SURETY TODAY PRESENTATION
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BID BONDS

Our topic today is Bid Bonds, and I will lead off with a primer on bid bonds, a sort of Bid Bonds 101 if you will. Then Lou and I will talk about some of the issues and case law that deal with bid bonds.

So to begin, I think it's helpful to look at what the standard procurement process is.

The Standard Procurement Process

- Typically, it begins with the Owner engaging an architect to design the project and to prepare plans and specifications for constructing the project
- These plans and specs are then made part of a Request for Proposal (RFP) or sometimes called an Invitation for Bids (IFB), which is then issued by the Owner to various potential bidders
- The RFP and applicable statutes or governing regulations will typically require that any bidding party must provide a bid bond with its bid
- These statutes, regulations and/or RFP will typically describe the requirements of the bid bond – amount, terms, duration, form, requirements for acceptability of the surety, etc.
- Under a typical sealed bid procurement after the bids are opened the contract is typically awarded to the lowest responsive and responsible bidder
- It is important to note that the bid bond is part of the determination of whether the bid is "responsive." Responsive means the bid must be an unqualified offer to perform in strict accordance with the RFP. If there are mistakes in the bid bond the entire bid can rejected by the Owner, so you need to be careful when these things are being issued..
- After the award, if the low bidder fails or refuses to enter into the contract, the Owner can then make claim against the bid bond.

A typical bid bond guarantees that if the principal is the successful bidder the principal will enter into a contract with the Obligee and will provide the security required *i.e.* the payment and performance bonds. The standard bid bond form for the federal government reads as follows:

Standard Form 24 (under the U.S. Code/FAR) provides:

"We, the Principal and Surety are firmly bound to the United States of America in the above penal sum. . . ." and I'm going to paraphrase here because there are all kinds of parentheticals.

"The above obligation is void if the Principal – (a) upon acceptance by the Government of the bid identified above, within the period specified therein for acceptance . . . executes the further contractual documents and gives the bonds required by the terms of the bid as accepted within the time specified . . . after receipt of the forms by the principal; or (b) in the event of failure to execute such further contractual documents and give such bonds pays the Government for any cost of procuring the work which exceeds the amount of the bid."

It has been held that the purpose of a bid bond is to afford protection against a change involving damage, loss or detriment to the party soliciting the bids caused by a principal's failure to perform its obligation under the RFP.

Bid bonds are required on Federal, State and local government projects and even on some private projects. As noted a moment ago, the requirements for bid bonds are typically set forth in procurement statutes or regulations, such as the Federal Acquisition Regulations (FAR) for federal procurements, and the terms of those statutes and/or regulations will control. In addition, terms regarding bid bonds will also typically be set forth in the RFP itself. Accordingly, when addressing bid bond claims, it is critical to read the governing statues, regulations and RFP terms, as well as, the terms of the bid bond itself.

Ordinarily, the bidder who is awarded the contract obtains the required performance and payment bonds from the same surety that issued the bid bond. This is why bid bonds are generally offered for nominal premiums. However, unless the governing statutes, regulations or RFP terms require otherwise, the surety that issues the bid bond is typically not required to issue the payment and performance bonds. Generally, the GAI or bond application documents make it clear that the surety is not obligated to issue any bonds it chooses not to. Notwithstanding that, there have been numerous cases by principal's seeking to either force the surety to issue bonds or seeking damages for a surety's failure to issue bonds. Bid bonds are generally viewed as separate and distinct from the payment and performance bonds. However, there are some jurisdictions where by statute the bid bond automatically converts into final bonds upon award of the project to the successful bidder.

The penal sum on a bid bond is typically expressed as a percentage, such as 5% or 10% of the bid amount. In some cases the bond amount is expressed as a percentage of the bid with a cap amount. The surety's maximum liability to the obligee is the penal sum on the bid bond. The bond's penal sum is often expressed as a percentage as opposed to a specific dollar amount to eliminate the last minute insertion of a specific dollar amount as most bids are completed by the principal until the last minute before submission.

