

STATE OF NORTH DAKOTA
ATTORNEY GENERAL'S OPINION 94-F-33

Date issued: November 23, 1994
Requested by: Henry Wessman, Department of Human Services

- QUESTION PRESENTED -

Whether a bidder's failure to execute the required bid security is a substantive omission requiring automatic rejection of the bid or a minor irregularity that can be waived or cured by post-bid corrective action.

- ATTORNEY GENERAL'S OPINION -

It is my opinion that a bidder's failure to execute the required bid bond is a non-waivable substantive omission requiring automatic rejection of the bid.

- ANALYSIS -

Although your question refers specifically to the Dakota Project,¹ bids on many public contracts in this state must be accompanied by "a bidder's bond . . . executed by the bidder as principal and by a surety company authorized to do business in this state" N.D.C.C. ? 48-02-04 (public buildings) (emphasis added). See also N.D.C.C. ? ? 11-11-28 (counties); 24-02-20 (state highways); 40-22-22 (municipal improvements by special assessment). The Dakota Project request for proposals (RFP) adopts this requirement and states that the "bid bond shall be duly executed by the Bidder as Principal and shall have as Surety a surety company acceptable to the States." Dakota Project RFP ? 4.25.

¹The Dakota Project is a joint effort of the North Dakota Department of Human Services and the South Dakota Department of Social Services (States) to implement an electronic benefits transfer system for the distribution of food stamp program benefits.

When requesting bids, a public body will often reserve both the right to waive minor irregularities in a bid and the right to reject any or all bids. Although these rights are not absolute, a public body that has the authority to insert requirements in its RFP also "has the right to require literal and exact compliance with them and to decline all bids as informal which do not so comply." 10 E. McQuillin, The Law of Municipal Corporations ? 29.65 (3d ed. 1990) [hereinafter McQuillin]. Because a public body may properly reject a bid for failure to comply with a requirement in its RFP or a statute that the bid bond be executed by the bidder, this opinion only addresses whether a bid must be rejected for that failure.

In deciding whether a bidder's failure to execute the bid bond is a substantive omission, one must first determine the effect of that failure on the enforceability of the bond.

"Suretyship is a contractual relationship, which results from two persons becoming obligated to the same creditor with one of them bearing the ultimate liability. In other words, if the debt is enforced against the surety, he then is entitled to be indemnified by the one who should have paid the debt before the surety was compelled to do so."

First Interstate Bank v. Rebarck, 511 N.W.2d 235, 239 (N.D. 1994), quoting State of Wis. Inv. Bd. v. Hurst, 410 N.W.2d 560, 562-63 (S.D. 1987). The "liability of the surety is ordinarily measured by the liability of the principal, and . . . the surety is not liable if the principal is not." 74 Am. Jur.2d Suretyship ? 25 (1974). "[I]t is of the essence of the surety's contract that there be a valid obligation of the principal." 74 Am. Jur.2d Suretyship ? 1 (1974). In other words, a suretyship cannot be created without an obligation between a bidder and the public body. However, although a surety bond "which lacks the principal's signature is in a sense incomplete, it may not, for that reason alone, be any the less binding." 74 Am. Jur.2d Suretyship ? 16 (1974).

If the principal is otherwise bound to perform the condition in the bond, the surety is liable under the bond even without the principal's signature. United States Fidelity and Guar. Co. v. Haggart, 163 F. 801, 809 (8th Cir. 1908); Restatement

of Security ? 101(2) (1941). See also 72 Am. Jur.2d Suretyship ? 16, 72 C.J.S. Principal and Surety ? 42 (1987), and cases cited therein. However, if the principal fails to execute the bond, and no obligation attaches to the principal outside the bond itself, the surety is not liable under the bond. Id.; Restatement of Security ? 101(2) (1941).²

Generally, a principal will be independently obligated by statute or contract to perform the condition of the bond. For example, performance bonds need not be executed by the principal because they are provided along with a separate contract between the principal as successful bidder and the public body. See Tanco, Inc. v. Houston General Ins. Co., 555 P.2d 1164, 1166 (Colo. Ct. App. 1976); Campbell v. Brower, 248 N.W. 581, 582 (Mich. 1933); Dakota Project RFP ? 5.39. The same is true for bonds of public officials. See State v. United States Fidelity and Guar. Co., 424 S.W.2d 199, 202 (Tenn. Ct. App. 1966); Annotation, Liability of Sureties on Bond of Public Officer as Affected by Fact that It Was Not Signed by Him, 110 A.L.R. 959 (1937). See also Castine v. New York State Tax Commission, 447 N.Y.S.2d 119 (N.Y. Sup. Ct. 1982) (tax bond).

