



RESIDENTIAL AND  
CIVIL  
CONSTRUCTION  
ALLIANCE OF  
ONTARIO  
**RCCAO** Constructing Ontario's Future

GM 6.1.7

## RCCAO comments on the City of Toronto Purchasing Policies.

*Prepared by Stephen Bauld Purchasing Consultants International Inc.*

We are going to address 10 different Policies and procedures that should be reviewed to make it more attractive to entice top quality contractors to bid on the City of Toronto's Tender and RFP documents. The purpose behind the comments we are bringing forward will attempt to assist the process by which the City of Toronto can work with the Contractors to bid on City Contracts.

After a meeting attended by Andy Manahan from RCCAO and myself on June 7<sup>th</sup>, we had the chance to meet with Lou Pagano, Director of Purchasing and Materials Management Division, at the City of Toronto. We were both impressed with the steps the City is presently taking to improve the existing procurement Policies and Procedures.

Our recommendations to the survey are only intended to provide some positive feedback as to the viewpoint of a survey I conducted with several contractors over the past two years in order to further understand the industry and the most prevalent concerns with respect to the Toronto procurement documents.

What we found as the biggest concern was over the degree of risk allocation passed on to the contractor by the City in many types of documents relating to the different construction projects and the multiple documents being used for each construction Tender, or RFP. The contractors reflected the added risk by passing on the extra costs to the City. A City generally does not examine each project on an individual basis to assess all the factors that contribute to the higher price of the overall bid amounts. This area of balanced risk allocation and the associated costs savings is an opportunity we could talk about at length with your procurement department.

By solving this problem by sharing some of the risk and yet not putting the City in harm's way, I had mentioned a possible 5% saving to the City by changing some of the ways Toronto allocates the risks. This was reviewed in my "Commentary on Government Procurement of Construction in the GTHA" in the report dated September 2009. A copy of the entire report can be found on the RCCAO website at [www.rccao.com](http://www.rccao.com), or I can send you a hard copy if you would prefer to have it on hand for future review of some of the other issues that I address, as well as the rest of the ideas brought forward to help make the system run more efficiently.

I am attaching some of the ideas that relate to the City of Toronto's specific issues for your review and comment and can be contacted at [www.purchasingci.com](http://www.purchasingci.com).

Submitted by Andy Manahan.

## THE PROCESS OF RISK ALLOCATION AND AVOIDANCE

### Number (1)

It might be thought that the best strategy in relation to risk is to avoid it entirely, as for instance, by completely shifting the risk to the other party. This approach clearly seems to have guided at least some of the thinking in relation to the present Front End documents.

However, this approach is not always practical. In some cases, the expected benefit from risk avoidance, hedging or diversification may not be worth the cost of taking such measures. Some types of risk relating to construction may be readily avoided or mitigated. Cold weather related risks, for instance, are best avoided by building when the weather is generally warm. However, it is not possible to eliminate such risks entirely. For instance, an individual summer may be inclemently cold. Where a risk cannot be avoided or substantially mitigated, it must be allocated to one or other of the parties to a contract. While a wide variety of risk allocation mechanisms have developed, all approaches to risk management are in fact based on the concepts that are related to the idea of hedging, diversification, or insurance.

Risk allocation influences price. It is generally accepted in the economic literature that where a party bears a higher level of risk, it should receive a higher return as compensation for this risk. Such a higher return does not mean excess profit; rather, it reflects the amortized cost of the risk. Despite the taking of all reasonable precautions, eventually, each risk associated with contracts of a given kind will be encountered. When that risk does materialize, all costs associated with it will have to be met.

Hence, even in a fully competitive market a contractor would earn a higher return on capital for any additional risk that it bears, in order to compensate it for any additional expected cost that will arise from those risks. Where a contract purports to allocate risk and yet limit the reward for assuming that risks, it is inherently unrealistic.

