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CONTRACT LAW

I. A UNILATERAL MISTAKE IN A CONTRACT BID DOES NOT NECESSARILY PRECLUDE THE BIDDER FROM RESCISSION

In *National Fire Insurance Co. v. Brown & Martin Co.*[1] a Federal District Court in South Carolina addressed the novel question under South Carolina law of whether a mistaken bidder is entitled to rescission of a contract and return of its bid bond when the bid is based on a substantial computation error.[2] The court held that rescission is appropriate if "(1) the error is so substantial that enforcement would work a great wrong, and (2) notice is given before the nonmistaken party has substantially changed its position so that it cannot be returned to the *status quo ante*."[3]

The defendant, Brown & Martin Company (Brown & Martin), submitted a $588,912 bid on a City of Columbia (City) sewer project. Brown & Martin also submitted a $29,445.60 bid bond. The bid instructions required a bid bond in the amount of five percent of the bid. If a bidder failed to execute the contract once awarded, the bidder would forfeit its bond.[4]

On November 15, 1988, the bids were opened, and it was discovered that Brown & Martin's bid was the lowest by approximately $100,000. Upon learning of this disparity, Brown & Martin's president, Mr. Pringle Boyle, immediately reviewed the bid. He discovered a $68,900 miscalculation. On November 16, 1988, the City Council voted to accept Brown & Martin's bid. Later that day the City received a hand-delivered letter from Boyle that sought withdrawal or correction of the bid. The City denied the requested change and warned that failure to execute the contract would result in forfeiture of the bid bond. Brown & Martin refused to execute the contract, and the City awarded the contract to the next lowest bidder.[5]

National Fire Insurance Company of Hartford (National), the issuer of Brown & Martin's bid bond, sought a declaratory judgment that the City was not entitled to recover the $29,445.60 bond. Alternatively, National sought a declaration that Brown & Martin had to in-

1. 726 F. Supp. 1036 (D.S.C. 1989), *aff'd mem.*, 907 F.2d 1139 (4th Cir. 1990).
2. *Id.* at 1039-40.
3. *Id.* at 1040.
4. *Id.* at 1037-38.
5. *Id.* at 1038-39.

demnify it for any amount National paid on the bond. Brown & Martin asserted that it was entitled to rescind the contract based on its mistaken bid and sought a declaration that the City was not entitled to recover on the bond. The City sought a judgment in the amount of the bond. All parties moved for summary judgment.[6]

Relying on three South Carolina cases, the court determined that South Carolina law permits "a contract [to] be rescinded for unilateral mistake not induced by the other party when the mistake is accompanied by circumstances which would make it a great wrong to enforce the agreement and the nonmistaken party may be returned to the *status quo ante*."[7] The court concluded that South Carolina courts would apply this general rule to bidding situations.[8] The court further supported its ruling by noting that the majority of jurisdictions which have addressed the issue have held "that under the proper circumstances a contractor should be permitted to withdraw a bid or rescind a contract when its bid is based on a mistake of fact."[9]

Applying the law to the facts before it, the court held that Brown & Martin was entitled to rescission and that the City could not retain the bid bond.[10] First, the court decided that the $68,900 computation error, which constituted 11.7% of the total bid, was a substantial mistake "and that enforcement of the contract would work a great wrong on Brown & Martin."[11] Second, the court found that Brown & Martin's prompt notification to the City allowed the City to return to the *status quo ante*.[12] When Brown & Martin refused to execute the contract, the City simply awarded the contract to the next lowest bidder.[13]

The court made these determinations despite bid instructions that prohibited the withdrawal of bids after the bid opening.[14] In support of its decision not to enforce this provision, the court cited to cases from several other courts that had found similar instructions "ineffective to prevent withdrawal or rescission where such relief is otherwise legally

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6. *Id.* at 1039.

