# *Home Electric v. Hall & Underdown Heating & Air Conditioning:* Mutuality Remains the Only Solution to the Construction Bidding Problem

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In *Home Electric v. Hall & Underdown Heating & Air Conditioning*,[1] the Court of Appeals of North Carolina addressed the issue of whether a contractor could invoke the doctrine of promissory estoppel to recover damages from a subcontractor.[2] The contractor had orally promised to perform duct work but withdrew his bid after the contractor was awarded the overall contract, but before the contractor accepted the subcontractor's bid.[3] Nevertheless, the contractor alleged that it was entitled to recovery[4] because

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[1] 358 S.E.2d 539 (N.C. Ct. App. 1987).

[2] Id. at 540-42.

[3] Id. at 540. An offer to enter into a contract must contain sufficient material terms. E.g., Premier Elec. Const. Co. v. Miller-Davis Co., 291 F. Supp. 295, 299-300 (N.D. Ill. 1968), *aff'd*, 422 F.2d 1132, 1135-35 (7th Cir. 1970). *See* C.H. Leavell & Co. v. Grafe & Assoc., Inc., 414 P.2d 873 (Idaho 1966); 1 PAGE, Contracts § 27. *See also* Loranger Constr. Corp. v. E.F. Hauserman Co., 384 N.E.2d 176 (Mass. 1978) (jury could conclude that defendant's offer was intended to induce plaintiff's promise or action thereby warranting a conclusion that there was a "typical bargain" supported by consideration rendering resort to doctrine of promissory estoppel unnecessary).

[4] *Home Electric*, 358 S.E.2d at 540. In *Home Electric*, the contractor sought to recover $29,000, the difference between the subcontractor's bid price and the actual cost for the subcontract work.

the elements of promissory estoppel were satisfied.[5] Specifically, the contractor alleged that it had justifiably relied to its detriment on the subcontractor's bid in formulating its bid on the overall contract.[6] Under the promissory estoppel doctrine, this justifiable reliance makes the subcontractor's promise an irrevocable firm offer.[7] However, under the doctrine, the subcontractor

[5] Section 90 of the *Restatement Second of Contracts* provides that:

> A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.

[6] *Home Electric*, 358 S.E.2d at 540.

[7] *Id.* The doctrine of promissory estoppel renders a promise enforceable if the promisee reasonably and foreseeably relies on the promise, and if injustice otherwise cannot be avoided. *See* Henderson, Promissory Estoppel and Traditional Contract Doctrine, 78 YALE L.J. 346 (1969). Reasonable reliance serves to hold the promisor in lieu of the consideration ordinarily required to make an offer binding. *See* Drennan v. Star Paving Co., 51 Cal. 2d 409, 414, 333 P. 2d 757, 760 (1958). Some courts and commentators have argued that since subcontractors know their bids will be used, and because the subcontractors in fact depend on such use to gain entry into the contracting process, a contractor's reliance on a subcontractor's bid is justifiable. *See* Comment, *The Subcontractor's Bid: An Option Contract Arising Through Promissory Estoppel*, 34 EMORY

cannot mutually bind the offeree, the contractor.[8] Thus, the contractor is free to seek a lower bid from another subcontractor.[9]

The *Home Electric* court held that the contractor could not use the doctrine of promissory estoppel as a substitute for consideration when seeking affirmative relief.[10] The Court reasoned that promissory estoppel is unfair because, under that theory, a contractor has no obligation to award a contract to a subcontractor, yet a subcontractor, merely by placing a bid, is obligated to the contractor if the contractor decides to use the subcontractor.[11] Moreover,

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L.J. 421, 430-31 (1985). Other courts, however, have found a contractor's reliance to be unjustified. *See, e.g.*, Robert Gordon, Inc. v. Ingersoll-Rand Co., 117 F.2d 654, 660 (7th Cir. 1941) (subcontractor's bid was "glaringly low"). Of course, unilateral or mutual mistake would make a contractor's reliance unjustified. Some courts have required a contractor to introduce evidence of business practices in the community to prove that its reliance upon a subcontractor's bid was justified. *See id.* at 660.

[8] *See Home Electric* 358 S. E. 2d at 541.

[9] Mitchell v. Siqueiros, 582 P.2d 1074, 1081 (Idaho 1978) (Bistline, J., dissenting).