This is a concept that we would have to discuss in greater detail to understand the viewpoints of the contractors and the City of Toronto to come to an agreement as to how the process can be beneficial to all parties involved.

## Risk and Price

### RISK ALLOCATION AND THE CONTRACTING PROCESS

#### Number (2)

Perhaps the most significant factor bearing upon the willingness of contractors to respond to a RFT or RFP is the manner in which the risks associated with the project to which it relates are allocated under the RFT or RFP documents.

There is an unfortunate tendency when discussing contract language to evaluate the provisions at issue by reference to woolly standards of fairness and unfairness. We reject such an approach. In our view, owners (whether public or private sector) have no *a priori* obligation to offer "fair" terms of contract to their contractors and other suppliers. In a market economy, the parties to a contract are expected to pursue their respective own best interest. A public authority such as the City of Toronto is no more to be expected to be "fair" or "reasonable" in its declared choice of what products (or services) to buy, and from whom to buy them, or the terms on which it is prepared to buy them, than suppliers are expected to be "fair" or "reasonable" in offering the best possible price that they can afford, or to compromise their other interests in relation to the proposed order.

Instead of focusing on the question of fairness, we look at a more basic question: does the apparent benefit offered by a particular contract clause work against the City's own long term interest by:

- (a) deterring competition for work;
- (b) favouring poor quality suppliers;
- (c) encouraging hedging in price; or
- (d) encouraging sharp practice and other forms of cheating by contractors or other suppliers.

Provisions that run afoul of these considerations are considered unrealistic. In practice, many provisions of this kind relate to risk allocation. Where the allocation of risk is unrealistic, given the comparative ability of the parties to anticipate and provide for the risk concerned, and the relative allocation of cost and benefit under the contract, the RFT or RFP is inherently unattractive. To the extent that it attracts bids at all, the prices submitted by the contractors will include substantial hedging against the costs associated with the risk. For this reason, it is in the interest of all owners seeking to have work carried out by a construction contractor (whether the work consists of an extension to the house, or the construction of a complex building project.) to give a balanced consideration to the manner in which they allocate risk in their proposed contract documentation.

It follows that one of the key considerations in the development of an optimal package of contract documentation is to allocate risk between the parties to the contract in an efficient manner. In principle, effective risk allocation will improve project performance and result in greater financial control. More specifically, contractual allocation of risk sets investment incentives for each party and exploits differences in their respective risk-bearing capabilities. Contracts should allocate risk in order to exploit fully the comparative differences in the levels of risk-aversion of the contracting parties or their ability to manage, hedge or shift that risk. The basic rules for achieving effective risk allocation are to allocate each risk:

- First: to the party best able to avoid or mitigate the risk;
- Second: where neither party possesses an ability to assess the party best able to absorb and spread the costs that are likely to arise should the risk arise (this factor takes into account which of the parties is the lowest cost insurer);
- Third: where neither party is better placed to absorb or spread the risk, to the party whose risk tolerance is otherwise at a higher rate.

The three goals of this process are to:

- Minimize the chance of an adverse event occurring.
- Minimize the extent of a loss resulting from non-performance of the contract.
- Spread such loss as may occur.

There are numerous factors, however, which undermine or complicate contractual risk allocation. Many of these derive from the probability that in most cases, while financial responsibility may be allocated by a contract to one party or another, usually both parties have at least some role to play in identifying relevant facts that are material to the assessment, detection and avoidance of risk.

Relevant factors in optimal risk allocation include the parties' history of cooperation with each other, risk environment uncertainty, and each party's demonstrated risk management commitment, as evidenced by its ability to identify and provide appropriately for risk. For achieving cost efficiency, different risk allocation strategies may suit the different conditions of each particular transaction. Put another way, neither party can afford to assume a risk, where there is serious doubt as to the other party's willingness and ability to identify

situations likely to increase the risk concerned, and to take the measures that are within the control of that party to reduce the chance of occurrence or the magnitude of any resulting loss.

