statements should be documented by assessors, and provided to bidders – successful or unsuccessful – where requested.
- Assessment of bids should be completed swiftly. Unexplained delays could compromise the perceived integrity of the process.

**ALTERNATIVE METHOD FOR CONSTRUCTOR SELECTION**

A number of litigation cases involving ‘alternative proposals’ (e.g. *Pratt Contractors v. Palmerston North City Council* (1995) in New Zealand, *Health Care Developers Inc. and Others v. The Queen in Right of Newfoundland (The Crown)* (1996) in Canada) have shown that the owner’s breach of its obligation to treat all tenderers fairly and equally was heavily associated with the competitive bidding which places much emphasis on a hard-dollar evaluation process and the fact that there was no clear set of criteria of how the ‘alternative proposals’ would be evaluated. Research to date has indicated that the alternative solution appears to be to adopt ‘non price driven’ selection process in which evaluation may include price but competition is primarily driven by factors other than price. A number of methods have been identified, one of which is that adopted by the Queensland Museum Board. This method was applied to the Museum of Tropical Queensland (MTQ) in Townsville.
The innovative approach adopted is not concerned with the selection of a particular contractor as a separate entity but a consortium with demonstrated experience in the total delivery of the project. The total project delivery system may include such components as:

- assessment and completion of the functional brief
- programming of the project
- preparation of the design brief
- preparation and maintenance of a cost plan
- design documentation
- construction
- preparation and supervision of contracts for maintenance of major plant and equipment over a specified period after date of final completion.

The expertise and innovation of all professions and trade persons alike is encouraged to provide a range of options to deliver a project that can prove to be a cost effective solution on a life-cycle basis whilst meeting the functional requirements of the project. The approach is to nominate price as a mandatory requirement and everyone is competing on the same price. The primary aim of this process is to deliver an operational facility that optimises the available funds and satisfies the functional requirements of the project (QMB 1997). Therefore, there is no tender price submitted by each tenderer in this method.

Consortia may be led by a construction company, a registered architect, engineer or other design professional, or others who can demonstrate through past experience the capability to undertake the works and guarantee delivery to budget and program.

The method involves a short-listing or pre-qualification process as well as a final evaluation of proposals. In both processes, the criteria and weightings are nominated up front so that every tenderer is aware of how they will be pre-qualified and how a contract-award decision will be made. In the MTQ project, the short-listing criteria and their respective weightings are composition of consortia 30%, demonstrated past experience of consortia and its individuals/companies 30%, extent of local involvement 25%, and level of innovation in proposal 15%, while the final evaluation includes nomination of consortia key personnel 5%, hierarchy of consortia 10%, the project delivery system 30%, review of the project brief 5%, draft cost plan 10%, draft program 10%, and presentation of proposals 30%.

SUMMARY

This paper highlights the problems with competitive tendering in relation to contractor-led innovation. In the traditional method, contractor-led innovation may be encouraged at the tendering stage through alternative tender. However, to enable acceptance by the owner, criteria for evaluation of and the scope of alternative tenders must be clearly defined in the tender document. By the same token, tender conditions for projects involving design must include criteria for evaluating that design, as well as criteria for evaluating performance. The criteria must be made known to all tenderers. Without such criteria, every tender becomes ‘alternative’ in as much as a contract award to one party is likely to be a breach of contract with another.

Guidance has been outlined of how to reduce the risk of owner falling into a breach of the ‘tendering contract’ in the competitive tendering process when it involves alternative tenders or design proposals. One of the alternative contractor selection methods identified has been briefly
described. It takes into account a process in which evaluation includes price but competition is primarily driven by factors other than price.

This paper has been mainly based on a review of the literature concentrating on matters related to the ‘tendering contract’ and contractor-led innovation. The next stage of the research will explore the factors influencing the opportunities for owners to encourage innovation from contractors.

**Reference**