

PUBLIC CONTRACT BASED ON MATERIALLY NONRESPONSIVE BID REVISED AFTER BID OPENING IS VOID

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1. The Valley Crest Landscape Case

In *Valley Crest Landscape, Inc. v. City Council and City of Davis*, 41 Cal. App. 4th 1432 (1996), the court reaffirmed the basic public contracting principle that bids for public works projects must strictly comply with material requirements in the invitation for bids. The court found that a bid mistake rendered a bid materially nonresponsive and ineligible for award and declared that a contract based on "corrected" bid information was void. In declaring the contract void, the court was unmoved by the fact that the contractor had substantially completed the project. This case illustrates the risk to contractors from a failure to strictly follow public contracting procedures, which can cause invalidation of an awarded contract.

(a) The Facts.

The City of Davis solicited bids for the construction of a park. North Bay Construction ("North Bay") submitted the lowest monetary bid, but its bid providing for 83 percent subcontracted work violated the City's standard specification that the prime contractor perform at least 50 percent of the work. Valley Crest Landscape, Inc. ("Valley Crest"), which had submitted a fully responsive bid, protested North Bay's bid as nonresponsive. After bid opening, the City contacted North Bay about the material deviation and advised that the bid would be deemed nonresponsive. North Bay responded that its bid was erroneous and provided what it claimed were the "actual subcontractor percentages" totaling 44.65 percent. Purporting to waive a minor bid irregularity, the City awarded the contract to North Bay based on the revised bid.

Valley Crest immediately put the City and North Bay on notice that North Bay's bid was ineligible for award, that any contract awarded thereon would be void, and that if the City and North Bay proceeded with contract performance, North Bay would act at its own risk because it was barred by case law and the California Constitution from receiving any compensation. Valley Crest then filed a petition for a writ of mandate, a writ of administrative mandamus and declaratory and injunctive relief. Among other relief, Valley Crest sought a declaration that the contract was void, an order prohibiting any performance, including payment, and an order compelling the recovery of any contract payments already made. The trial court denied the relief sought and entered judgment in favor of the City and North Bay.

**PUBLIC CONTRACT BASED ON MATERIALLY NONRESPONSIVE BID
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(b) The Appellate Court's Decision.

Valley Crest appealed the trial court's decision, arguing that North Bay's bid revision after bid opening violated the bid mistake statutes. *Pub. Contract Code* sections 5101 and 5105. The City and North Bay responded that the City merely had waived a minor irregularity in North Bay's bid. The appellate court agreed with Valley Crest's arguments and reversed. The court held that the subcontractor percentage requirement was a material element of the bid, and thus North Bay could not change its bid to correct the mistake in stating the percentages. The Court of Appeals found that "the doctrine that inconsequential irregularities may be waived does not permit this change in the subcontractor percentages." The court explained that waivers of minor irregularities are permitted only when the bidder is not given an unfair advantage by being allowed to withdraw its bid without forfeiting its bid bond. North Bay's claimed mistake was the type of mistake which would have entitled North Bay to seek relief from its bid because it made the bid materially different than intended and occurred in completing the bid. Since North Bay had the right to be relieved of its bid, it had a benefit not available to other bidders; "it could have backed out. Its mistake, therefore, could not be corrected by waiving an 'irregularity.'" Accordingly, the court held that the City "could not permit the mistake as to [a] material element of the bid to be corrected by purporting to waive an irregularity. Since North Bay's uncorrected bid was nonresponsive, its contract is invalid." *Valley Crest Landscape*, 41 Cal. App. 4th at 1443. The case was then remanded to the trial court for issuance of "corrective orders in conformity" with the opinion.

At the time the Court of Appeal issued its decision, the contract was approximately 98 percent complete. Of the adjusted contract price of \$4.1 million, all but approximately \$700,000 had been paid to North Bay. In petitions for rehearing, North Bay and the City challenged the court's finding of the contract as void. They asserted that the conclusion could trigger the line of cases prohibiting contractors from receiving any compensation for performing void contracts. They argued that those cases should not apply when there has been a defect in the bidding process, as opposed to an absence of competitive bidding. The appellate court denied the petitions and modified its opinion to state that it was not expressing any opinion on North Bay's entitlement to payment in quasi-contract or on some other theory for the reasonable value of its labor and materials, though citing the cases which prohibit payments on void public contracts.