Governments are among the largest corporate entities in the country. With the amount of money they spend each year they need a complete understanding of the scope of the overall problem.

"Risk! Construction projects have an abundance of it, contractors cope with and owners pay for it. The construction process is subject to more risk and uncertainty than many other industries. The process of taking a project from initial investment appraisal to completion and into use is complex, generally bespoke, and entails time-consuming design and production processes. It requires a multitude of people with different skills and interests and the coordination of a wide range of disparate, yet interrelated activities. Such complexity, moreover, is compounded by many external, uncontrollable factors."

Risk is an implicit element in the execution of capital projects. It manifests itself in numerous **large enough** **that** considerations would seem to be relevant:

- which party is able to insure against the risk at the lowest cost;
- which party stands to derive the most benefit from the project to which the risk relates;

Generally, in a construction contract, such risks will normally be allocated to the owner, as it is the owner who will enjoy the benefit of the improvement to the property to which the contract relates.

#### ONE-SIDED CONTRACT TERMS

##### Number (3)

Risk allocation is only one of the ways in which a public authority can make its construction work unattractive to the private sector. Another is in reserving to itself an unrealistic level of freedom in relation to the contract.

Unilateral rights create risks that otherwise would not be present in a contractual relationship. They run counter to the concept of reciprocity on which contracts are based. Ultimately, a contract is no more than a voluntary, binding obligation to which two or more parties undertake to adhere. Where one party seeks to qualify that undertaking in such a way that is not actually bound to anything, it will find that few contractors and suppliers are prepared to bid for its work. This concern has obvious implications in relation to government contracting. Although the government budgetary process creates a greater need for price certainty in the case of government construction than applies with respect to most private sector construction, this necessity does not justify a unilateralist approach to construction contracting on the part of government. Problems arise when a government seeks to structure its contracts in such a way that:

- it may escape liability for its own failure to perform;
- it may cancel its obligations unilaterally without payment of compensation, or reduce the scope of the work that it has ordered;
- it may recoup a windfall reduction in the cost of the project due to minor breaches of contract, in an amount far beyond any realistic assessment of its damages;

- it may unilaterally chose to extend the contract to cover additional work, at a discounted price not tied either to the business risk that such additional work presents to the contractor, or prevailing market prices at the time when the work is ordered.

Provisions of this nature work against the interest of a government which seeks to employ them. To give two specific reasons: Contracts are often priced on the basis of an assumed volume of business. Unless a contractor has confidence that the government is entering into a firm commitment, it may treat the contract as little more than an expression of interest. As a result, the contractor will include a hedge in its price, to avoid the risk of an adverse fluctuation in the spot market price. When a government seeks a unilateral “termination for convenience” clause, the logical assumption is that is not really entering into a “contract” for the supply of goods or services—that is, for a legally binding commitment. Rather, what it is asking for is a contract under which it has the option to request the supply of services at a settled price. However, unlike the normal option contract, the government does not pay an option price, in consideration of the Contractor’s undertaking. Instead, the Contractor in the transaction assumes all of the risk of adverse market fluctuation in price. It may recover in relation to that risk only if the government actually takes delivery of a supply. In such a case, the contractor is most likely to quote the ordinary price at the retail level for the work concerned: no price concession is offered for the volume of work that the proposed contract represents.

Is there a valid role for such provisions? In principle, there is, because democratically elected legislatures need the right to control the setting of the government’s budget for each fiscal year, through the annual appropriate process. So far as I have been able to determine, however, cases in which a Canadian government has cancelled a contract due to a failure to secure an appropriation are rare. In practice, it is very unusual for a government to invoke a unilateral right to terminate and for the most part the value of business remains constant from year to year. Inserting a “termination for convenience” clause in a construction contract is like buying an insurance policy. Like all insurance policies, the clause has a cost. However, it is a policy over which the government-owner exercises almost complete control. Governments need to ask themselves whether it is worth paying a large premium to buy a right that they rarely use.

