



Failed Frontrunner Negotiations and Liability for Damages

by Maureen Sullivan

How do you handle discussions with your frontrunner in a Request for Proposals (RFP) process? When can you break off negotiations and move to the next-ranked proponent, while still ensuring fairness of process? How much information must proponents have, if termination of negotiations can be based on budgetary concerns?

The Canadian International Trade Tribunal (CITT) ruling dealing with these important questions has now been confirmed by the Federal Court of Appeal in *Defence Construction (1951) Limited and Zenix Engineering Ltd., 2008 F.C.A. 109*.

Background

The facts of this case are fairly straightforward. Along with five other proponents, Zenix submitted a proposal in response to a Request for Abbreviated Proposals (RFAP) issued by Defence Construction, a federal Crown corporation, for life-safety assessment and remediation analysis of modular quarters for use by the Department of National Defence (DND). As the highest-ranked proponent, Zenix entered into negotiations with Defence Construction, as anticipated in the RFAP. During negotiations, Zenix offered to lower its price for the services and had further discussions about including certain elements of cost in this amended price.

Following these discussions, months passed, with Zenix hearing nothing from Defence Construction. After repeated enquiries, Zenix finally learned that Defence Construction had initiated negotiations with and awarded the contract to the second-ranked proponent. Defence Construction had never notified Zenix that negotiations were at an impasse or that its pricing was still out of line with budget estimates, nor did Defence Construction give Zenix a final opportunity to refine its pricing. All communication with Zenix had simply ceased.

The CITT Ruling

On application by Zenix, the CITT ruled that Defence Construction had violated the terms of the RFAP, and it ordered Defence Construction to compensate Zenix by an amount equal to the profit it had lost as a result of Defence Construction awarding the contract to another proponent. In addition to breaching the express terms of the solicitation, the CITT found that Defence Construction had breached its Agreement on Internal Trade (AIT) and North American Free Trade Agreement (NAFTA) obligations by failing to disclose the Department of National Defence's budget limits to Zenix, during negotiations.

The RFAP anticipated negotiations with a frontrunner, and included the following fairly standard language: “Negotiations will include an agreement on a maximum amount for services authorized by Defence Construction Canada [DCC]. In the event that these negotiations fail, DCC will enter into negotiations with the second-ranked proponent.” The main question in this case is: What constitutes “failed negotiations”? The CITT concluded that Defence Construction was required to advise Zenix that the negotiation had reached an impasse on the maximum amount for services to be provided. It was also required to advise Zenix about the opportunity to meet a price imposed by the DND’s budget limitation. In the CITT’s view, only after communicating this information to Zenix and seeking a final response from Zenix could Defence Construction have reached the conclusion that negotiations had indeed failed.

The CITT further concluded that Defence Construction had violated article 506(6) of the AIT and article 1015(4)(d) of NAFTA, in that it did not respect the criteria in the RFAP. Since the negotiations between Zenix and Defence Construction had not failed, Defence Construction was not entitled, under the provisions of the RFAP, to begin negotiations with the second-placed proponent. Because of this, the CITT ordered damages payable to Zenix for its lost profits.

The Federal Court of Appeal Ruling

Defence Construction sought judicial review of the CITT decision to the Federal Court of Appeal, arguing that the CITT lacked jurisdiction to adjudicate the complaint under NAFTA. Because Defence Construction did not argue that the Tribunal lacked jurisdiction under the AIT, its argument that the Tribunal lacked jurisdiction under NAFTA was of no consequence, and the Federal Court of Appeal dismissed that portion of the appeal.

In referring to the Supreme Court of Canada decision in *Martel Building Limited v. Canada*, [2000] 2 S.C.R. 86, the Federal Court of Appeal concluded that the CITT had gone too far in finding that Defence Construction should have, during the course of negotiations with Zenix, disclosed the DND’s maximum budget for the contract. Neither the language of the RFAP nor the provisions of the AIT require disclosure of the budget limits. In the words of the Supreme Court, “such disclosure would be incompatible with the activity of negotiating and bargaining.”

The Federal Court of Appeal did, however, uphold the CITT finding that Defence Construction had acted contrary to the provisions of the RFAP by unilaterally concluding that the negotiations had failed, and by entering into negotiations with the second-ranked proponent. Zenix had no reasonable basis for concluding that there were any problems with its modified proposal, and the facts clearly show that Zenix was open to further negotiation. But Zenix was never accorded that opportunity, and Defence Construction left it in the dark as to the status of the contract.

Lessons Learned

The key lesson from this important decision is to take care in drafting and applying your ‘right to negotiate with the frontrunner’ provisions. Be explicit about how those discussions will be conducted, and about what constitutes “failed negotiations.”

From a practical perspective, treating vendors fairly and equally includes fairness in conducting any negotiations. Proponents should be given ample and clear notice that negotiations are coming to an end, and a final opportunity to submit acceptable revisions to the proposal, before the purchasing organization can commence negotiations with the second-ranked proponent.

This decision clearly reinforces what procurement professionals already know: any negotiations done in the context of a competitive process *must* be conducted in good faith, and in strict accordance with the express language of the solicitation document.

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