7. *Id.* (citing Scott v. Mid Carolina Homes, Inc., 293 S.C. 191, 199, 359 S.E.2d 291, 296 (Ct. App. 1987), *overruled on other grounds*, Ward v. Dick Dyer & Assocs., Inc., 403 S.E.2d 310 (S.C. 1991); King v. Oxford, 282 S.C. 307, 313, 318 S.E.2d 125, 128-29 (Ct. App. 1984); Jumper v. Queen Mab Lumber Co., 115 S.C. 452, 458-59, 106 S.E. 473, 475 (1921)).

8. *Id.* at 1040.

9. *Id.* at 1039 (citing Annotation, *Right of Bidder for State or Municipal Contract to Rescind Bid on Ground That Bid Was Based upon His Own Mistake or That of His Employee*, 2 A.L.R.4TH 991, 1003-1021, 1029-1038 (1980)).

10. *Id.* at 1040.

11. *Id.*

12. *Id.*

13. *Id.*

14. *Id.* & n.9.

justified."[15] Having reached these conclusions, the court granted summary judgment to National and to Brown & Martin.[16]

In a subsequent motion to alter or amend the decision, the City asserted that Brown & Martin's mistake resulted from negligence, and therefore, the company was not entitled to equitable relief under South Carolina law.[17] The City relied heavily on the 1883 case of *Kennerty v. Etiwan Phosphate Co.*,[18] which states that equitable relief is unavailable to a party who enters a contract based on a mistaken belief if the mistake was caused "solely by the negligence or inattention of [that] party" and not because of any fault of the other contracting party, "except under very strong and extraordinary circumstances, showing imbecility or something which would make it a great wrong to enforce the agreement."[19]

The district court distinguished *Kennerty* on two grounds. First, the court noted that "the *Kennerty* court did not hold that a contracting party's negligence bars equitable relief under all circumstances."[20] Second, the court pointed out that the plaintiff in *Kennerty* sought reformation, not rescission—a distinction the *Kennerty* court also noted.[21] The *Brown & Martin* court then cited *Hester v. New Amsterdam Casualty Co.*[22] for the proposition that a court may grant rescission, depending on the circumstances, for a unilateral mistake even if the mistaken party is negligent.[23] Most jurisdictions that have addressed the issue allow relief from a bid for unilateral mistake under certain circumstances.[24] Courts differ, however, on the standard of care a bidder must exercise before rescission is appropriate. Some states require only that the mistake not result from " 'a failure to act in good faith and in accordance with reasonable standards of fair dealing.' "[25]

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15. *Id.* (citations omitted).
16. *Id.* at 1041.
17. *Id.* (on motion to alter or amend).
18. 21 S.C. 226 (1884).
19. *Id.* at 235.
20. *Brown & Martin*, 726 F. Supp. at 1041 (on motion to alter or amend).
21. *Id.* (citing *Kennerty*, 21 S.C. at 239).
22. 268 F. Supp. 623 (D.S.C. 1967).
23. *Brown & Martin*, 726 F. Supp. at 1041-42 (citing *Hester*, 268 F. Supp. at 630).
24. *Id.* at 1039 (citing Annotation, *supra* note 9, at 1003-21, 1029-38); *see, e.g.*, Elsinore Union Elementary School Dist. v. Kastorff, 54 Cal. 2d 380, 353 P.2d 713, 6 Cal. Rptr. 1 (1960); Regional School Dist. No. 4 v. United Pac. Ins. Co., 4 Conn. App. 175, 493 A.2d 895, *cert. denied*, 196 Conn. 813, 494 A.2d 907 (1985); First Baptist Church v. Barber Contracting Co., 189 Ga. App. 804, 377 S.E.2d 717 (1989); Cataldo Constr. Co. v. County of Essex, 110 N.J. Super. 414, 265 A.2d 842 (Ch. Div. 1970); Arcon Constr. Co. v. State, 314 N.W.2d 303 (S.D. 1982).
25. Marana Unified School Dist. No. 6 v. Aetna Casualty & Sur. Co., 144 Ariz. 159, 165, 696 P.2d 711, 717 (Ct. App. 1984) (quoting RESTATEMENT (SECOND) OF CONTRACTS § 157 (1979)), *review denied*, 144 Ariz. 159, 696 P.2d 711 (1985).