Analogous problems arise where the government orders a particular volume of construction work, but reserves the right to order additional work of the same kind at the same price. Again, the risk of price escalation is shifted to the contractor. To justify the assumption of such a risk, the contractor will factor the risk of adverse price fluctuation into the contract. However, contractors of uncertain scope give rise to further risk that may deter a contractor from bidding. A contractor must match workforce to work flow. Fixed costs may increase where volume of work is raised above a given level (e.g. due to the need to procure additional capital equipment to carry out the work). Under a contract of uncertain scope, workforce matching and fixed cost budgeting is complicated—for some contractors, to an unacceptable degree.

Equally unrealistic are efforts to secure something for nothing, or for considerably less than it ought to cost. There are a range of provisions of this kind which have become common in Ontario government contracting.

#### Site Conditions

##### Number (4)

Provisions of this kind include clauses that seek to transfer to the contractor the risk of differing site conditions, extremely adverse weather, or some other factor outside the control of the control of the contractor. Even if reasonable diligence is exercised by all persons concerned in a project the risk may still arise. Weather related risk, to which reference has already been made, fall within this class. So too do unknown site conditions—particular those that exist arose even where reasonable site inspection and test drilling has taken place. Provisions of this kind cover the following types of problem:

- Requiring the contractor to assume all risk related to undiscovered site conditions

- Requiring the contractor to assume risk related to the rehabilitation of latent environmental problems not shown to be attributable to the owner.
- Absolving the government-owner from liability in relation to the accuracy of information that it has provided (e.g. soil tests, plans, etc.)

Provisions of this kind often give rise to liability indirectly. They impose an obligation upon the contractor to carry out comprehensive site inspection to identify all conditions that may influence the cost of construction, prior to submitting its bid. The reality is that there is only limited information relating to environmental rehabilitation costs, water table levels and varying site (e.g. soil and bed-rock conditions) that can be identified through the limited testing and site inspection. Although in an isolated case, provisions of this nature may prove to have a benefit, but that benefit is dearly bought.

Under an optimal construction contract, the price paid by the owner would reflect all costs incurred in the construction. Efforts to get the finished product for less are not realistic. Sensible contractors will avoid bidding for contracts offered on such terms, or will include a substantial hedge in their price, so that the risks are reduced to an acceptable level.

The unrealistic provisions of a contract may often not be serious when considered on an isolated basis. Virtually every contract will have some unattractive aspect to it. Unfortunately, the problem is that contractors do not consider such provisions individually. Rather, the viability of the contract is assessed as a totality. While one or two clauses would not present an insurmountable problem, numerous provisions will likely deter many attractive bids. While one provision may not result in significant hedging, five or six are almost certain to do so. As the number of unrealistic provisions increases, no amount of hedging is likely to seem equal to the exceptional risk that a prospective contract presents. At this point, the possible contractors melt away.

#### OPEN, FAIR AND TRANSPARENT PROCUREMENT

##### Number (5)

A further institutional aspect of public procurement that sets it apart from its private sector equivalent concerns the overall procurement process. The driving objectives of public procurement are fairly well known: Public procurement should be conducted in a manner that is open, transparent and fair. Thus, the City of Toronto's Purchasing and Materials Management Policy states:

"The City supports effective, objective, fair, open, transparent, accountable, and efficient procurement processes through the solicitation of multiple bids, proposals and direct negotiation.

The purpose of this policy is to protect the interests of the City, the public and persons participating in the procurement process and to reinforce fairness, openness, transparency and integrity by adopting consistent and standard approaches for:

- selecting the appropriate type of procurement process to be used;
- communicating with vendors throughout the process;
- identifying and dealing with common irregularities in bids;
- evaluating proposals;
- dealing with vendor complaints;

- providing unsuccessful vendors with feedback; and
- maintaining records on vendor performance under contracts.”