On April 18, 1996, the California Supreme Court denied requests to depublish the opinion.

(c) Proceedings After Remand

After the case was remanded to the trial court, the City and North Bay moved to permit the City to pay North Bay for the reasonable value of work completed to date and to retain North Bay to complete the project. They relied upon theories of quantum meruit and equitable estoppel. Valley Crest opposed those motions and moved for leave to amend its writ petition to assert a claim for damages. The case now has been settled.

2. **The Effect of the Decision**

(a) Application of the Bid Mistake Statutes Where Mistake was not in Bid Price

Initially, the *Valley Crest* decision is important because it is the first published decision to hold that the bid mistake statutes are not limited to mistakes in bid price. While not in any way stating that the statutes are limited to mistakes in bid price, each of the prior published decisions involved facts where the mistake was in the price. Noting this history, the *Valley Crest* court stated:

Section 5103 [of the Public Contract Code] does not provide the mistake must be in the price, only that it makes the bid materially different than intended and be a mistake in filling out the bid. (*Pub. Contract Code*, section 5103, subds. (c) and (d).) As this case shows, there can be factors other than price which are material to the bid. Here the requirement that the prime contractor perform at least 50 percent of the work was such a factor.

Valley Crest, 41 Cal. App. 4th at 1442.

(b) Voiding Public Contract for Violation of Competitive Bidding Laws Despite Substantial Completion of the Project

Of greater importance, the case confirms the willingness of courts to find contracts awarded based on a defect in the bidding process void, notwithstanding substantial completion of the project. The potential effect of such a result is that a contractor which performs an improperly awarded public contract could be forced to return all monies received. This result is based on more than 130 years of California Supreme Court precedent, as well as the California Constitution, precluding all payments on contracts violating the competitive bidding laws. The theory advanced for a contrary result is that a distinction should be drawn between a defect in the competitive bidding process and an absence of competitive bidding, and this distinction warrants payment to the contract awardee under quantum meruit or equitable estoppel.

1. Quantum Meruit

As stated in *Konica Business Machines U.S.A., Inc. v. Regents of University of California*, 206 Cal. App. 3d 449 (1988):

The purpose of requiring governmental entities to open the contracts process to public bidding is to eliminate favoritism, fraud and corruption; avoid misuse of public funds; and stimulate advantageous market place competition. [Citations, including *Miller v. McKinnon*, 20 Cal. 2d 83, 88 (1942).] Because of the potential for abuse arising from deviations from strict adherence to standards which promote these public benefits, **the letting of public contracts universally receives close judicial scrutiny and contracts awarded without strict compliance with bidding requirements will be set aside**. This preventative approach is applied even where it is certain there was in fact no corruption or adverse effect upon the bidding process, and the deviations would save the entity money. [Citations, including *Miller v. McKinnon*.] The importance of maintaining integrity in government and the ease with which policy goals underlying the requirement for open

**PUBLIC CONTRACT BASED ON MATERIALLY NONRESPONSIVE BID
REVISED AFTER BID OPENING IS VOID**

competitive bidding may be surreptitiously undercut, mandate strict compliance with bidding requirements.

Id., at 456-457 (emphasis added). Given these policies of the competitive bidding laws, the California Constitution and case law prohibit any payment on a contract made in violation of those laws. Cal. Const. art. 11, section 10; *Miller v. McKinnon*, 20 Cal.2d 83 (1942); *Reams v. Cooley*, 171 Cal. 150 (1915); *Zottman v. San Francisco*, 20 Cal. 96 (1862). This law does not support a distinction between cases where there was a defect in the bidding process, as opposed to an absence of competitive bidding. It is settled law that no payments of any kind can be made where the agency was without authority to make the contract. Cal. Const. a. 11, section 10. As explained by the California Supreme Court in *Miller v. McKinnon*, citing its earlier decision in *Reams v. Cooley*, 171 Cal. 150, when a statute prescribes the method of contracting, a contract made in violation of the statutorily prescribed mode is void and no liability under quantum meruit can arise:

