

## **Bid Shopping**

**Eric Degn**  
America's Home Place  
Gainesville, Georgia

**Kevin R. Miller, Ph.D.**  
Brigham Young University  
Provo, Utah

Bid shopping is considered an unethical practice used by contractors to gain advantage over their clients in the bidding process. Bid shopping can be harmful to the construction industry because it creates an unhealthy business environment, eliminates the benefits of the bid system, promotes lower standards of quality performance, delays project completion and reduces job site safety. Attempts have been made to stop bid shopping through contract law but these attempts have not been successful. Educating contractors of the effects of bid shopping is a means of helping to reduce the amount of bid shopping that occurs.

**Key Words:** Bid Shopping, Ethics, Estimating

### **Introduction**

Graduates of construction programs will be responsible to discover and use processes that allow contractors to build cheaper, faster and more efficient projects. To accomplish this, students must be taught methods that accomplish this goal and informed about methods that do not accomplish this goal. One method that prevents the goal of building cheaper, faster and more efficient projects is bid shopping. Bid shopping is an unethical practice that hinders progress in construction and hurts the construction industry.

To better explain how bid shopping has a detrimental effect on the construction industry, this paper examines how bid shopping occurs in the bidding process, the difference between pre- and post-award bid shopping and the effects of each, and what has been done to try and eliminate the practice.

### **The Bidding Process**

When a project is competitively bid, the owner hires an architect to create a set of plans and allow general contractors (contractor) to submit bids to build the project. In most states, statutory law requires that the prime contract for a governmental/public project is awarded to the lowest responsible bidder, whose bid meets those requirements set by the awarding authority. In the case of public projects, the awarding authority, or owner, is the public/governmental agency, and the projects are paid for through tax monies.

These laws further state that except under exceptional circumstance, once the prime contract has been awarded to the contractor, the awarding authority is prohibited from either re-soliciting bids for the project or renegotiating the bid price with the determined lowest bidder (Dufficy, 1989).

The purpose of these laws is to protect the awarded contractor and allow for the public projects to be performed at the lowest possible price or tax dollar. Private owners may also bid their projects using the competitive bid system or they may elect to negotiate the contract. Unlike the governmental/public agency owners, the private owners are not bound by law to award the project to the lowest responsible bidder.

Most building projects cover a large and broad scope of work, making it impractical for the contractor to perform most of the work itself. To complete the project on time and be the lowest responsible bidder on the bid, the contractor needs to solicit subcontract bids from subcontractors. Subcontractors submit their bids to the contractor to be incorporated into the contractor's bid. Once the prime contract has been awarded, the subcontractors become bound to the contractor in the same way the contractor becomes bound to the owner. This applies to public/governmental bids as well as private owner bids. That is, subcontractors are legally obligated to perform the work for the price specified on the bid. However, current law does not prohibit the contractor from re-soliciting or renegotiating the bid price after the prime contract has been awarded.

There are many different kinds of subcontractors in the construction industry, and competition among these groups is often strong. This competition allows the contractor to have the work performed at the lowest possible price. In theory, this sort of competition is healthy for the industry because it keeps the cost of construction down. This enables the contractor to receive a fair price for the subcontracted work, and the saved money is then passed on to the owner of the project. In reality, however, competition can lead the contractor to take advantage of subcontractors through the use of excessive bargaining pressure in the form of bid shopping.

### **Bid Shopping**

Bid shopping is an unethical practice in which a contractor discloses the bid price of one subcontractor to another in an attempt to obtain a lower bid price. Included in bid shopping is "bid peddling," in which subcontractors themselves offer to undercut the known bid of another subcontractor. Bid shopping can occur both before and after the project owner awards the prime contract to the contractor.

#### *Pre-Award Bid Shopping*

Many people consider pre-award bid shopping, or bid shopping that occurs prior to the awarding of the prime contract, as an acceptable expression of free competition. "It (pre-award bid shopping) ultimately benefits the (owner) by arriving at the lowest possible bid for, and consequently the cost of, the project" (Dufficy, 1989).

#### *Effects of Pre-Award Bid Shopping*

Although this sort of competition may seem beneficial in terms of lower costs and market dynamics, the resulting savings do not come without a price. Subcontractors devote time and money to the preparation of their bids. To try and prevent contractors from shopping their bids,

subcontractors submit their bids to the contractor just prior to the time that the contractor is required to submit their bid to the owner. The reasoning is that the contractor won't have time to shop their bids to other subcontractors. This practice is often referred to as "just in time bid submittal."