Although these terms are often used imprecisely or even interchangeably, the term “open” means that all qualified suppliers are entitled to bid; “transparent” means that the process by which procurement decisions were made is comprehensible to an objective outsider; and “fair” means that procurement decisions are made according to stated rules and on an impartial and objective basis.

Commitments of the kind indicated in the Purchasing and Material Management Policy have important pricing implications. Some of these are subtle. For instance, the City’s Purchasing Policy further provides:

“A Call for Tenders shall be used to obtain bids for construction, whenever the requirements can be precisely defined and the expectation is that the lowest bid meeting the requirements specified in the Call would be accepted, subject to any other provisions of the City’s Municipal Code.”

Except with respect to small construction projects, this is a surprising preference. RFTs perform poorly when projects are complex and contractual design is incomplete. They also stifle communication between the buyer and the contractor, preventing the buyer from taking advantage of the contractor’s expertise when choosing how to design the project. These drawbacks are almost certain to lead to an increased price in all but the most simple construction projects.

Requirements of this kind eliminate the opportunity for negotiating optimal contract terms. This feature of public contracting has been determined to increase the cost of contracting in the public sector—particularly, albeit far from exclusively, in relation to the development of light rail systems. As the Federal Transit Administration’s 2005 Analysis of Capital Cost Elements and Their Effect on Operating Costs notes:

“The traditional approach to capital project procurement (“Design-Bid-Build”) involves separate contractors for the design and construction of projects, thereby reducing opportunities for innovative cost-saving designs. After a low-bid contract is awarded, project costs can easily grow by 20% or more. Alternative techniques seek to increase the flexibility of this process to allow for greater innovation and incentives for cost savings:

- In general, negotiated procurements take longer and add costs up front, but result in better cost control and project value. These methods are familiar to many international contractors, because they are common overseas.
- Design-Build procurements use a single contractor for both of phases of the project to create more opportunities for cost savings, but require a greater degree of involvement and technical proficiency from the transit agency.

“For projects that involve new technologies and where advance completion of the final design is not possible (as with many ITS projects), or where communication between designer and contractor is a major issue, new contracting processes may be more appropriate.”

A similar point was made by the New Zealand Controller and Auditor General, in his publication Procurement Guidance for Public Entities:

“In principle, advertising an open request for tender or proposal should be the preferred method for higher value and/or higher risk procurement. ... It offers all interested suppliers fair and equitable opportunity, and allows a range of competing offers to be evaluated when assessing value for money. However, the method should be appropriate to the market for the particular goods or services, and the circumstances of the procurement. These considerations may mean that an open call for tender or proposal is not practicable or cost-effective, or may not produce the best procurement outcome.”

It is not difficult to identify practical problems that can arise from the RFT and RFP approach that have adverse cost consequences. Where some of the competitors who are likely to bid for a contract are below the normal performance standard of the industry, a low-bid procurement shifts risk to the customer and increases the need for management and oversight. Thus, there is a need in any public procurement process, to structure the terms of the contract in such a way as to encourage the best firms to bid; and also to create an evaluative process that allows strong bidders to be differentiated from their weaker competitors. Few public procurement agencies have developed such methodologies.

So strong is the preference in the public sector for open and competitive procurement that we seriously doubt whether it would be possible to depart from this methodology in relation to the Transit City project. Quite apart from the preferences of City Council, both the Federal and Provincial Governments strongly support competitive procurement. It is therefore necessary to find some means of working most effectively within it, having recognized the additional risk and cost potential that this method of procurement presents in relation to large capital infrastructure projects.

Government policies that have an adverse impact on efficient procurement do not end with process related concerns. To keep costs of procurement to a minimum in the face of such process and content related concerns, there are only a few limited set of options. These include:

- Take all reasonable steps to keep those risks associated with the project allocated in the most efficient manner.
- Eliminate unrealistic provisions that discourage bids, and encourage bidders to hedge their prices.
- Create a process of contract an administration that is sufficiently flexible and fair to ameliorate anti-competitive consequences of the process of contract award and budget approval.

