Legal leaders

Experts peg trends in procurement law

By Lisa Wichmann

From bidder disputes to landmark court cases, 2010 is shaping up to be a busy year for legal issues. In early January, *Purchasingb2b* convened a roundtable of legal and procurement experts to delve into the major drivers for the months ahead.

The general prediction is that we'll see more disputes this year–partly because of the poor economy. Participants talked about ways to avoid litigation through careful drafting, and how to best manage disputes when they arise. They also discussed new regulations such as the Ontario government's Supply Chain Guideline.

"Because of the way it's been drafted, [the guideline] has triggered a very strong reaction from the marketplace," said Denis Chamberland, a commercial lawyer with Aird & Berlis LLP (Toronto). "There are many public buyers that have started to adjust their practices and their policies to comply with the new guideline requirements."

Currently under review, the guideline aims to bring more accountability to public procurement. There's a mandatory requirement for organizations to set up bid protest procedures, allowing suppliers to submit protests over any aspect of the procurement process. It will require some adjustment, but overall, Chamberland said the guideline is positive.

"It's going to raise the bar enormously…within the broader public sector, and one effect of that will be [improvement] in the private sector," he said. "The supplier base is going to become much more knowledgeable about procurement and as that happens, we're more likely to see a lot more debriefings than we've had in the past, and some disputes as well…which isn't necessarily a bad thing."

Massively out of step

Those disputes will likely prompt public agencies to develop clearer rules around procurement. But the guideline does have a serious drawback. It favours the 'Contract A/Contract B' method of buying that's been in place since the R vs Ron Engineering case back in 1981, Chamberland said.

In that notorious case, the Supreme Court of Canada decided Contract A is formed when a bidder responds to a request for proposal (RFP). At that point, the buyer must deal fairly and equally with all bidders without showing favouritism.

Though Contract A has been underpinning public procurement since 1981, practitioners have found ways to circumvent it. The Contract A process usually means attaching the whole contract to the RFP–an unreasonable challenge for many organizations, given the contract could be 70 or 80 pages long.

"The guideline is almost entirely tilted in favour of having Contract A or B, which is a very sort of rigid way of doing procurement. And we know that in the public sector, whether it's universities or hospitals…I'd say 90 percent of the time when people do an RFP they can't do Contract A or B because they can't put the entire contract in the RFP," Chamberland said.

"So 90 percent of the time, people send out an RFP with the idea that there's going to be negotiating and drafting on the back end…But the guideline says 'no, that's not the way competitive procurement works.'"

Because this part of the guideline is "massively out of step" with the marketplace, Chamberland and others hope it can be revised. One suggestion on the table is the "best and final offer" system used extensively in the US, or just recognition in the guideline of the need for open-ended negotiations.

Our roundtable of legal experts met in January. Back: Denis Chamberland and William Pigott. Middle: Marvin Huberman and Michele Sweeting. Front: Brian Habjan.

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Tercon poses turmoil

Guideline or no, Contract A may be in peril for another reason. The case of Tercon Contractors Ltd vs BC Ministry of Transportation and Highways is currently before the Supreme Court of Canada. Industry stakeholders say the pending decision could throw the bidding process into turmoil.

"It has the possibility of rubbing out Ron Engineering, like getting rid of this whole Contract A [process]…So to me, that's huge because it's going to have a big impact in Canada," said William Pigott, a partner with Toronto-based law firm Miller Thomson LLP.

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The crux of the case is that the BC ministry included a "liability clause" in its RFP, claiming the clause protected it from any legal action arising out of the tendering process. Tercon, the losing bidder, sued and won $3.3 million from the BC government, but the decision was reversed on appeal, and is now before the Supreme Court.

If the Supreme Court decides in favour of the BC government, buyers will be able to use the liability clause to do as they please in procurement. In other words, they will no longer be accountable to fairness requirements. Pigott says this would put the industry back to where it was before the Ron

Engineering case. Is that necessarily a bad thing? Not at all, he said.

"For a couple of hundred years before Ron Engineering came along we managed to buy stuff, managed to build things, managed to run our hotels and our railroads and our hospitals and everything else, so to me it wouldn't be a disaster."

In Pigott's view, suppliers are smart, and they'll figure out how to thrive if the rules of the game change. Despite perception to the contrary, it is possible to have competitive procurement without Contract A, he explained.

"I do a lot of work for hospitals and a couple of universities and a lot of them are very sophisticated purchasers right now. They understand Contract A and they step outside it frequently when it makes no sense for the buy."

While some fear suppliers will be battered by the elimination of Contract A, Pigott feels the market will keep itself in balance. "Enlightened buyers don't write procurement documents that say 'I can shaft you if I wish' because that's a bad way to start a long-term relationship," he said.

"Over time, the courts will work out a way to sanction people that go out there, put their vendors through a whole lot of work and a whole lot of money with no intention of buying... What I think the courts will ultimately do is apply a negligence sort of measure to that and say, 'you're going to reimburse these people all their money.'"

Poorly written RFPs

Brian Habjan, a director specializing in procurement transformation with PricewaterhouseCoopers LLP in Toronto, weighed in to elaborate on Pigott's point.

"It's still a fair and open market. And if you're a difficult, high-maintenance customer, putting in those types of [liability] clauses...you're not going to have a very good supply base. And that's just going to diminish the value for your organization because you're going to have less competition and [fewer] vendors that want to work for you."

Habjan has spent equal amounts of time in the public and private sectors, giving him insight into the challenges of both. In the public sector, he's noticing more focus on transparency.

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"Back in the fall...there was some bad press about some of the large [Ontario] healthcare organizations. We're having a chance to work with one of those organizations in terms of trying to tighten up their policies and really taking a look at the end-to-end procurement process and making sure it's aligned with the government regulations."