While this practice, used by subcontractors as a defense against bid shopping, does keep the contractor from bid shopping, it can also act as a double-edged sword. The problem is, if the subcontractors turn in their bids just prior to the deadline of the contractor's bid turn, the contractor is unable to check for any discrepancies or errors. These discrepancies and errors, of course, lead to increased costs, disputes over the scope of work, and the general inefficient prosecution of work (Foster, 1997).

### *Post-Award Bid Shopping*

Despite all of the problems associated with pre-submission negotiations, it is post-award bid shopping that is considered the most harmful to the construction industry. In post-award bid shopping, the contractor seeks to obtain a lower price from a second subcontractor, after having already been awarded the prime contract through the original subcontractor's bid. Post-award bid shopping serves only to benefit the contractor, as monies from these savings are used to increase the profit margin rather than being passed on to the public authority or owner.

The steps to bid shopping are simple. First, the contractor solicits bids from various subcontractors for the scopes of work on the project. It should be mentioned that soliciting these bids and/or listing them in its own prime contract bid does not bind the contractor to these subcontractors in any way.

Second, the contractor returns to the subcontractors and attempts to further chisel down their bid prices by using the incorporated subcontractor's bid as a negotiating tool. This happens after the awarding of the prime contract, but before the contractor enters into a subcontract agreement. To do this, the contractor gives the subcontractors permission to use any means possible to achieve the lower price, including suggesting design modifications under the guise of "value engineering" (Mechanical Contractors Assn., 2001).

Lastly, the contractor repeats the above steps, using the lowest received bid each time as the benchmark until the lowest possible price is obtained. Each subcontractor is forced to either reduce his or her costs and/or profit margin, or forfeit being awarded the contract. Those that can afford to do so will drop out, while those who need the work are forced to remain. This process continues until "all but one subcontractor drops out of the bidding or there appears to be no further reduction attainable" (Mechanical Contractors Assn., 2001).

### *Effects of Post-Award Bid Shopping*

The post-award bid shopping effects on the industry are discussed below. Although there are many detrimental effects associated with bid shopping, this paper focuses on the following five.

*Creates an adverse business environment.* Bid shopping affects the industry by creating an unhealthy business environment. In order for a project to be built on time and within the budget, the owner, architect, contractor and subcontractor need to be able to work together as a team. This teamwork is necessary to allow for timely problem solving and efficient performance of the work. Bid shopping destroys team spirit and cooperation by creating a spirit of distrust and self-interest among project team members. “Subcontractors who have been shopped to the point where they don’t know whether the job will be profitable aren’t likely to exhibit a spirit of trust with the other “team” members. Bid shopping is more likely to produce a situation where everyone is their own team and the game is survival” (Mechanical Contractors Assn., 2001).

In bid shopping, everyone looks out for themselves rather than the good of others and the project. The contractor, insensitive to a subcontractor’s financial position, seeks to increase the profit margin at the subcontractor’s expense. The subcontractor, in an effort to stay in business, seeks to do whatever it takes to finish the project as cheaply as possible. The owner expects the contractor to have all of the work performed on time and according to the specifications despite whatever problems the contractor may have with the subcontractor. All of this self-interest makes it difficult to work together as a team.

The problem is further amplified because bid shopping creates a spirit of distrust between contracting parties. The subcontractor, assuming that the contractor could care less whether they stay in business or not, presumes that the contractor devalues their opinion and seeks further ways in which to take advantage of them. The contractor, knowing that he is held responsible for the finished product, presumes (with reason) that the subcontractor will attempt to cut as many corners as possible in order to save costs. All of this distrust further destroys team spirit and creates an adverse work environment.

*Defeats the purpose of the competitive bid system.* Bid shopping affects the industry by eliminating the benefits that are supposed to flow from the competitive bidding system. Projects are awarded through a competitive bid system because it is supposed to allow for quality work to be performed at the lowest price. A competitive bidding system works best when a large number of bids are submitted with differing prices over the same scopes of work. When this occurs, the award can be given to the lowest priced bid, and the project can be built for the lowest cost. Bid shopping frustrates the competitive bid system because it reduces the number of submitted bids and raises their prices overall.

If a contractor is known to have a history of bid shopping, the subcontractor may decide to submit a bid to all the contractors bidding the project, except for the “bid shopping contractor,” or they may not bid on the project entirely. Another option for subcontractors is to simply inflate their initial bids in an effort to secure bargaining room against future attempts at chiseling them down (Dufficy, 1989). Either way, the system is frustrated because fewer people compete, the price of construction is artificially high, and any savings that are attained through bid shopping are not passed on the owner.