#### TYPES OF COMPETITIVE PROCUREMENT PROCESSES

##### **Number (6)**

The following competitive processes are to be used to give effect to the purpose of this policy:

A Call for Pre-qualification shall be used, and precede a Call for Tenders, Quotations or Proposals in order to identify and pre-select bidders, where it is deemed that the nature and complexity of the work involved warrants the time.

In my view on the topic of pre-qualifying bidders it was designed to insure that there is a reasonable prospect that each bidder that participates in a tender will have the demonstrated ability (i.e. expertise, capitalization and resources ) to perform the final contract in a satisfactory manner. I agree that pre-qualification is not used for all types of contracts. However, many smaller contractors feel that this process is used to prohibit some companies from bidding for City work.

Pre-qualification should be required to demonstrate that the contractor has an existing potential to perform a specific contract or contracts of a particular type, by giving evidence of their:

- (1) experience on similar work;
- (2) staff training, experience and other expertise;
- (3) previous levels of customer satisfaction in relation work (e.g. by way of letters of reference )
- (4) third party verification of the performance characteristics of their products:



- (5) health, safety or similar policies;
- (6) Financial strength.

This is just to name a few ideas for meeting the bar to be able to get pre-qualification for a tender for the contractors. The problem is that if you set the bar to high you may be cutting down the number of good bidders. Not to suggest you use any contractor that applies but when you say you must have done five projects of similar nature, or must have been in business for 10 years, and so on, you cut down on the bidding pool to the point that only maybe 4 contractors can qualify to even pick up the bid.

It is important therefore to ensure that the City allows those contractors who are able to do the job correctly to have a fair chance to bid. When the general idea becomes to bundle all the small jobs together to get one large contractor to do them, you will soon find that the small family contracting companies will no longer be in operation.

### Non-Competitive Procurement Process

#### Number (7)

A non-competitive procurement process shall only be used if one or more of the following conditions apply and a process of negotiation is undertaken to obtain the best value in the circumstances for the City:

1. The goods and services are only available from one source or one supplier by reason of:
  - (i) a statutory or market based monopoly
  - (ii) scarcity of supply in the market
  - (iii) existence of exclusive rights (patent, copyright or licence)
  - (iv) need for compatibility with goods and services previously acquired and there are no reasonable alternatives, substitutes or accommodations
  - (v) need to avoid violating warranties and guarantees where service is required
2. An attempt to purchase the required goods and services has been made in good faith using a competitive method and has failed to identify a successful supplier.
3. The goods and services are required as a result of an emergency, which would not reasonably permit the use of the other methods permitted.
4. The required goods and services are to be supplied by a particular vendor or supplier having special knowledge, skills, expertise or experience which cannot be provided by any other supplier.
5. The nature of the requirement is such that it would not be in the public interest to solicit competitive bids as in the case of security or confidential matters.
6. Any other sole or single source purchase permitted under the provisions of the Purchasing or Financial Control Chapters of the City's Municipal Code.

Based upon such articles as the one in the Toronto Star last week, "Sole source purchases in Toronto reached \$154 million last year, one may question whether everyone in the City of Toronto is familiar with the policy. I would make an educated guess that if a complete audit were to be done on all the purchases in this period of time there may be some which would not fall under any one of the rules set out in this policy. I have no problem with what the policy states, but such a large size of purchases raises the concern whether everyone is following the policy properly. I would suggest that a wide-scale training program with senior City staff be conducted to let them know how and when this policy is to be invoked. This kind of program may minimize the resorting to this approach where it may be inappropriate.

## Evaluation

### Number (8)

An Evaluation Team shall be established for all proposal calls. It shall be comprised of divisional staff member(s) with the relevant experience to evaluate proponents' submissions. The size of the Evaluation Team shall be reflective of the complexity and dollar value of the assignment and shall not be comprised of less than two members. Staff representatives from operational and support units shall be included on the Evaluation Team where appropriate, especially for complex or high profile projects and those having corporate-wide implications.