[10] *Id.*

[11] *Home Electric*, 358 S.E.2d at 542. Thus, the court distinguished using the doctrine of promissory estoppel for defensive relief from using the doctrine for affirmative relief. The court held that North Carolina law did not permit a plaintiff to use the doctrine of promissory estoppel

the court stated that contractors "can avoid this problem entirely by securing a contract with the contractor at the onset, conditioned on a successful bid.[12] Such a contract would create a unilateral contract at the time that the contractor is awarded the overall contract. [13] The contractor's act of obtaining the overall contract would be the bargained-for consideration given in exchange for, and envisioned by, the subcontractor's promise.[14]

It is highly unlikely that contractors will secure their contracts with subcontractors at the onset, conditioned on a successful bid.[15] Given the fact that only

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for affirmative relief. *Id.* Thus, the court rejected the Fourth Circuit's interpretation of North Carolina law in L&M Campbell Co., Gen. Contractors v. Virginia Metal Indust., 708 F.2d 930 (4th Cir. 1983), which held that a contractor could invoke the doctrine of promissory estoppel for affirmative relief from a subcontractor refusing to satisfy a bid.

[12] *Home Electric*, 358 S.E.2d at 542.

[13] *Id.*

[14] *See* James Baird Co. v. Gimbel Bros., 64 F.2d 344, 345 (2d cir. 1933).

[15] *Id.; see* C.H. Leavell & Co, v. Grafe & Assoc., Inc., 414 P. 2d 873, 877-78 (Idaho 1966). At a minimum, the subcontractor's offer must contain sufficient material terms such that it is reasonable for the contractor to begin performance, thereby forming a unilateral contract.

subcontractors are bound by the promissory estoppel doctrine, why would a contractor, which enjoys a superior bargaining position, bind itself at such an early stage of the bidding process if it can, virtually without the threat of liability,[16] shop around and almost always find a better price? Courts that permit contractors to use the doctrine of promissory estoppel effectively condone this "bid shopping" practice. "Bid shopping" occurs when a contractor, after being awarded the overall contract, uses a subcontractor's low bid as a tool in negotiating lower bids from other subcontractors.[17] Under the promissory estoppel doctrine, in every case the contractor is free to delay its acceptance of the lowest subcontractor bid for a period of time and re-open bargaining with other subcontractors.[18]

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[16] *See* Shultz, *The Firm Offer Puzzle: A Study of Business Practice in the Construction Industry*, 19 U. CHI. L. REV. 237, 270 (1952).

[17] *See infra* note 59.

[18] *See* J. SWEET, LEGAL ASPECTS OF ARCHITECTURE ENGINEERING AND THE CONSTRUCTION PROCESS § 32.02, at 728-29 (3d ed. 1985); Comment, *Construction Bidding Problem: Is There a Fair Solution to Both the General Contractor and Subcontractor,* 19 St. Louis U.L.J. 552, 564 (1975). "Bid peddling", on the other hand, is the practice whereby subcontractors attempt to undercut the bid prices of other subcontractors in order to get the job from the contractor. Usually, bid peddling is simply

If a contractor engages in bid shopping, the lowest bid given by the subcontractor provides the contractor with a protective ceiling on the cost of the work.[19] At the same time, a contractor can increase its profits by engaging in post-award negotiations by obtaining a better price.[20] If the contractor obtains a better price, it can accept the lower price, and the subcontractor which gave the initial lowest bid is without legal recourse to stop the contractor from accepting the post-award bid.[21] If the contractor does not find a better price, however, it can accept the lowest subcontractor bid.[22] If the subcontractor with the lowest bid refuses to perform, under the doctrine of promissory estoppel, the contractor may enforce the subcontractor's promise, which had served as the contractor's protective ceiling, by invoking the doctrine of promissory estoppel. The inequity created by the promissory estoppel doctrine

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the subcontractor's response to the bid shopping conducted by a contractor. Consequently, as far as this article is concerned, bid shopping and bid peddling may be treated as one.

[19] *Home Electric*, 358 S.E.2d at 542.

[20] *See* SWEET, *supra* note 18, at 728-29.