There are two general types of bid bonds generally speaking – "Forfeiture" and "Damages." In a "forfeiture" bid bond the surety forfeits or pays the penal sum on the bid bond whenever liability is established regardless of the amount of actual damages or whether the obligee has incurred any damages at all. In a "damages" type bid bond the surety will typically be required to pay the difference between the principal's bid and the next lowest bidder, not to exceed the penal sum of the bond. The manner in which a typical bid bond works can be explained using an example:

Example: Assume that when the bids were opened on a hypothetical procurement the principal's bid was $500,000. The next low bidder's bid was $550,000, thus the principal's bid is the low bid. The bid bond submitted with the bid had a penal sum of 5% of the bid. When the award is made to the principal as the lowest bidder, and the principal refuses to sign, then the Obligee awards the contract to the next low bidder at $550,000, incurring $50,000 in "damages." The difference between the principal's bid and the amount of the contract ultimately awarded is the amount of damages, but in this case, the damages would be limited under the bid bond to the 5% or $25,000 under that example.

With that bid bond primer in mind, I will turn it over to Lou.

Lou: I'm going to go over a couple of cases that show how the owner attempts to get that protection from the bid bond but the case that I'm going to go over they didn't because they messed up, which is why I'm going to talk about them as far as what can a claims handler do when he gets a bid bond claim?

The first one is out of Baltimore City in federal court where a joint venture submitted the lowest bid for a Baltimore City project. It was $40,000,000 and of course, as with a lot of government contracts now days, it had minority participation goals as part of the requirements of the bid. So, the contractor, along with its $40,000,000 bid, also submitted a bid bond in the amount of $817,125. The bid bond, as Mike described, was conditioned upon return of either the contractor's bid being rejected or if the contractor's bid was accepted and the contractor accepted and delivered the contract, the furnished performance and payment bonds. Baltimore City awarded the contract and the contractor in turn provided executed copies of the contract, the performance and payment bonds and proof of insurance. In this case what happens was after Baltimore City had awarded the contract to the bidder to the contractor, the contractor was supposed to finalize his subcontracts with the minority subcontractors he had listed in his bid. Unfortunately, there arose some significant disagreement with the contract terms with the minority contractors, so the contractor sought to substitute one of the minority contractors from its original submission. The request was denied by the City and then the City, and I'll use the term "annulled" the contract and sought liquidated damages in the amount of $817,125 basically seeking the bid bond. I use the term "annulled" because I think everybody's going to wonder what happened to the performance and payment bond. They annulled the contract so the only issue here was could the City get the bid bond? What the court decided was that the contractor had complied with all of the terms of the bid documents, they executed the contract and furnished performance and payment bonds, and once performed, the performance bond, not the bid bond, became the City's protection. That is, the City could not go back and merely, if you will, call the bid bond into question and say it was a liquidated damage. They had to go under a performance bond, which they didn't; they call it an annulment. The first time when you look at a bid bond, it gives the owner protection, but only with respect to exactly what it says. It says it protects the owner from the contractor executing the contractual documents and giving the bond. In this case, and I'll provide the cites later, the owner received that protection so the bid bond was no longer in force and effect.

Another mistake that an owner made was in a case out of Iowa. There, the City requested bids for a public improvement, and of course, the IFB required each bid to be accompanied with

a bid security that the successful bidder would enter into a contract for the work bid upon. There, the contractor submitted a low bid of $719,000 and a bid bond in round numbers of $71,000. Here, the City, I think Mike mentioned it as well, conditionally awarded the contract to the contractor subject to concurrence of the award by the Iowa Department of Natural Resources. The City did not issue a notice of bid acceptance, but instead, forwarded the contractor's proposal to DNR for its concurrence. What happened later was DNR advised the City that the contractor's proposal did not conform to the minority business enterprise/women's business enterprise requirements in the IFB, and therefore, the DNR could not concur in the award. For reasons unknown the contractor could not provide additional documentation requested by the City. Instead, the contractor requested the City to return its bid bond as the contract was not awarded within 30 days as required by the IFB. In this case, the invitation for bid said that the award, if made, was going to have to be made within 30 days. After receiving that, the City retained the bid bond, accepted the second lowest bidder's bid and brought an action against the contractor and its surety. The City sought $71,958 against the bid bond as liquidated damages. There, the court determined that the term "successful bidder" is the bidder whose bid the governing body has accepted. There, the City did not issue acceptance of Harper's bid and only passed a resolution of awarding the contract to Harper subject to DNR approval. Hence, Harper was not the successful bidder and the City was not entitled to Harper's bid bond because it didn't execute or award the contract within 30 days. This goes back to Contract Law 101 from college that the period of acceptance is only good for 30 days and after that, the contractor, which he did in this case, basically rescinded or revoked the offer, and therefore, if the offer was revoked, it couldn't be accepted. Therefore, the surety was also not liable because the surety's liability is what it says in the bid bond. It says if the bidder doesn't execute the contract and what not, the surety released as well in that sense.