Because a principal is almost always bound outside the bond, several of the cases cited above simply state that a bond need not be executed by the principal. Cf. Tanco, Inc., 555 P.2d at 1166. In holding that a bid bond is enforceable without being executed by the principal, the New Mexico Supreme Court simply adopted the general rule and ignored the requirement that the principal be liable outside the bond. State v. Integon Indem. Corp., 735 P.2d 528, 530 (N.M. 1987). However, as established in the authorities cited above, the general rule applies only when the principal is liable outside the bond. The decision in State v. Integon Indemnity Corp. is inconsistent with these authorities and the cases cited therein. When the bidder has not executed the bid bond, the liability of the surety depends on whether the bidder is bound outside the bid bond to execute the contract.

²Although a surety may be equitably barred by its conduct from denying liability in an action to enforce a bond that is not executed by the principal as required, the bond is nevertheless legally unenforceable. See In Re Guardianship of Hampton, 374 N.W.2d 264, 267 (Minn. 1985).

A request for bids is merely an invitation for offers, and not an offer to accept any particular bid. Olson v. Beacham, 102 N.W.2d 125, 128 (N.D. 1960). A public body's acceptance of the lowest responsible bid frequently "constitutes a binding contract, and this is the theory on which the action for damages for refusing to execute a contract with the accepted bidder is based." McQuillin ? 29.80 at 529. "However, in many cases it has been observed that the mere acceptance of a bid does not necessarily constitute a contract." Id. at 530.

In the case of public contracts, certain additional formalities are often required by statute or by the request for bids under such statutes, such as the execution of a written contract, or the requirement that a satisfactory bond be furnished. In such cases, even after acceptance of the bid has occurred, no contract is formed until the requisite formality has been complied with.

1 Samuel Williston, A Treatise on the Law of Contracts ? 4:10 at 343-44 (4th ed. 1990). "Whether a contract was complete on the award, or a subsequent written contract was contemplated depends upon a proper construction of the steps taken by the parties concerned, in view of the applicable law." McQuillin ? 29.80 at 530.

Regardless of when contract formation occurs, a bidder is free to revoke its bid before a contract is formed unless, as in an option contract, it has received consideration to keep its offer open. 1 Arthur L. Corbin, Corbin on Contracts ? 2.27 (Rev. ed. 1993); Restatement (Second) of Contracts ? 44 cmt. a (1981). Until it provides an enforceable bid security, a bidder is "free to decline to accept the contract without suffering any economic penalty whatsoever." Cubic Western Data, Inc. v. New Jersey Turnpike Auth., 468 F.Supp. 59, 66 (D.N.J. 1978).

However, "[w]hat becomes of the deposit, in case of a revocation, is quite a different question from that of irrevocability." Corbin, supra, at 246. "Even if the revocation is held to be effective, it is also usually held that the offeree may keep the deposit." Id. As the Restatement of Contracts explains, supra at 117-18, "the offer is treated as irrevocable for the purpose of determining

rights in the deposit, but the offeror's power of revocation is not otherwise impaired." Thus, forfeiture of the bid security as liquidated damages is a bidder's only liability for revoking its bid before a contract is formed.

Because a bidder is not liable outside the bid security for revoking its bid, the bidder's failure to execute the bid bond as principal makes the bond unenforceable against the surety as well. If bid security is required, but a bidder has provided only an unenforceable bid bond, the issue then becomes whether that failure is a substantive omission that cannot be waived.

Courts apply two criteria to determine if a specific noncompliance with a statute or RFP constitutes a substantial irregularity:

[F]irst, whether the effect of a waiver would be to deprive the [public body] of its assurance that the contract will be entered into, performed, and guaranteed according to its specified requirements, and second, whether it is of such a nature that its waiver would adversely affect competitive bidding by placing a bidder in a position of advantage over other bidders or by otherwise undermining the necessary common standard of competition.

McQuillin ? 29.65 at 462-63.