"Under such circumstances the express contract attempted to be made is not invalid merely by reason of some irregularity or some invalidity in the exercise of a general power to contract, but the contract is void because the statute prescribes the only method in which a valid contract can be made, and the adoption of the prescribed mode is a jurisdictional prerequisite to the exercise of the power to contract at all and can be exercised in no other manner so as to incur any liability on the part of the municipality. Where the statute prescribes the only mode by which the power to contract shall be exercised, the mode is the measure of the power. A contract made otherwise than as so prescribed is not binding or obligatory as a contract and the doctrine of implied liability has no application in such cases."

Id. at 92-93, some emphasis added. See also *Zottman v. San Francisco*, 20 Cal. at 102 (where the mode describing how to contract is prescribed, that mode is the measure of the power and must be followed; "[a]side from the mode designated, there is a want of all power on the subject"). The supreme court held that not only is the contractor precluded from recovery under quantum meruit for the value of services rendered, but indeed is required to return any payments received. *Miller v. McKinnon* at 88-92. The rationale is twofold. First, the competitive bidding laws are designed to protect against "fraud, corruption, and carelessness on the part of public officials and the waste and dissipation of public funds." *Id.* at 88. Second, persons contracting with public agencies are presumed to know the laws regarding bidding, and if a contractor performs an invalid contract, that contractor is merely a volunteer acting at its peril. *Id.* at 89.

Applying these principles precludes recovery by a contractor which was not entitled to the contract award due to a material defect in the bidding process. Public Contract Code section 20162 requires all contracts for public projects in excess of \$5000 to be "let to the lowest responsible bidder after notice." This statute prescribes the only method by which a valid public works contract can be made. Thus, it is a "jurisdictional prerequisite to the exercise of the power to contract", and the prescribed mode "is the measure of the power." *Miller v. McKinnon* at 91-92. When, as a result of either a defect in the bidding process or on an absence of competitive bidding, the contract is awarded to one other than the lowest responsible bidder, the award violates the prescribed mode and thus the public agency lacks all authority to make the contract.

**PUBLIC CONTRACT BASED ON MATERIALLY NONRESPONSIVE BID
REVISED AFTER BID OPENING IS VOID**

Therefore, there can be no right of recovery under quantum meruit for the value of services rendered.

In *Greer v. Hitchcock*, 271 Cal. App. 2d 334 (1969), the court applied precisely this analysis in an action involving a defect in the bidding process. There, the low bidder sought to raise its bid price after bid opening, claiming mistake. The public entity denied the revision, awarded the contract based on the original bid, changed its mind and purported to award a new contract to the bidder based on the revised bid. Though the original contract was proper, the court held the second contract void and disallowed any payment thereon, including on theories of quantum meruit, ratification and/or estoppel, because the contract violated the statutory requirement that contracts be let only to the lowest responsible bidder. *Id.* at 336-337.

Konica Business Machines U.S.A., Inc. v. Regents of University of California, 206 Cal. App. 3d 449 (1988) is not authority for a different result. Though the Court of Appeal there posited a question about applying the void contract rule where there was a defect in bidding process, as opposed to an absence of competitive bidding, the court expressly declined to decide, and therefore the case is not authority on this issue. The court simply allowed, pending re-bid, a day-to-day relationship between the putative awardee and the Regents for the provision of services at the voided contract rate. The court did not authorize continued performance and payment under the void contract in contravention of supreme court and constitutional law.

Finally, allowing payment under quantum meruit would be contrary to the policies of the competitive bidding laws. Public agencies could award a contract in violation of the competitive bidding laws, have the work performed, pay the charges therefor, and then have the payments deemed proper under a theory of quantum meruit. The necessity of maintaining integrity in competitive bidding should preclude such a result.