*Promotes lower work quality.* Bid shopping affects the industry by promoting lower standards of work performance. Post-award bid shopping “endangers the quality of ... construction projects inasmuch as subcontractors who perform under unconscionable subcontracts allowing for

negligible margins of profit are tempted to provide inferior services and materials in order to cut costs” (Dufficy, 1989). What this means is that in an effort to make up for lost profits, cash-strapped subcontractors may be tempted to cut corners by using improper materials or employing improper installation procedures.

Quality can be further compromised through the subcontractor’s hiring practices. In an effort to cut costs even more, the subcontractor may choose to employ underpaid or under trained labor over skilled professionals. These workers often lack the training and experience to perform the same quality of work as their better-paid counterparts. The problem is only worsened when a communication problem exists due to a lack of language skills, which is also common with under trained workers. Cost control could also force the subcontractor to reduce manpower allotment to the bare minimum. Either way, the project quality is compromised because the workers are unable to produce the same quality of work within the same time restraints that could have been achieved had the hiring practices of the subcontractor remained the same.

*Delays project completion.* Bid shopping can delay the project completion. One of the ways in which this can happen is a through lack of planning. “A bid that has been shopped ... is often awarded to an unqualified subcontractor who entered into the process late in the bid phase and has not adequately planned for the job” (Mechanical Contractors Assn., 2001). Often times a contractor awards a subcontract bid to a subcontractor who has hardly seen the construction documents, but assumes that he could perform the work for less than his competitor. This is especially true with smaller subcontractors who have very little overhead and are desperate for work. If the subcontractor has not planned and prepared properly for the job, chances are they will not be able to complete it on time. This may also lead to increased cost for general requirements because of the extended project schedule.

Another reason for improper planning on the part of the subcontractor is due to just in time subcontract bid submittals. As mentioned earlier, this is a means used by the subcontractor to thwart pre-award bid shopping by the contractor. Because the bids are received just prior to becoming legally binding, the contractor is unable to obtain clarifications from subcontractors. The clarifications that the contractor may want to obtain from the subcontractors may include scope of work clarifications, the subcontractor’s manpower availability, or the work backlog of the subcontractor.

Other delays attributed to bid shopping come from reduced manpower, end of project rework and poor employee morale. Bid shopping forces a subcontractor to reduce the costs in an effort to break even or make up for lost profits. One way in which a subcontractor can do this is by reducing the crew size. Obviously, by reducing the size of the crew, the odds of finishing the project on time are less likely than they would have been if the original crew size been kept. The subcontractor may seek to further cut costs through corner cutting. When quality specifications have not been properly met, the result may be increased delays due to end of project rework.

If money continues to be tight, the subcontractor may even find himself unable to pay his employees in a timely manner. Pay delays, forced overtime and an adverse business environment all help to create unhappy employees who become less motivated to finish the work on time.

*The Human Toll.* Lastly, bid shopping has a detrimental effect on the lives of the people involved in the construction industry by exposing them to additional risk. Bid shopping exposes our subcontractors to additional financial risks by forcing them to take a loss of profit in order to get the job. “When confronted with bid shopping, a subcontractor whose bid was used to win the prime contract must either acquiesce in post-award negotiations and reduce its margin of profit on the subcontract or not be awarded the contract. Either decision has led to the lost profits and the economic ruin of many subcontractor businesses” (Dufficy, 1989).

Worst of all, bid shopping exposes our workers to additional safety risks by tempting the subcontractor to either push insufficiently sized crews to complete the work on schedule or cut costs on safety equipment. This could contribute to the already high industry risk by causing an accident on the job site that could result in the injury or death of a worker. Both of these risks, financial and safety, are unreasonable to require from subcontractors, and are the very cause of the elimination of the practice of bid shopping. It must be understood that these are people and not just businesses that are being affected by bid shopping.

### *Why Bid Shopping Exists*

To prevent bid shopping, one must understand why it occurs. Bid shopping exists due to the inability of the subcontractor to tie the contractor to their bid. As mentioned earlier, the owner protects the contractor against post-award negotiations tactics under statutory law. Unlike the contractor, however, no such protection exists for the subcontractor. Under common law, the contractor is not obligated to enter into a contractual agreement with a subcontractor, even though the subcontractor’s bid was used in the preparation of the (contractors) bid (Foster, 1997).

Although no contractual relationship actually exists that can bind the contractor to the subcontractor, the subcontractor, on the other hand, may find themselves bound to the contractor by way of its submitted bid. “Courts generally allow the contractors to hold subcontractors to their bids, even though a subcontractor has made an honest mistake in preparing its bid and no formal subcontract was ever created” (Stockenberg, 2001). As a result, the contractor is guaranteed a price on the scope of work and, having avoided entering into a formal subcontract, “is free to engage in further negotiations with these as well as other subcontractors in order to secure a still lower bid” (Dufficy, 1989).