[21] *Id.*

[22] *Id.*

outweighs the benefit of the doctrine, namely protecting contractors from reneging subcontractors.[23] As a result of their superior bargaining position, contractors can easily protect themselves by securing a contract conditioned on a successful bid on the overall contract.[24] However, many contractors may not want to do this because they want to engage in bid shopping.[25]

Bid shopping is detrimental to the bidding process. First, subcontractors are often forced to pad their bids in order to make reductions in price after the overall contract is awarded.[26] The result of this is that the owner often has to pay more for the bid on the overall contract.[27] Where a public project is involved, the public suffers this economic burden.[28] Second, bid shopping prevents the realization of the benefits of full and fair competition

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[23] *Id.*

[24] *See Home Electric*, 358 S.E.2d at 542.

[25] *See supra* note 12.

[26] *See* SWEET, *supra* note 18.

[27] *See* Ring Const. Corp. v. Secretary of War, 8 T.C. 1070, 1089 (1947).

[28] *Id.*

among contractors and subcontractors.[29] It impairs the incentive, morale, and ability of each party to perform, especially subcontractors because of their inferior bargaining positions.[30]

This article proposes a rule of construction industry contract formation that would curtail the practice of bid shopping. It proposes first that courts discontinue applying promissory estoppel in the construction bidding context. Second, it acknowledges that a subcontractor and a contractor may form a contract by conditioning it on the award of the overall contract. More importantly, it proposes that courts analyze whether the parties have agreed upon sufficient terms to form a contract.[31] Even if the parties have conditioned their contract on the overall contract, this basic tenet of contract law cannot be ignored. Parties may have a unilateral contract, i.e., a promise

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[29] Southern Cal. Acoustics Co. v. C.V. Holder, Inc., 71 Cal. 2d 719, 79 Cal. Rptr. 319 n.5 (Cal. 1969). To a certain extent, this has been minimized by legislation requiring contractors to list names and work to be performed by their subcontractors when bidding in public construction contracts. *See, for example,* CAL. GOV'T CODE § 4104 (West 1988).

[30] *Id.*

[31] *Id.*

accepted by a return promise only if the promise contains sufficient terms to form a contract.

The rule proposed in this article necessarily adopts the common-law rule enunciated in *James Baird*. In *Baird*, the court held that contractors must accept subcontractors' bids by means of a promise in order for the parties to have a contract.[32] The court rejected the contractor's position that a contract was formed when it was accepted by performance, namely submitting the bid to the awarding authority.[33] Before reaching the acceptance issue, however, there is another issue that was not dealt with by the court. That issue is the focus of this article, namely whether the parties have agreed upon sufficient terms to form a contract. Under the "Rule of Mutuality," if both parties to a contract do not agree upon sufficient terms to form a contract, then neither party is bound.[34] Under this rule, if both parties are not bound, then neither is bound.[35] To

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[32] *See* James Baird Co. v. Gimbel Bros., 64 F.2d 344, 345 (2d Cir. 1933).

[33] *Id.* at 344.

[34] *Id.* at 346.

[35] *Id.*

understand why this basic tenet of contract law should no longer be ignored by the courts, a more detailed analysis of the common-law[36] and promissory estoppel[37] approaches to the problem is necessary. After this is done, the article discusses ways subcontractors may protect themselves under the promissory estoppel approach, which has been adopted by a majority of jurisdictions.[38] This discussion also aids subcontractors in protecting themselves in the jurisdiction adopting the rule of mutuality.

The classic doctrine of construction industry contract formation was stated in *James Baird.* In *Baird,* the Second Circuit held that a contractor's use of a subcontractor's bid in an overall bid does not constitute an acceptance of an offer for a unilateral contract. In the court's view, a subcontractor is free to revoke his bid because the sub contemplated a return promise and when the contractor failed to give a return promise, it did not supply any consideration to form a contract.[39]

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[36] *See supra* note 3.

[37] *Id.*

[38] *See infra* notes 40-46 and accompanying text.

[39] *See infra* notes 47-58 and accompanying text.

In *Baird*, a subcontractor promised to perform linoleum work, but withdrew its bid after finding out that it had made a mistake in computing its bid.[40] The subcontractor withdrew its bid before the contractor was awarded the overall contract, but after the contractor had sent his bid on the overall project to the owner.[41] Because the subcontractor's bid for linoleum was used by the contractor in computing the estimated cost of that job, as well as the contract, the contractor was placed in a difficult financial position when the subcontractor withdrew its bid.[42] Nevertheless, the Second Circuit ruled in favor of the subcontractor because the contractor never accepted the subcontractor's offer.

