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OBLIGATIONS OF TENDERERS AND BID BONDS IN CANADA

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A party's obligation to follow through with a contract when its tender has been accepted has proven to be a problematic matter in Canada. This issue has arisen most often with respect to alleged forfeitures under bid bonds that provide for payment of a penal sum if a tenderer does not honour its tender. In *The Queen (Ontario) v. Ron Engineering & Construction (Eastern) Ltd.*[1] the Supreme Court of Canada finally bestowed some clarity in an area that previously had been characterized by confusion and contradiction. American lawyers might wish to compare the Canadian approach to that taken by the Supreme Court of California in *Drennan v. Star Paving Co.*[2]

The impact of *Ron Engineering* on the law of bid bonds must be evaluated against a background of the older case law. Bid bonds have been the subject of several Canadian decisions that recognize that the bid bond works a forfeiture and that circumstances may exist in which equity must step in and relieve against forfeiture.

Canadian case law predates the widespread use of modern bid bonds. The first case was *Brandon Construction Co. v. Saskatoon School Board*,[3] a trial decision in the Saskatchewan Supreme Court. The tenderer, Brandon Construction (Brandon), made a cash deposit with its tender as a gesture of good faith. In fact, the tender documents referred to the contractor's cash deposit as a "guarantee of good faith."[4] The court interpreted these words to mean that the tender was made in good faith and that if this tender was accepted, the tenderer would enter into

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1. [1981] 1 S.C.R. 111 (Can.).
2. 2.51 Cal. 2d 409, 333 P.2d 757 (1958).
3. [1912] 5 D.L.R. 754 (Sask. S. Ct.).
4. *Id.* at 756.

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the necessary contract. According to the court, the contract language meant that if the tender was accepted but the tenderer refused to enter into a contract, then the deposit would be forfeited to the school board.[5]

The problem that eventually came before the court in *Brandon* was discovered by the tenderer only when his bid was accepted. Brandon recalculated its tender price and found that it could not complete the contract at a profit, and, therefore, sought to withdraw its tender.

The school board declared that the construction company had forfeited the deposit, and Brandon sued for its recovery. At trial the court dismissed the plaintiff's action, but on appeal Brandon persuaded the court that its deposit in reality was a penalty, as opposed to a genuine pre-estimate of damages. Therefore, the school board could not keep the deposit. The court would have allowed the forfeiture only if satisfied that the amount of the deposit was a genuine pre-estimate of the school board's damages.[6] Throughout the early cases, courts persisted in treating bid deposits as forfeitures requiring equitable relief.

The advent of compensated suretyship in the Canadian marketplace compelled use of the bid bond. This bond provided for payment of the lesser of either (1) the penal sum stated in the bond or (2) the difference in contract values between the bonded tender and the next accepted tender. The bid bond was successful in avoiding the law against penalties because its wording contemplated payment of the actual damages sustained by the owner, with the penal sum as an upper limit or "upset amount."

In *Hamilton Board of Education v. U.S.F. & G.*[7] a bid bond was before the court. The outbreak of the Korean War had intervened between preparation of the contractor's tender and its acceptance, thereby escalating all labour and material prices by 7% to 15% and leaving the tenderer with an unavoidable $50,000 loss before he even began construction.[8] Learning of this loss, the contractor notified the owner that the tender was with-

5. *Id.* at 757.

6. *See* Ron Eng'g & Constr. E. Ltd. v. The Queen (Ont.), 24 O.R.2d 332 (Ct. App. 1979).

7. [1960] O.R. 594 (High Ct. of Justice).

8. *Id.* at 597.

drawn. The board immediately called upon the bid bond, but the surety denied liability. The court concluded that the ordinary rules of contract law applied in the case of construction contracts and that a tender, therefore, was merely an offer subject to acceptance. The tender, as an offer, could be withdrawn at any time prior to acceptance.[9] The court also held that the bid bond had no validity apart from the tender it supported; consequently, only if a tender was accepted in accordance with the laws applying to all contracts could the bond properly be called on.[10]

In *Hamilton Board of Education* the tender or offer had been nullified by withdrawal before the owner could have accepted it. Thus, the owner could not properly claim on the bid bond — notwithstanding the fact that on its face, the withdrawal appeared to be the very event upon which the bond was conditioned.

