Who Pays When the Bid Is Wrong?

by Scott Hofer

When you bid on a construction project, you are subject to contract formation law — the law of offer and acceptance — which holds contractual duties absolute. Short of absolute impossibility, no hardship, foreseen or unforeseen, will free either party from the bargained-for exchange of promises. Until recently, this meant contractors could not claim relief from bid mistakes or price changes. This effectively prevented a bidder from finding a mistake simply to get out of a poor bargain. However, a cursory view of case law in this area reveals that today's courts are more willing to consider relief for certain types of mistakes.

Current contract law defines a mistake as "a belief not in accord with the facts." Common mistakes include misconstruing plans or specifications, inaccurately estimating labor, and transferring data incorrectly. These and other bid mistakes can be financially disastrous, but predicting when courts will consider relief is difficult.

Types of Mistakes

To claim relief, you must first distinguish between a mistake as to facts existing at the time of the bid offering and a mistake as to expectations of future occurrences or circumstances. The latter are deemed business judgments, and contract law allocates these risks to the bidding party, forcing the bidder to perform or suffer the legal consequences of breach.

If a mistake concerning existing fact is found, courts will inquire whether it was *mutual* or *unilateral*. A mutual mistake arises when both parties' beliefs are erroneous. In this case, courts are willing to conclude that a contract was never formed. A unilateral mistake occurs when only one party has a mistaken belief. Courts usually reason that to allow relief based on a unilateral bidder mistake would be to take away the non-mistaken party's bargain. Consequently, sanctity of contract principles prevails and relief is typically denied.

But realities such as time pressure in submitting bids have caused courts to liberalize this once strict view. Most courts now recognize a limited right of avoidance for unilateral mistakes. This break from the common law rule of no rescission requires distinguishing between clerical or arithmetic errors, which will attract relief, and errors in judgment, which will not.

You can typically claim relief for clerical errors even if the mistake could have been avoided through the exercise of reasonable care. At issue is the degree of carelessness beyond which the bidder will not be protected. Most courts have found that the degree of carelessness was not high enough to deny relief. Current contract law states that relief will not be denied unless it amounts to a bad faith failure to act in accordance with reasonable standards of fair dealing.

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Courts usually grant relief when a person to whom a bid was offered knew or should have known it included a mistake and "snapped up" the bid to secure a favorable contract. In this circumstance, laws of equity prevent the owner from being unjustly enriched, and the law of contract provides no basis for his reliance in forming the contract. In other words, because the person accepting the bid knew or should have known it contained a mistake, the courts consider this equivalent to a mutual mistake for the purposes of rescission.

Making Your Case

Although requirements for rescission are not concrete, a mistaken bidder seeking relief will usually need to show all of the following:

- the offeree knew or should have known of the error;
- the mistake involved a duty or promise that was a significant basis for forming the contract;
- there was no neglect of legal duty, like failing to supervise employees;
- enforcement as is would be unconscionable (unduly burdensome);
- there was no detrimental reliance (the offeree did not purchase materials or make other commitments based on the mistaken bid);
- prompt notice of the mistake was given;
- the bidder can return compensation already paid; and
- the bidder had not assumed the risk of the mistake through contract.

An example of how the requirements have been applied is the case of *Elsinore Union Elementary School District v. Kastorff*. Kastorff failed to account for the cost of plumbing subcontract work in submitting his bid to Elsinore. Despite immediate notice upon discovery of the error, Elsinore demanded performance. Kastorff refused and Elsinore brought suit. The court found that the mistake was material and not the result of neglect of a legal duty. The court also found that enforcement of the contract as-is would be unconscionable, and granted Kastorff relief.

From the *Elsinore* case and other cases like it, it is safe to assume that when an owner knows or has reason to know of the bidder's material mistake at the time of acceptance, the bidding party is not bound. However, difficulty arises in determining what magnitude of error should have been apparent from the face of the offer. There is some indication that, to attract relief, an error must be larger than one-third of the agreed price. For example, in *Heifetz Metal Crafts, Inc. v. Peter Kiewit Sons' Company*, Kiewit's bid for kitchen work on a hospital was one-third less ($52,000) than the next low bid. The court rejected his plea for relief and held the contract enforceable.

Price Changes

Two additional bidding issues, unrelated to making a mistake, are a change of price and additional expense, both of which have to do with a change in events after the bid is made. Courts deal with these issues under the theories of impracticability and frustration of purpose, and are less receptive to claims for relief. The fact that performance has become economically burdensome or unattractive is not sufficient to make performance impractical — even if it results in extensive loss. Many courts, before considering performance impracticable and allowing relief, require a bidder to show that the loss would cause a loss for the entire year.

A rising or falling market is no justification. Bargaining for this risk is exactly what contract formation theory is designed to protect. For the courts to consider relief, the rise in cost must be due to some unforeseen contingency which alters the central nature of performance. Unfortunately for builders, the case most often used to define an "unforeseen contingency" is *Transatlantic Financing Corp. v. United States*, which demonstrates the courts' reluctance to find impracticability in performance. Transatlantic contracted to ship a full cargo of wheat from Texas to Iran via the Suez canal. When war broke out between Egypt and Israel, the canal was closed and Transatlantic had to steam an extra 3,000 miles around the Cape of Good Hope. The court found that in order to relieve performance, it must find an unexpected contingency had occurred, the risk of which was not allocated to the aggrieved party, and that the occurrence rendered performance impracticable. The court ruled that these changed circumstances — the closing of the canal due to war — did not make performance excessive or unreasonable for Transatlantic. Though the added expense amounted to $43,972 over the $305,845 contract price, performance was not legally impossible and the risk of such increase in performance cost was assumed by the bidding party. Price increases are also generally assumed to be included in the risks bargained for in the bid, and contractors will be held strictly bound.

Check Your Numbers

Obviously, a builder can find relief for bidding mistakes, but it is almost never easy. The best course is to check and double check your numbers, and try to provide for unlikely future events that may affect your costs.

Beyond that, be prepared to stand by your bid. The Superior Court of California has demonstrated the seriousness of bid proposals. In *Drennan v. Star Paving Co.*, Star's bid for a paving subcontract to Drennan, the general contractor, was half its actual cost. Although Star's bid error may have been honest, the court found that the resulting loss fell on the party who caused it. Injustice could only be avoided by enforcement of the promise, and the bid was held binding. ■

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