Some require that the mistake "not have come about because of the violation of a positive legal duty or from culpable negligence."[26] Others require that the mistake have "occurred notwithstanding the exercise of reasonable care."[27] On the other hand, a few jurisdictions preclude rescission of contracts that involve any unilateral mistakes in the bidding context.[28]

The *Brown & Martin* court did not explicitly define the standard of care it applied. The court acknowledged that erroneous bids "usually involve some degree of negligence," but decided "that the bidder's lack of care *vel non* should not necessarily determine its right to relief."[29] This statement suggests that only gross negligence or willful misconduct by a bidder will lead to an automatic denial of relief for a unilateral mistake.

The *Brown & Martin* approach to unilateral mistakes in bids appears to be designed to maintain the integrity of South Carolina's competitive bidding practice. The requirements for a successful claim ensure that bidders will not be allowed to rescind contracts for minor errors. The requirement of substantial loss protects the nonmistaken party against rescission for minor errors without penalizing bidders for inadvertent mistakes. As one court noted, "It is not in the public interest to hold a bidder to a contract which would compel performance at a substantial loss due to a serious error in his bid proposal."[30]

In conclusion, the district court held that a bidder is entitled to rescission of a contract and return of its bid bond when a computation error is so substantial that enforcement would work a great wrong, provided that the bidder gives notice to the nonmistaken party before that party has significantly changed its position. The court made this decision notwithstanding bid instructions that prohibited the withdrawal of bids after bid opening. The court did not explicitly state what standard of care a bidder must exercise in preparing the bid in order to be entitled to relief, but it implied that only bidders guilty of gross negli-

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26. Baltimore v. DeLuca-Davis Constr. Co., 210 Md. 518, 527, 124 A.2d 557, 562 (1956).

27. Wil-Fred's Inc. v. Metropolitan Sanitary Dist., 57 Ill. App. 3d 16, 21, 372 N.E.2d 946, 951 (1978).

28. *See* John J. Bowes Co. v. Inhabitants of Milton, 255 Mass. 228, 233-34, 151 N.E. 116, 118 (1926); Board of Educ. v. Sever-Williams Co., 22 Ohio St. 2d 107, 113-14, 258 N.E.2d 605, 609-10, *cert. denied*, 400 U.S. 916 (1970); Colella v. Allegheny County, 391 Pa. 103, 108, 137 A.2d 265, 268 (1958).

29. National Fire Ins. Co. v. Brown & Martin Co., 726 F. Supp. 1036, 1039 n.8 (D.S.C. 1989) (citations omitted), *aff'd mem.*, 907 F.2d 1139 (4th Cir. 1990).

30. Edward D. Lord, Inc. v. Municipal Utils. Auth., 133 N.J. Super. 503, 508, 337 A.2d 621, 623 (App. Div. 1975).

gence or willful misconduct should automatically be denied relief.

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II. COURT APPLIES RECENTLY ADOPTED STANDARD THAT LOST PROFITS MUST BE ESTABLISHED WITH REASONABLE CERTAINTY IN BREACH OF CONTRACT ACTIONS INVOLVING CONTEMPLATED BUSINESSES

In *South Carolina Federal Savings Bank v. Thornton-Crosby Development Co.*[31] the South Carolina Court of Appeals affirmed a special damages award arising from the breach of a construction contract for a new business venture. The special damages were for lost profits, loss of investment, and the amount of a deficiency judgment.

Simply because a business has not begun operations no longer precludes recovery for lost profits in South Carolina, but instead gives rise to an evidentiary requirement that damages be proved with reasonable certainty.[32] An injured party may recover the lost profits of a new business if the lost profits are a natural consequence of the breach, are foreseeable, and can be established with reasonable certainty.[33]

In *Thornton-Crosby* the issue of recovery of special damages for lost profits, loss of investment, and a deficiency judgment on a construction loan arose after the breach of a construction contract. Thornton-Crosby Development Company (Thornton-Crosby) contracted with T.R. Tucker Construction Company (Tucker) to build a condominium complex in Garden City, South Carolina. After numerous construction delays, Tucker cosigned Thornton-Crosby's construction loan to induce the lender to extend the loan period. A few months later Tucker abandoned the project. It abandoned the incomplete project almost eleven months after the completion date called for in the contract because

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31. 399 S.E.2d 8 (S.C. Ct. App. 1990).