2. Equitable Estoppel

Asserting hardship, the contract awardee could also argue that it should be compensated under the doctrine of equitable estoppel when it has performed under a contract subsequently declared void. However, to date the supreme court has found this argument also unpersuasive. As stated in *Reams v. Cooley*, 171 Cal. at 157, it "invariably" is argued that a "great hardship" will result if a public agency is allowed to retain the benefit of the contractor's work without compensating the contractor. But:

[T]he provision of the law limiting the power . . . to validly contract, except in a prescribed mode, proceeds from a consideration of public policy . . . adopted as the policy of the state . . . and it would be difficult to perceive what practical public benefit or result could accrue by legislative limitation or prohibition on the power of such bodies to contract if courts were to allow a recovery where the limitation or prohibition is disregarded.

Similarly, in *Zottman v. City and County of San Francisco*, 20 Cal at 104-105, the supreme court stated:

It may sometimes seem a hardship upon a contractor that all compensation for work done, etc. should be denied him; but it should be remembered that he ... when he deals in a

**PUBLIC CONTRACT BASED ON MATERIALLY NONRESPONSIVE BID
REVISED AFTER BID OPENING IS VOID**

matter expressly provided for in the charter, is bound to see that the charter is complied with. If he neglect this, or choose to take the hazard, he is a mere volunteer, and suffers only what he ought to have anticipated. If the statute forbids the contract which he has made, he know it, or ought to know it, before he places his money or services at hazard.

Miller v. McKinnon, 20 Cal. 2d at 89 too is in accord. After citing the above-quoted language in *Reams and Zottman*, the court stated that contractors are presumed to know the law with respect to the requirements of competitive bidding and act at their peril.

Given the rule that contracts which are beyond the power of the agency to make are void, the courts have held that equitable estoppel may not be invoked against the public agency to deny payment thereon, notwithstanding any hardship to the contractor. *Los Angeles Dredging Co. v. Long Beach*, 210 Cal. 348, 353 (1930); *County of San Diego v. Cal. Water etc. Co.*, 30 Cal. 2d 817, 825-826 (1947) (estoppel may not be invoked where mode is measure of power; not may it be invoked "where it would operate to defeat the effective operation of a policy adopted to protect the public"); *Paterson v. Board of Trustees*, 157 Cal. App. 2d at 820 (application of estoppel where mistake in bid "would be tantamount to specific enforcement of a void promise and contrary to both the policy and letter of the law"). Where, as in *Valley Crest*, the deviation from the public bidding laws here was not simply an "informality" in a contract that the City had the power to make but results in the award of the contract to one other than the lowest responsible bidder, the public agency has no power to make the contract. Thus, the principles of equitable estoppel should not be applicable.

3. Choices For Contractors

The obvious lesson from the *Valley Crest* decision is that contractors should take great care in bidding on public projects to ensure full compliance with all material terms. A fertile ground for error is when the bid documents include the 50 percent subcontracting limitation, either by incorporating the CalTrans standard specifications or expressly including such a specification. Given the last minute rush often associated with bidding, it is easy for bidders to misstate or overstate their subcontractor percentages and suddenly find themselves in the same position as North Bay.

Ghilotti Construction Co. v. City of Richmond, 45 Cal. App. 4th 897 (1996), rev. denied 8/28/96, suggests one possible solution: stand on the original bid but provide assurance that the subcontracting limitation can be complied with during performance without changing the bid price. That is precisely what the low bidder did there when its bid exceeded the 50 percent subcontracting limitation by 5.5 percent. The court found that since bid price was not affected, the deviation was immaterial and could be waived, especially since the contractor ultimately would comply with the specification. In light of *Valley Crest*, however, bidders should be careful about relying on this approach. In particular, if the bidder makes an error in its bid documents regarding the subcontractor percentages, arguably it has submitted a bid different from that intended. This could then permit the bidder to withdraw its bid without forfeiting its bid bond -- the unfair advantage the court found in *Valley Crest* and which precluded the City from waiving the deviation as immaterial.

**PUBLIC CONTRACT BASED ON MATERIALLY NONRESPONSIVE BID
REVISED AFTER BID OPENING IS VOID**

Another option when bid documents reference the subcontracting limitation is for bidders to ascertain definitively from the public agency before bid day whether the limitation is a bidding requirement or only a performance issue. If the latter, a mistake in listing the percentages in the bid may not be fatal. In summary, under the current law, contract awardees should proceed with great caution if performance is begun while a bid protest is pending because they may risk nonpayment.

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