### *Attempts to Curb Bid Shopping*

In an effort to tie the contractor to the bid, and therefore control post-award bid shopping, some states have created statutes requiring that the contractor supply a list of subcontractors that are intended to work on the project. Oregon recently passed such legislature in 1999, insisting that the names all first-tier subcontractors furnishing labor or materials, be submitted within four working hours of the bid submittal deadline (ENR, 1999). The hope is that, by requiring that these subcontractors be listed on the contractors bid received by the owner, the owner can hold the contractor to use the subcontractors listed on their bids.

Unfortunately such legislation doesn’t always hold. In the California case of *Klose v. Sequoia Union High School District*, the court held that such statutes “did nothing to obligate the

contractor to the subcontractor” (Foster, 1997). Due to the system of precedence, or the tendency of the courts to follow after proceeding rulings in our legal system, supreme courts in Idaho and Minnesota also reached similar decisions.

Other attempts to curb bid shopping practices include efforts to change the traditional concept of offer and acceptance principles through the Uniform Commercial Code. According to the code, the contractor’s use of a subcontractor’s bid in the preparation of the its own bid, constitutes an acceptance of that offer once the contractor has been awarded the prime contract. Unfortunately, these attempts, like the many other national attempts to prevent bid shopping, have proved largely ineffective (Dufficy, 1989).

Finally, in its latest efforts to eliminate the consequences brought about by bid shopping, the American Subcontractors Association submitted to congress to enact The Construction Quality Assurance Act of 2001. This bill was reintroduced to Congress on March 19, 2003 (Mendes, 2003). This bill, once it is passed, will give contracting officers the right to investigate bid shopping allegations on all federal contracts over one million dollars. Under this new act, penalties for bid shopping could include contract cancellation, fine covering the differences between bid prices and debarment (Angelo, 2001). Whether the act will have any effect remains yet to be seen.

#### *Why Legislation Have Failed*

The three main reasons why legislative attempts to stop bid shopping have failed are the following:

First, when subcontractors submit their bids just in time, the contractor does not have enough time to thoroughly analyze each bid before submitting their bid to the owner. As a result, the contractor may find that a subcontractor’s bid that was already submitted has either an incomplete scope or was overlapped by another bid that was also submitted. As a result, the contractor may need to change the subcontractor to one who’s scope of work is more complete or fits in better with the other subcontractor bids. Given the above conditions, the disallowance of changing subcontractors after the bid would greatly hamper the contractor’s ability to manage the project.

Second, the contractor should have the right to select whomever they want to use for a project. There may be other considerations such as past performance on a project that may influence the contractor’s selection of subcontractors.

Third, a contractor may need to change to a different subcontractor after the bid due to manpower availability. The subcontractor may not have the manpower to meet the schedule that the contractor wants to use. While the contractor could legally force the subcontractor to perform on the project, the contractor may elect to use a different subcontractor that has the manpower available to work on the project.

At bid time, the contractor may have received only one or two bids and felt that the subcontractor bids were too high, therefore, plugging in their own numbers. The contractor then attempts to

find a subcontractor that will perform the work at the plugged-in price. If the contractor cannot find a subcontractor to meet their price, then the contractor's profit is reduced.

### *Suggestions for Reducing Bid Shopping*

The first step towards the elimination of bid shopping is to educate the contractors and subcontractors about the effects of bid shopping as described in this paper. Then hopefully the contractors and subcontractors will refrain from engaging in bid shopping practices. This may seem idealistic, but it is a step in the right direction.

A more realistic solution to help curb bid shopping would be to incorporate standard bid forms for each project. This would greatly reduce the risk to the contractor on bid day, by helping reduce the potential for missed scopes of work or double coverage. The standardized bid form would reduce the need for a contractor to change subcontractors after the bid opening.

Subcontractors allow themselves to be bid shopped. If subcontractors would not reduce their price when pressured by the contractors, the bid-shopping contractors would go out of business.

### **Conclusion**

In this paper, bid shopping and its negative effects on the construction industry have been closely examined. Legislation has been enacted in an effort to eliminate these harmful consequences, but has been overturned in the courts thus far. The only way to effectively control bid shopping is by controlling ourselves and influencing those around us to do the same. Hopefully this paper will help educate contractors on the negative affects of bid shopping and will help influence them to avoid the practice of bid shopping. If bid shopping could be eliminated in our companies and our industry, everyone will benefit.

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