He said a big focus for 2010 in both sectors will be the content and quality of RFPs, which are often too vague. "If you don't put in the contractual terms, which is really getting down to the brass tacks of exactly what you want... it's tough for the supplier to price things out properly. It typically prohibits them from putting in a best and final offer, because there's too much risk."

In addition to poor or incomplete bids, badly crafted RFPs can open up the procurement department to opportunistic suppliers. "If they see a poorly written RFP...[suppliers] say 'well, this is a target-rich organization... They don't have a very sophisticated procurement department.' Therefore they almost see that as an opportunity– a profitable account potentially."

In his experience, disputes are often caused by the human component, or relationships. He's seen clients who have developed a good, long-term relationship with a supplier, and are therefore reluctant to go through a big competitive process for bids when new projects arise or are expanded.

It's human nature, and will always be a part of procurement. But Habjan feels there are strategies to make procurement more robust. In particular, he sees value in bringing more formality.

"There's an increasing trend overall to develop more formal supplier management programs. And that's being mostly driven by the procurement function in collaboration with the legal department and operations."

In the public sector, the programs are driven largely by goals to be transparent. In the private sector, supplier management is used to offset risk. "What are the legal and contractual components and how can you help mitigate risks and ensure supply continuity for your organization...and evaluate suppliers to make sure they're in good financial condition?"

Know your vendor

The recommendation is already in play at Toronto-based Four Seasons Hotels and Resorts, where Michele Sweeting, senior vice-president of capital planning and procurement, deals with risk daily.

"My team is about 45 people and our biggest challenge in the world today is risk management," Sweeting said. "Most of the money we pay vendors is paid up front...It's all custom work. We give money in advance of receiving anything. So understanding your vendor is critical to making decisions."

Most Four Seasons vendors are overseas, adding even more complexity. The company doesn't own the hotels, but issues RFPs for construction, products and services on behalf of owners around the world.

In essence, Four Seasons spends the owners' money on their behalf, requiring the company to be constantly diligent about cost and accountability.

"As money has become tighter, we have found that our ownership groups are much more interested in what we do for them. They want us to have much greater transparency, and ease of understanding how we analyze a bid... In the past two years we have had to provide documentation to ownership teams who then question line items...I expect that trend to continue."

To offset risk, Sweeting's team is careful to choose vendors who are the right fit for the company's culture. The luxury hotel goods market is small, so she devotes a lot of time to developing suppliers through bidder debriefings, which are arranged as informal conversations telling losing bidders why they didn't win the business.

Though some buyers shy away from debriefings, feeling they open the organization up to risk, Sweeting says this type of feedback helps develop a vendor pool, and allows the suppliers to grow and evolve with the company. She's also careful about how each contract is handled.

"You have to use the process that's appropriate to the buy you're making. Many times we have sole vendors, sole proprietors and we don't go out for a new bid for every item that we might be looking at. It just isn't practical and it isn't how we run our business," she said.

"And yet, if we wanted to demonstrate fairness, we're very confident we could provide that information."

Sweeting has never had a major bidder dispute. When conflicts do arise, they're dealt with based on the depth of the issue and the history of the relationship. At the time of the discussion, for instance, the hotel was having an issue with malfunctioning high-definition channels in guest rooms.

"We're in the midst of resolving a very serious quality issue and a service failure on our side as a company... But it's not as though we're going to jump to some sort of dispute resolution immediately with a vendor we've dealt with for years and years and has been very supportive of what we do."

The three Ps

That's exactly the right approach, according to Marvin Huberman, a lawyer and specialist in commercial litigation and dispute resolution. He emphasizes the importance of tailoring the dispute resolution process to each individual case.

He expects a rise in disputes this year, in part because of the slumping economy. "In tough times, tough positions get taken." The courts have recognized the trend, and made adjustments, such as raising the limit to $25,000 from $10,000 for Ontario Small Claims Court.

"You're going to see a lot more small business types...having greater access and affordability and effectiveness in bringing cases to court. On the other hand, in larger organizations, you're going to see greater efforts at resolving disputes through negotiation, mediation, arbitration, or hybrid processes."

Most cases that start in court eventually settle out of court, he added. Though the perception exists that alternative dispute resolution methods like mediation and arbitration are cheaper and faster, they can be the opposite, depending on the people involved.

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That said, mediation is the best approach for 90 percent of disputes, he said. But it's wise to set some limits. "You need to actually tailor-make your arbitration to what you really think you're going to need. So, for example, you could limit how many days the hearing is going to be. You could limit how many witnesses are going to be called. You could limit the arbitrator's ability to give wild awards."

The requirement to try negotiation or another form of dispute resolution before going to court should be included in the RFP, he advised. That way, bidders agree ahead of time to try alternative methods.

When tackling disputes, he said to remember the three Ps: the people, the problem and the process. Often, the problem is a lack of information, such as a bidder not understanding why the proposal was denied.

"If only you would just tell them, then they wouldn't have a problem, perhaps. The other issue is maybe you have the wrong people involved in the process–[you can have] personality disputes, history, baggage, someone who just doesn't get it, maybe someone without authority. It's just frustrating. So let's jump those people and go higher up in the organizational chain."

Clearly, disputes and other legal issues require careful planning. The general theme at the roundtable discussion was keeping bidder/purchaser relationships healthy, through communication and a willingness to be fair and reasonable. It's a solid approach for keeping things quiet on the legal front this year. **b2b**

More coverage

Our roundtable covered other issues as well. Look for the following companion articles:

- To debrief or not to debrief; and
- Fairness monitors: what are they?

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