Writing for the majority, Judge Learned Hand stated that, in the construction industry, a promise is the envisioned mode of acceptance.[43] If the contractor does not

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[40] *See, e.g.*, Debron Corp. v. National Homes Constr. Corp., 493 F.2d 352 (8th Cir. 1974); Constructors Supply Co. v. Bostrum Sheet Metal Works, 291 Minn. 113, 190 N.W.2d 71 (1971); Wargo Builders, Inc. v. Douglas L. Cox Plumbing & Heating Inc., 26 Ohio App. 2d 1, 268 N.E.2d 597 (1971).

[41] *See* James Baird Co. v. Gimbel Bros., 64 F.2d 344 (2d Cir. 1933).

[42] *Id.*

[43] *Id.*

accept the subcontractor's offer by a mutual promise, then the parties do not have a contract, and therefore, the subcontractor is free to revoke its offer until the time that the contractor accepts it.[44] The court's holding necessarily implies that the parties must agree upon sufficient terms to form a contract.[45] That means that the subcontractor must make a promise containing sufficient material terms to constitute a valid offer. Of course, a counter-offer containing material terms made by the contractor, if accepted by the subcontractor, could also be involved. Nevertheless, the key is that the parties agree upon sufficient terms so as to form a contract. Hence, the parties would have a contract by reason of their mutual promises.

Twenty-five years after the *Baird* decision, the California Supreme Court agreed with Judge Hand, holding that the use of a bid is not an acceptance. In *Drennan v. Star Paving Co.*,[46] Judge Traynor was faced with the facts almost identical to those in *Baird.* Like *Baird*, a

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[44] *Id.*

[45] *Id.*

[46] *Id.*

subcontractor had revoked his promise after the contractor had used his bid in computing his bid for the overall contract.[47] Unlike *Baird*, however, the court permitted the contractor to recover on the theory of promissory estoppel.[48] The court reasoned that subcontractor should expect a contractor to use the lowest bid he receives.[49] Therefore, in the court's view, a contractor's reliance on a subcontractor's bid is reasonable and foreseeable.[50] Consequently, a contractor's reliance warrants implying a "subsidiary promise" by the subcontractor.[51] The promise impliedly made by a subcontractor to a contractor is that the subcontractor would not revoke its offer for a bilateral contract until the contractor had been allowed a reasonable time to accept.[52] Therefore, under this view, the contractor's reasonable and foreseeable reliance serves as

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[47] *See supra* note 3.

[48] 51 Cal. 2d 409, 333 P.2d 757 (1958).

[49] *Id.*

[50] *Id.*

[51] *Id.*

[52] *Id.*

a substitute for the requirement of consideration.[53]

In *Drennan,* the court permitted the contractor to recover on the theory of promissory estoppel.[54] The court thus held that the contractor's reliance on the subcontractor's bid was reasonable and foreseeable.[55] However, the court recognized that the doctrine of promissory estoppel could be unfairly abused by contractors. Consequently, the court held that the doctrine was inapplicable where (1) the contractor's reliance was unreasonable; (2) the subcontractor's bid was revocable,[56] (3) the contractor unreasonably delayed acceptance; or (4) the contractor engaged in bid shopping.[57]

Under *Drennan,* it is clear that if a contractor engages in bid shopping, it may not recover under the theory of promissory estoppel. If *Drennan's* holding is applied correctly, contractors would be discouraged from conducting bid shopping. Contractors would be dissuaded from bid

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[53] *Id.*

[54] *Id.*

[55] *Id.*

[56] *Id.*

[57] *Id.*

shopping because they would know that if any bid shopping was discovered, the contractor would not be permitted to recover. Since promissory estoppel is the predominant means of recovery for contractors in subcontractor bid cases, it stands to reason that if courts consistently denied recovery to contractors engaging in bid shopping, then contractors would be deterred from engaging in such activity. Nevertheless, the courts are not applying *Drennan* correctly.