A failure to provide an enforceable bid security easily satisfies the first criteria. The purpose of bid security is to guarantee that the bidder, if successful, will execute a contract for the performance of the work. Board of Educ. of Carroll County v. Allender, 112 A.2d 455, 460 (Md. 1955); McQuillin ? 29.66; Dakota Project RFP ? 4.12. As explained above, without an enforceable bid security, the public body has no assurance that a successful bidder will enter into a contract.

I believe the second criteria is also satisfied. It can be argued that the bid security required for some projects is so insignificant compared to the entire project that a waiver would have no effect on competitive bidding. However, among responsible bidders, even the small cost of obtaining a bid security can place complying bidders at a disadvantage by

increasing the cost of their bid. In addition, although frequently computed as a fraction of the value of a project, the amount of bid security required is a rough estimate of the potential cost of accepting the next lowest bid or readvertising for bids, and should not be compared to the value of the project.

The same argument was raised in Hillside Township v. Sternin, 136 A.2d 265, 271 (N.J. 1957). In affirming the trial court's decision that the public body could not waive a failure to provide bid security of only a few hundred dollars, the New Jersey Supreme Court concluded that any consideration of the significance of the bid security would require "an evaluation . . . of sensitive, subtle, and subjective criteria" that would only add uncertainty to the competitive bidding process. Id.

Waiving a failure to provide bid security, regardless of how soon the omission may be cured, also "allows the announced low bidder to negotiate with the public agency after the bids are opened, up until the time this bidder actually procures the Letter of Surety, if it does so at all." Cubic Western Data, 468 F.Supp. at 67. If the low bidder is free to revoke its bid, that freedom can be used as a negotiating tool. Id.

Regardless of the amount required for a particular project, I agree with the conclusions in Cubic Western Data and Hillside Township that waiving a bidder's failure to provide bid security would deprive the public body of its assurance that a contract will be formed, give the noncomplying bidder a competitive advantage, and generally undermine the bidding process by treating bidders unequally. Therefore, it is my opinion that a failure to provide enforceable bid security, if required, is a substantive omission.

This office has said that bid security benefits the public and can be waived in proper circumstances. Letter from Assistant Attorney General John Adams to Harold Kelly (June 19, 1961), citing Report of the Attorney General of North Dakota, July 1, 1950 to June 30, 1952 at 12-13; see also McQuillin ? 29.66. However, this general rule has not been applied to waive substantive omissions, but is only a restatement of a public body's right to waive technical irregularities.

The power to waive irregularities in a bid security is most

commonly used where a bidder has provided a different form of bid security or an enforceable bid security for a smaller amount than required. See Report of the Attorney General, supra (citing cases); Board of Educ. of Carroll County, 112 A.2d at 457; McQuillin ? 29.66 at n.7. If the irregularity is substantive, such as when no bid security is provided or a defective bid bond is "tantamount to no bond at all," it would be an abuse of discretion for the public body to accept the bid.³ Superior Hydraulics v. Town of Islip, 453 N.Y.S.2d 711, 715 (N.Y. App. Div. 1982); Cubic Western Data, 468 F.Supp. at 67; Hillside Township, 136 A.2d at 271 (no security provided); McQuillin ? 29.66.

A public body must reject a bid containing a substantive irregularity "since noncompliance with substantial requirements places bidders on unequal footing, and destroys free and fair competition." McQuillin ? 29.78 at 528. Therefore, it is my opinion that a failure to provide enforceable bid security is a substantive omission that cannot be waived.

In conclusion, a bond is enforceable against the surety, even if it is not executed by the principal, if the principal is otherwise liable outside the bond. However, a bidder is not liable outside the bid security for revoking its bid before a contract is formed. Thus, a bidder's failure to execute the bid bond as principal makes the bond unenforceable against the surety as well. A failure to provide enforceable bid security, if required, is a substantive omission that cannot be waived. Therefore, it is my opinion that a bidder's failure to execute the required bid bond is a non-waivable substantive omission requiring automatic rejection of the bid.

- EFFECT -

This opinion is issued pursuant to N.D.C.C. ? 54-12-01. It governs the actions of public officials until such time as the

In addition, the Dakota Project RFP states that "[b]ids shall be rejected automatically for . . . [f]ailure to provide bid security." Dakota Project RFP ? 4.12. Thus, the States have not reserved the right to waive this omission.

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issue is decided by the courts.

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