Subsequent to *Hamilton Board of Education* further refinement in the law of bid bonds occurred in *Belle River Community Arena Inc. v. W.J.C. Kaufmann Co.*,[11] a decision authored by Mr. Justice Southey in the Trial Division of the Supreme Court of Ontario. In this case, after having submitted its tender to the owner, the contractor discovered that it had missed one of seventy-five "summary sheets"[12] used in preparing its tender. The result was that the $600,000 tender was more than $70,800 below its intended value.[13] Perhaps aware of the *Hamilton Board of Education* decision, the owner attempted to take advantage of the contractor's error by accepting the tender even after notice of the error. Thereafter, the owner commenced an action upon the bid bond. The owner further cemented its position by immediately entering into a formal contract with the next highest bidder.[14]

In the course of reaching a decision on the various issues of the case, the trial judge carefully considered the various steps that an obligee should take as a condition precedent to making a

9. *Id.* at 599.
10. *Id.*
11. 15 O.R.2d 738 (High Ct. of Justice), *appeal dismissed*, 20 O.R.2d 447 (Ct. App. 1978).
12. *Id.* at 740.
13. *Id.*
14. *Id.* at 740-41.

valid claim on a bid bond. The condition of the particular bid bond in the *Belle River* case was as follows:

> NOW, THEREFORE, THE CONDITION OF THIS OBLIGATION is such that if the aforesaid Principal (Kaufman) shall have the tender accepted within sixty (60) days from the closing date of tender and the said Principal will, within the time required, enter into a formal contract and give the specified security to secure the performance of the terms and conditions of the Contract, then this obligation shall be null and void; otherwise the Principal and the Surety will pay unto the Obligee the difference in money between the amount of the bid of the said Principal and the amount for which the Obligee legally contracts with another party to perform the work if the latter amount be in excess of the former.[15]

The court held that in order to make a claim on the bid bond, the obligee-owner needed to obtain an unequivocal refusal from the tenderer before expiration of the sixty-day period that the tender stipulated for acceptance.[16] Because the contractor had not been presented a contract for unequivocal refusal, the court denied the claim against the bonding company.

These decisions must now be read together with the Supreme Court of Canada decision in *Ron Engineering*.[17] In this case, Ron Engineering had delivered a $150,000 cash deposit with its tender of $2,748,000. After submitting its tender, the contractor discovered that it had failed to include a $750,000 item for "own force's" work.[18] The information for tenderers stipulated the following:

> Except as otherwise herein provided the tenderer guarantees that if his tender is withdrawn before the Commission shall have considered the tenders or before or after he has been notified that his tender has been recommended to the Commission for acceptance or that if the Commission does not for any reason receive within a period of seven days as stipulated and as required herein, the Agreement executed by the tenderer, the Performance Bond and the Payment Bond executed by the tenderer and the surety company and the other documents re-

15. *Id.* at 744.
16. *Id.*
17. [1981] 1 S.C.R. 111 (Can.).
18. *Id.* at 114-15.

quired herein, the Commission may retain the tender deposit for the use of the Commission and may accept any tender, advertise for new tenders, negotiate a contract or not accept any tender as the Commission may deem advisable.[19]

In *Ron Engineering*, however, the owner did not make the same mistake as the owner had in the *Belle River* case. Immediately after being notified of the tenderer's mistake, the owner in *Ron Engineering* attempted to protect its position with respect to the bid deposit by presenting to Ron Engineering a contract in the prescribed form for execution. Particularly noteworthy is the fact that the owner did not execute the contract before presenting it to Ron Engineering; the court, however, did not base its decision on this issue. Since the "Information for Tenderers" in the construction contract did not require the owner to execute the contract before presentment to the tenderer, the court held this fact to be irrelevant.[20]

In accordance with earlier decisions, the Ontario Court of Appeal held that the owner could not accept a tender after it was informed that the tender was mistaken in some fundamental term.[21] On this point, however, the Supreme Court of Canada overturned the Ontario Court of Appeal. The court noted a provision in the information for tenderers, which provided that the tenderer could not withdraw its tender for a period of sixty days after submission without also forfeiting its bid deposit.[22] Ron Engineering had taken the interesting position in every court below that it had *not* withdrawn its tender[23] but, rather, that the owner's knowledge of a mistake in a fundamental term of the tender prevented him from accepting the tender.[24]

Justice Estey for the Supreme Court of Canada held that this provision in the information for tenderers created a separate and unilateral contract, which he termed "contract A," arising upon the very submission of a tender. The court recognized the existence of a practice in the construction industry, as distinct from other commercial situations, and formulated the following

19. *Id.* at 113-14.
20. *Id.* at 118-19.
21. *Id.* at 117.
22. *Id.* at 113-14.
23. *Id.* at 120.
24. *Id.* at 116.