32. Drews Co. v. Ledwith-Wolfe Assocs., Inc., 296 S.C. 207, 213, 371 S.E.2d 532, 535-36 (1988) (citing South Carolina Fin. Corp. v. West Side Fin. Co., 236 S.C. 109, 122, 113 S.E.2d 329, 336 (1960)). The *Drews* court placed South Carolina among a growing number of jurisdictions that follow this approach. *See* Note, *The New Business Rule and the Denial of Lost Profits*, 48 OHIO L.J. 855, 868-74 (1987). For an analysis of the developments leading up to South Carolina's transition to the evidentiary use of the new business rule, see *Annual Survey of South Carolina Law, "New Business Rule" No Longer a Per Se Rule of Nonrecoverability of Lost Profits*, 41 S.C.L. REV. 195 (1989). This rule traditionally barred recovery of lost profits for new businesses on the ground that these profits were speculative. *See, e.g., Drews*, 296 S.C. at 210, 371 S.E.2d at 534 (" 'When a business is in contemplation, but not established or not in actual operation, profit merely hoped for is too uncertain and conjectural to be considered.' ") (quoting Standard Supply Co. v. Carter & Harris, 81 S.C. 181, 186-87, 62 S.E. 150, 152 (1908)).

33. *Drews*, 296 S.C. at 213, 371 S.E.2d at 535-36.

Thornton-Crosby was financially unable to perform.[34]

The lender sued to foreclose its mortgage on the project and named both Thornton-Crosby and Tucker as defendants. Thornton-Crosby crossclaimed against Tucker for breach of the construction contract, and Tucker responded in kind. The lender prevailed in its foreclosure action, which resulted in a deficiency judgment against Thornton-Crosby and Tucker. Thornton-Crosby prevailed on its contract claims against Tucker. Tucker appealed.[35]

The court of appeals affirmed. Relying on testimony offered by Tucker's own expert, the court concluded that Thornton-Crosby had established the amount of lost profits with reasonable certainty.[36] The court found that the lost profits were a natural consequence of Tucker's breach and were reasonably foreseeable at the time the parties contracted.[37] The court also decided that damages for the deficiency judgment rendered against Thornton-Crosby in the mortgage foreclosure action were a recoverable element of special damages.[38]

In addition to challenging the award as an improper element of special damages, Tucker also argued that Thornton-Crosby should not recover for the deficiency judgment because then Tucker might "have to pay the deficiency judgment twice, while Thornton-Crosby pays nothing at all."[39] Tucker assumed that this result could occur if Thornton-Crosby did not apply the damages award to satisfy the entire deficiency judgment because Tucker would still be liable on the debt.[40]

The court rejected Tucker's argument because it was "based on speculation and a mistaken legal conclusion."[41] The court noted that no evidence supported Tucker's assumption that Thornton-Crosby would not pay the entire deficiency or that the bank would attempt to collect the debt from Tucker.[42] The court also noted that if the lender instituted an action against Tucker, the company would have recourse to avoid paying the amount of the deficiency twice.[43] The court concluded that Tucker had "overlook[ed] a critical point: by seeking the

34. *Thornton-Crosby*, 399 S.E.2d at 10.
35. *Id.*
36. *Id.* at 11-12.
37. *See id.* at 12.
38. *Id.*
39. *Id.*
40. *Id.*
41. *Id.* at 13.
42. *Id.*
43. *Id.*

full amount of the deficiency as contractual damages, Thornton-Crosby has necessarily bound itself to pay the entire deficiency."[44]

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44. *Id.*