New challenges in construction contracting

by Robert C. Worthington

The Supreme Court of Canada decision in *Naylor Group Inc. v. Ellis-Don Construction Ltd.* [2001] 10 C.L.R. (3d)1 has substantially changed the landscape for sub-trade bidders, prime contractors and, ultimately, owners (public or private) in competitive bidding procurements. This decision is a blow to the unethical practice of "bid-shopping" by prime contractors (and probably owners) and extends competitive bidding law down one step to the prime contractor/sub-contractor level.

The facts of the case were fairly simple. Ellis-Don planned to bid on an Invitation to Tender for hospital construction. The owner (hospital) had decided to use a common construction practice for sub-trades to submit their bids to a bid depository. Under this scheme, sub-trades put in bids for parts of the work in advance of the formal close of bidding to the owner. Prime contractors choose a sub-trade bid and list that sub-trade in their bid to the owner.

Naylor Group had put in a sub-trade bid for electrical work, which was lowest. Ellis-Don used Naylor's bid in its bid to the owner. However, after Ellis-Don won the contract, it sought to change sub-trades (to a non-bidder company, at Naylor's price) due to union affiliation problems. Naylor sued, arguing Ellis-Don was bid-shopping and couldn't change sub-trades.

The Ontario Court of Appeal, and later the Supreme Court of Canada (SCC), agreed with Naylor.

According to the SCC, when Ellis-Don listed Naylor's bid, it became legally bound to use Naylor in the performance of the work unless there were "reasonable objections" from the owner. In other words, a Bid Contract A was formed between the prime contractor and the sub-trade bidder when Ellis-Don used Naylor's name and price in their bid to the owner. Thus, when Ellis-Don won the award, they became bound to Naylor, unless the hospital objected to Naylor being the electrical sub-contractor on the project.

In this case, the hospital did have a reasonable objection (union affiliation). However, the union affiliation was known to Ellis-Don prior to Ellis-Don listing Naylor as its electrical sub-contractor. This prevented Ellis-Don, in the Court's opinion, from raising this as a valid reason for not using Naylor. When Ellis-Don did not use Naylor, they breached their contract with Naylor. The damages to be paid were the lost profit Naylor suffered from the contract breach.

With this decision, the SCC moved the binding nature of bidding down a level, again to protect the integrity of the tendering process. With the stroke of a pen, it redefined the nature of relationships in the construction industry.

It is no longer possible for a prime contractor to list a sub-trade in their bid, and then, after winning the project contract, "shop" the sub-trade contract to others, seeking to reduce the price of the sub-trade contract. Unless the owner has objected to the sub-trade bidder, for the contractor to do so would be a breach of the Bid Contract A between the prime contractor and the sub-trade. This could result in an award of lost profit as damages to the listed sub-trade bidder. And, this exact scenario has already occurred in *A. Dynasty Roofing (Windsor) Ltd. v. Marathon Construction Services (1991) Inc.* (March 11, 2000) File No. 99/G5-46265 (Ontario SCJ).

Equally, it will no longer be possible for a sub-trade bidder, after the prime contractor wins the project contract using the sub-trade bidder's bid, to back out of its obligation to perform or to change pricing with the prime contractor.

Now in law, the prime contractor and their listed sub-trades will be bound automatically to each other the moment the prime contractor becomes legally bound to the owner (i.e., at close of bidding). All of the implied common law legal obligations of competitive bidding law regarding full disclosure, equal treatment and good faith will now apply to the prime contractor/sub-contractor relationship, at least when there is a formal tender procurement conducted (e.g. when using the bid deposit system, as in the Ellis-Don case).

Thus far, the Supreme Court of Canada's reasoning only applies when formal tendering processes are used between the prime contractor and its sub-trades.

The Supreme Court of Canada also appears to be prepared to allow an owner to object to the listed sub-contractor. The power of the owner to object to a sub-trade may have arisen, however, because this power was in the hospital's Invitation to Tender. It is a standard clause in most construction contracts. (But, you should ensure it is in yours.)

Owners should expect more prime contractor (and even sub-trade bidder) requests for a "reasonable objection" as these players seek to avoid the legally binding nature of their relationship. Owners should take great care before they object to a listed sub-contractor to ensure their objection is both based in fact and is reasonable. If they don't, the owner could find themselves dragged into any resulting litigation, and could conceivably be liable if the objection was unreasonable, or was a sham to allow the prime contractor to avoid their new legal obligations to the listed sub-trades.

How all of this will unfold remains to be seen, but if the outcomes are at all similar to the changes wrought by *The Queen v. Ron Engineering,* it could be significant for all involved in construction contracting.

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