All calls are to include clear specifications and evaluation criteria, terms and conditions that can be applied in a fair and consistent manner to all respondents. The Evaluation Team will be responsible for evaluating all submissions.

In any request for proposal, the proposals received must first be evaluated before any determination of the best proposal can be made and the contract be awarded to the successful proponent. In my view, the policy is good, however the perception of some of the general contractors is that this process is used to pick the contractor that the City wants to do the work.

It must be clearly stated in the RFP how every point is given to the proponent as well as how it can be achieved. My feeling is that too much speculation goes into this process. As a previous purchasing manager of a large City I saw the scoring of the proposals have a wide range of numbers depending on the person scoring the contractor. I always suggest the selection of the most qualified and experienced people to be part of the evaluation process. They must know the purchasing policies and procedures, as well as the product or construction project that they will be evaluating before joining the evaluation team.

When a bidder feels that the person who won the contract does not have the proper expertise to carry out the work, it is very likely they will consider the bid was rigged. As a result, whether they are actually right or wrong, they will not waste any more money or time bidding on the next tender or RFP that comes out from the City for a long time to come.

## Vendor Performance

### Number (10)

The City shall maintain records of vendor performance on all contracts. The information shall be used to ensure contract compliance, to supplement a pre-qualification process or to justify an award to other than the low bidder where it can be demonstrated that such records are part of the evaluation process and criteria.

I have seen many different forms of this process over the years and in my opinion it would be very difficult to monitor the results for every contract at a City as large as Toronto.

I would say that in general terms ongoing assessments of all aspects of organizational activity plays an important role in supporting the corporate strategy. In the private sector, supply chain management is recognized as a major component of competitive strategy to enhance organizational productivity and profitability. In recent years, organizational performance measurement and metrics have received much attention from researchers and practitioners. These measures and metrics have successfully been used to improve strategic, tactical and operational planning and control. Corresponding efforts have not been undertaken in the municipal sector, in part due to the limited resources devoted to the procurement function, and in part due to the limited role that such measurement can play in improving supplier-customer relationships, given the overall public sector approach to procurement. The limited attention that the public

sector has given to this important aspect of the purchasing function is troubling. Proper performance monitoring is an integral element of strategic purchasing. In the private sector supplier evaluation systems are critical for firms seeking to establish long-term relationships with those of their suppliers who have been shown to have a positive impact on the firm's overall performance. Due to the rules and regulations of Government procurement this type of approach would be very difficult to do effectively.

## CONCLUSION

### THE UNIQUE PROBLEMS OF GOVERNMENT PROCUREMENT

Most private sector institutional construction in Ontario that is built on a design-bid-build or similar stipulated sum basis is now carried out using contracts based upon CCDC2. Many of the larger owners modify this contract extensively to suit their particular needs or concerns, or the unique circumstances of the project that they plan to carry out. However, the modern tendency is strongly towards uniformity of approach. In the private sector, price is very often the deciding consideration in capital expenditure, as price will eventually determine the overall profitability of the activities that will be carried on at or through the capital asset that is to be built. Generally, adhering to industry standard documentation in construction contracting will result in lower prices and will make the work that is being offered by the owner more attractive to prospective contractors. Standardization leads to a shared understanding of contract language. Such a reduction in the transactional risk associated with the contract documentation process allows contractors to bid more aggressively for the work in question.

In the public sector, price is obviously an important consideration, but there are other competing considerations which must be factored into decision making. These include public service delivery objectives and the demands of the "open, fair and transparent" competitive bidding process that is characteristic of government procurement. The City has indicated that it does not wish to rely on CCDC2 as such, but that it is prepared to move toward contract documents that are more consistent with industry expectations to the extent that this can be justified, taking into account the particular needs and concerns of the City of Toronto. In my opinion, this is essentially the correct approach. Moving towards consistency of documentation within industry expectations facilitates price competition. However, the benefit of unique terms may on occasion outweigh the price sacrifice that is suffered by reason of departure from industry standard documents. While the measurement of that benefit is often very difficult, there is no question that governmental needs often differ sharply from those of the private sector. Since CCDC2 was originally drafted primarily to address construction by private sector owners. I feel that some modification will almost certainly be required.