The one thing, going back to the standard form 24 which catches some sureties and contractors, is the bottom or last part of it, if you want to pull that up one day. It says: "Each surety executing this instrument agrees that its obligation is not impaired by any extensions of time for acceptance of the bid that the principal may grant to the government. Notice to the sureties of extensions is waived, however waiver of the notice applies only to extensions aggregating not more than 60 calendar days in addition to the period originally allowed for acceptance of the bid." So in the case we just went over, the government could have, but they chose not to, ask the bidder to extend the period of time for acceptance of his bid, and under most bid bonds, the surety's obligations are likewise extended for some period of time. You have to read the bid bond to see how long that extension is, if there is one. Most of the time, the government asks for extensions of bids when they have a problem such as other entities or other things having to be part of the award process. Many times, as last here in the State of Maryland, it is not unusual for a contract, even with 60-day language for acceptance not to be awarded within 120 or 150 days after bid opening because of the other approvals they have to get. In those cases, at least in the State of Maryland, they ask for an extension of time from the bidder and they have the same language as standard form 24, which means that the surety likewise automatically extends, at least for the first extension.

The other case I would like to talk about is on the contractor's end but still gets out of the bid bond. That one is out of Indiana where a contractor submitted a bid of $2,997,000 and of course the bid bond in the amount of 10%. I won't go through the facts of how he made the

mistake, but basically it was one where they were all talking in the office with about five minutes left to bid the job, throwing out numbers back and forth, and somebody forgot a decimal point such that the bid, instead of being $3,300,000, somehow got reduced to $2,997,000 basically a $300,000 mistake. The contractor immediately called the owner within a few minutes after bid opening saying that there was a mistake and that they would like to rescind their bid. The school said "no" and the school sued the contractor and the surety for its bid bond, which was 10%. There, the court held, which is pretty much the same but varies from state to state that when a bid mistake results from clear cut clerical errors, those types of mistakes are excusable. If the mistake, however, is one of judgment, there is no such relief, that is the contractor is stuck with his bid. In that case, the surety was released from its bid bond because the principal did not have any liability on the underlying contract; that is it should have been allowed to rescind its bid, and therefore, again the surety is no longer liable. So, that's the other type of case where the surety, when making a claim for the bid bond, can raise that as a defense.

Mike: So basically, you're sitting there and you get these bid bond claims in and my advice to you would be, as I said earlier, get into the statutes and the governing regulations. Look at that bid bond and read what the requirements are. There are a number of cases out there that recognize if the government doesn't accept the bid in the manner that is required under the applicable statutes, regulations, the RFP or the bond, the surety can be discharged and released from the obligation under the bond.

For example, in ***Commissioners of Sewerage of Louisville v. National Surety Co.***, 145 Ky. 90 (1911), the surety was released from its bid bond because the obligee did not actually accept the bid. The RFP required a price for steel bars that were specified in the plans and specs. The steel bars had a performance standard that was association with them so they had to have a certain capability to withstand certain forces, and so in the bid, the principal specified a certain manufacturer for its steel pipes and submitted that bid on that condition. It was the low bidder, and the government came back and said they were accepting the bid, but they weren't accepting the manufacturer. They wanted the bidder to provide the steel bars from someplace else. That was held to be not an acceptance of the bid because the bid was conditioned on the manufacturer, and it went back to an issue of price. This manufacturer had an acceptable price for the bidder and the government was saying it didn't want to accept that manufacturer, so that ended up being a situation where the court held that the bid was conditional on the manufacturer, the obligee's failure to accept that bid as it was, was actually a rejection of the bid and the surety was not held responsible.

Another example was ***Northeastern Constr. Co. v. City of Winston-Salem***, 83 F.2d 57 (4th Cir. 1936). In that case, the City of Winston-Salem (the "City") issued an RFP for the construction of an extension of its public sewer system. Northeastern Construction Co, ("Northeastern") submitted the low bid along with a bid bond. The bid bond was a damages type of bond and was conditioned on the award of a contract to the principal in accordance with the terms of the RFP and the bid submitted. The City notified Northeastern that it was the low bidder and that it intended to award the contract to Northeastern, but Northeastern refused to enter into the contract. The facts revealed that when the City provided notice of its intent to make the award it also advised Northeastern that it intended to reduce the amount of the sewer pipe to be installed by 20,000 LF (approximately 15% of the total). Northeastern responded to