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restatement of the position of an obligee respecting the bid deposit:

> The test, in my respectful view, must be imposed at the time the tender is submitted and not at some later date after a demonstration by the tenderer of a calculation error. Contract A (being the contract arising forthwith upon the submission of the tender) comes into being forthwith and without further formality upon the submission of the tender. If the tenderer has committed an error in the calculation leading to the tender submitted with the tender deposit, and at least in those circumstances where at that moment the tender is capable of acceptance in law, the rights of the parties under contract A have thereupon crystallized. The tender deposit, designed to ensure the performance of the obligations of the tenderer under contract A, must therefore stand exposed to the risk of forfeiture upon the breach of those obligations by the tenderer. Where the conduct of the tenderer might indeed expose him to other claims in damages by the owner, the tender deposit might well be the lesser pain to be suffered by reason of the error in the preparation of the tender.[25]

The "contract A" analysis used in *Ron Engineering* has been followed in *Gloge Heating & Plumbing Ltd. v. Northern Construction Co.*[26] and *Town of Slave Lake v. Appleton Construction Ltd.*[27] The Supreme Court of Canada reaffirmed this analysis in *Northern Construction Co. v. City of Calgary.*[28] In *Calgary* the trial judge followed the principle set out in the *Belle River* decision that an unequivocable refusal to enter the contract is a prerequisite to claim the bid bond. The Alberta Court of Appeal, in a divided decision, overturned the trial judgment; the Supreme Court, citing the "contract A" approach of *Ron Engineering*, upheld this decision.[29]

The Canadian approach as set down in *Ron Engineering* should be compared with that taken by the Supreme Court of California in *Drennan.* In *Drennan* a paying subcontractor attempted to revoke a tender upon which a general contractor had relied in successfully obtaining a contract to build a school. The

25. *Id.* at 121-22.
26. 27 D.L.R.4th 264 (Alta. Ct. App. 1986).
27. 53 A.L.R.2d 177 (Alta. Q.B. 1987).
28. [1987] 2 S.C.R. 757 (Can.).
29. *Id.* at 758.

tender was silent as to the subcontractor's right of revocation. The subcontractor however, contended that the tender was a result of a mistake and that it was entitled to revoke the tender. The court found for the general contractor in an action for damages, ruling that the general contractor's reasonable reliance on the tender made it irrevocable.

In reaching its decision, the court cited section 90 of the *Restatement of Contracts*: "A promise which the promisor should reasonably expect to induce action or forebearance of a definite and substantial character on the part of the promisee and which does induce such action or forebearance is binding if injustice can be avoided only by enforcement of the promise."[30]

The court concluded that the subcontractor had reason not only to expect that the general contractor would rely on its tender, but also to desire that the general contractor should do so.[31] In coming to this conclusion, the court considered whether the subcontractor had a duty to be careful in preparing its tender due to the foreseeable harm that the general contractor would suffer if its tender turned out to be mistakenly produced. Although not determining whether damages for such negligence might be recoverable, the court did apply these considerations in concluding that the general contractor was within the protection of the doctrine expressed in section 90 of the *Restatement of Contracts*.[32]

The court also considered whether an implied term of revocation existed in the circumstances, but found that this was not the case. In its reasoning on this point, the court drew analogy to section 45 of the *Restatement of Contracts*,[33] which concerns offers for unilateral contracts. According to section 45, unilateral contracts include subsidiary promises that prevent revocation of an offer after an offeree has acted in detrimental reliance upon the offer.[34]

A comparison of *Ron Engineering* and *Drennan* is instructive. The Supreme Court of Canada also referred to the doctrine of unilateral contracts in its decision, but in a different manner

30. RESTATEMENT OF CONTRACTS § 90 (1932) [hereinafter *Restatement*].
31. 51 Cal. 2d at __, 761 P.2d at 760.
32. *Id.*
33. RESTATEMENT, *supra* note 30, § 45.
34. *Id.*

than did the Supreme Court of California. In *Ron Engineering* the offer in the unilateral contract was made by the owner; the tenderer accepted the offer to bring contract A into existence. In *Drennan* the analogy was such that the subcontractor was the offeror, and thereby under the doctrine of section 90 of the *Restatement of Contracts*,[35] reasonable reliance would make the offer irrevocable.[36]

Contrast this with the contract A approach in *Ron Engineering*, whereby the Supreme Court of Canada found submission of the tender to crystallize a contract distinct from the contract that was to govern the actual contemplated construction. Experience will show whether the construction bidding process in Canada has been served well by a legalistic approach that apparently supplants a notions of fairness and reasonable reliance, the cornerstones of *Drennan*.

35. RESTATEMENT *supra* note 30, § 90.
36. 51 Cal. 2d at ___, 761 P.2d at 760.