Governments are subject to much higher public expectations in relation to integrity in procurement than is the private sector. In government, there is a strong bias in procurement towards the award of contracts through a competitive process, rather than by way of negotiation. There is also a strong commitment to a system of procurement that is open to all qualified bidders, transparent to the public in terms of the manner in which successful bidders are selected, and fair to all bidders who compete in the process. In contrast, in the private sector, factors such as relationship development play a more important role.

The media and much of the general public often raise the question as to why Government and Government Agencies cannot operate in the same manner as a business. The ready answer to this question is the simple fact that they are not a business. Government expenditure is not incurred with a view towards generation of a profit, but rather with a view towards delivery of service to the public. Often, the people to whom the service is directed are unable to pay the full cost of service provision. In other cases, the very purpose of the service is to encourage people to move away from apparently "cheaper" options towards some more socially beneficial choice.

Public transit affords an obvious example of the latter aspect of public service delivery. The goal of increasing public transit availability is to encourage the public to make greater use of public transit, as opposed to using

their own vehicles. The cost of public transportation is likely to be a determinant of the public's willingness to do so. In addition a significant portion of the people who make use of public transportation are lower income earners. They include the working poor, students, and people on fixed incomes. These people cannot afford to pay higher prices for their transportation.

One basic question to address in this survey is the question of how much departure from prevailing industry practice is justified by the unique concerns of public procurement, and the nature of public service delivery. As I indicated above, contractual terms and practices that deviate from the industry norm must usually be bought at a price. The critical question for the City of Toronto is how much is it prepared to pay for the benefit of dictating its own terms of contract? The importance of trimming costs can be brought home by considering this simple fact that on a \$6 billion construction project, a one per cent saving in cost is equal to \$60 million. What if the savings were just two per cent?

Can such costs be saved? In my view, they can—but doing so requires some modification to established practice. Although it is not possible to assess the precise pricing impact of these variations, it is a reasonable conjecture that they result in higher costs for goods and services to the public sector, all other factors (e.g. amount and timing of order, prevailing market conditions, and general credit risk) being equal. The reason for this is that although governments are by far and away the largest individual customers for goods and services in Canada (including construction) they purchase only a relatively small percentage of the total of what is sold in the overall Canadian economy. Procurement practices that vary from the mainstream may give rise to uncertainty. Such uncertainty gives rise to risk. Risk will be factored into price. Moreover, many businesses are not sufficiently sophisticated to be able to market effectively to a customer base that solicits the supply goods and services in a manner that differs from the mainstream of the market.

This also leads to price increase. Rough but nevertheless indicative evidence of such higher pricing can be found in such standard industry reference texts as Hanscomb's *Yardsticks for Costing*, 2008. For instance, a private sector multi-storey commercial office building had a per square foot cost of \$136; in contrast, a provincial courthouse had a per square foot cost of \$341. Similarly, while a recreational center had a per square foot cost of \$216, an enclosed shopping center had a per square foot cost of \$193. I have studied the figures in Hanscomb's on several occasions over the years, and in each case, I have found that government construction costs are significantly higher than the cost incurred by private sector owners in procuring comparably configured facilities. As the foregoing examples illustrate, the level of over-spend varies widely, but always the pattern is the same.

Some of the most critical differences between public and private sector procurement are institutional in nature. Such practices would be difficult to modify. Accordingly, while it remains important to identify the price consequence of these practices, one does so not in the hope of avoiding the practices concerned, but rather to sensitize any discussion of the specific terms of contract included in the contract document to the fact that many of the inherent practices of public procurement already lead toward a higher level of cost than would be incurred in private sector projects of similar size and scope.