the City prior to the actual award of the contract advising it deemed that the change was a substantial deviation from the RFP and the bid and that such a change amounted to a rejection of the bid. Therefore, Northeastern refused to accept the contract and in fact, sought to withdraw its bid. The City refused to accept or allow withdrawal, and engaged another contractor to perform the work at a higher cost. Suit was then filed against Northeastern and its surety. The underlying trial court held in favor of the City. The Appellate Court (4th Circuit) reversed. The Fourth Circuit found that the reduction of the work was a material alteration in the terms of the RFP and resulted in a failure to have a "meeting of the minds" which is necessary for a valid contract. The Court further noted that a bid is an offer of contract and that any variation in the acceptance is a rejection of the offer and constitutes a counter offer and unless accepted by the bidder does not create a binding obligation at all. The Court stated that the surety had guaranteed a bid for the entire contract and not a reduced portion of the contract and the surety could not be held on its bond for a different bid than it originally guaranteed.

So reviewing and examining the terms of the purported acceptance of the obligee can often give the surety an "out" if you will on its bond if the government is doing something outside of what was originally contemplated.

Lou: One of the things we talked about was mistakes and the federal government is pretty clear about that in FAR section 14.407, which governs mistakes in federal procurement. The states are a little all over the place, if you will. Most states permit contractors to perform or rescind their bids. Reformation is a little tougher at the state level. Most states will allow you to rescind it, that is to revoke your bid or your offer because of a mistake because there is no meeting of the minds there. Reformation at the state level is a little tougher to get because you're allowing a bidder to say "I gave you a price of $X and I really meant $X plus, and oh, by the way, give me the award at the same time." So, there are not as many cases on reformation at the state level as there are for rescission. There are some states out there that won't even allow you to rescind. There's a case out of Minnesota, *Rocha Corp. v. City of St. Paul*, 814 N.W.2d 365 (Minn. App. 2012) (rescission permitted due to clerical error over objection of second-low bidder, overturned on appeal); that didn't allow the bidder to even rescind based on the mistake.

In the federal government of course, it is by FAR and depending on the circumstances, a bidder may be allowed to correct its bid and not be permitted to withdraw the bid, which is a little odd, or the bidder may be permitted to withdraw its bid and take back the accompanying bid bond. That's in FAR section 14.407-3 (deals with mistakes discovered before award). A federal agency may permit correction of a bid where clear and convincing evidence establishes both the existence of a mistake and a bid actually intended. FAR section 14-407-3(a). Also, if you want to look, the case of *Brommel Contr. v. U.S.*, 596 Fed.2d, 448, Ct. Cl. 1979 discusses when a bidder may withdraw its bid without forfeiture of its bid bond. Generally, that's where it's allowed to rescind its bid because it can show its mistake. Mike and I kicked around before about this and I couldn't find any cases that give us an exact mathematical calculation for when the owner should have known a mistake. They all come to that conclusion, but no cases we found said if it's a 5% mistake, 10% mistake. Most cases, at least when I worked for the government, most of the time when they were hit around 10% was when things went off on the owner's side about should we ask for verification, because in the federal government, you're supposed to ask for verification of a bid where you knew or should have known there was a

mistake. I don't know where the 10% comes from, whether it's because over 10% over the engineer's estimate you have to look at the bid and get approval, or whether it's because of the bid bond that's usually 10% but somewhere around 10% is where the mistake red flag should show up from the owner's standpoint. In the federal government you can even correct mistakes after award but that's the same thing.....they can either allow you to rescind the contract or reform the contract, but they only allow you to reform the contract after bid opening if again, the mistake is clear and convincing evidence that the mistake was made and if the mistake is made unilaterally by the contractor, the mistake is so obvious as to charge the contracting officer with notice of the probability of the mistake. That's in FAR section 14.407-4. There is a Federal Claims Court case that discusses the unilateral mistake. The court listed five elements of proof necessary to establish a unilateral mistake after the award:

1. The contractor must show by clear and convincing evidence that the mistake in fact, occurred prior to the contract award;

2. The mistake was a clear cut clerical or mathematical error or a misreading of the specification, not a judgmental error;

3. Prior to award, the government must have known or should have known that a mistake had been made, and therefore, should have requested bid verification;

4. The government did not request the verification or its request for verification was inadequate; and

5. Proof of the intended bid is established.

If you can establish those five things even after the award, the contractor is allowed to either rescind, depending on the circumstances, or allowed to correct the bid price, both of which obviously helps the surety either on a bid bond question or possibly at that point a performance and payment bond question.