Incredibly, few courts have denied recovery to a contractor for engaging in bid shopping.[58] As presently applied, the doctrine of promissory estoppel unjustly permits a contractor to recover for purportedly relying on a subcontractor's bid by incorporating it into its overall bid when the contractor actually did not rely on it, as evidenced by the fact it engaged in bid shopping.[59] Under this interpretation, the contractor is protected but the subcontractor remains vulnerable because the contractor may,

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[58] *Id.*

[59] This is probably a result of the fact that the subcontractor is required to introduce conclusive evidence of bid shopping. Obviously, this is very difficult, if not impossible to do. *See, e.g.,* Constructor's Supply Co. v. Bostrum Sheet Metal Works, Inc., 190 N.W.2d 71, 74 (Minn. 1971).

after winning the bid, engage in bid shopping.[60]

Since the majority of jurisdictions have followed *Drennan*, however, it is necessary to discuss how a subcontractor can defeat a contractor's claim for recovery under the theory of promissory estoppel.[61] First, the subcontractor must have made an affirmative promise to do something.[62] Second, the contractor must demonstrate that his reliance was reasonable.[63] Third, the contractor must demonstrate that his reliance was foreseeable.[64] Fourth, the contractor must demonstrate that it will suffer substantial detriment as a result of its reliance if the promise is not enforced.[65]

Regarding the first element, a subcontractor may argue that his promise failed to include sufficient material terms to form a contract; for example, a performance bond, the

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[60] *See supra* note 59.

[61] *Id.*

[62] Comment, *Promissory Estoppel: Subcontractor's Liability in Construction Bidding Cases,* 63 N.C.L. Rev. 387, 393 (1985).

[63] *Id.*

[64] *Id.*

[65] *Id.*

price, scope of work, indemnification and dispute resolution. If one or more of those terms are missing, the contractor may argue that no "binding offer" existed.[66] The subcontractor may also argue that its promise was merely an "invitation to offer".[67] As a safety device, the subcontractor may, if it has the bargaining power, limit the duration of his promise.[68] If the contractor does not accept his promise within that time period, the parties would not have a binding contract.

Regarding the second element, a subcontractor, may argue that its bid was so low that the contractor knew or should have known that the subcontractor made a mistake in computing its bid.[69] It is at best questionable for a subcontractor to argue that a contractor did not meet the

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[66] *Id.*

[67] *See supra* note 39; SWEET, *supra* note 18, at 731.

[68] *E.g.*, Leo F. Piazza Paving Co. v. Bebek & Brkich, 141 Cal. App. 2d 226, 296 P.2d 368 (1956); Cannavino & Shea, Inc. v. Water Works Supply Corp., 361 Mass. 363, 280 N.E.2d 147 (1972).

[69] *E.g.*, Sharp Bros. Contracting Co. v. Commercial Restoration, Inc., 334 S.W.2d (Mo. App. 1960) (bid must be accepted in ten days). *But see* S.M. Wilson & Co. v. Prepakt Concrete Co., 23 Ill. App. 3d 137, 318 N.E.2d 722 (1974) (protection lost by continuing to deal after expiration of deadline).

third element of promissory estoppel because subcontractors know that the lowest of their bids will be used, in effect, and depend on their bids to get into the contractual process.[70] As to the last element, the contractor can usually demonstrate that he relied on the subcontractor's bid by "incorporating" it into his own bid and thus suffered substantial detriment. Although formal incorporation is not necessary, a contractor must introduce sufficient proof on this issue. Evidence of bid shopping, preferably by the contractor itself concerning the contract at issue, should be introduced by the subcontractor to negate the contractor's contention that he relied on the subcontractor's bid.[71] If this cannot be established, evidence of bid shopping by contractors in the community may be permitted.[72]

**Conclusion**

The *Drennan* decision was a commendable attempt to limit

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[70] *See, e.g.*, Robert Gordon, Inc. v. Ingersoll-Rand Co., 117 F.2d 654, 660 (7th Cir. 1941) (subcontractor's bid was "glaringly low").

[71] *See* Comment, *The Subcontractor's Bid: An Option Contract Arising Through Promissory Estoppel*, 34 Emory L.J. 421, 430-31 (1985).

[72] *E.g.*, Premier Elec. Const. Co. v. Miller-Davis Co., 422 F.2d 1132, 1135-36 (7th Cir. 1970), *r'hrg. en banc denied*, (7th Cir. 1970).

the sometimes harsh results of the *Baird* decision. The *Drennan* court intended its decision to be more equitable in that it would protect a contractor's reliance by enforcing the subcontractor's promise. The problem is that the subcontractor has made a promise which often does not contain material terms. Considering the contractor's superior bargaining position, the contractor can, if he wishes, make harsh terms part of the contract. To curtail bid shopping, courts must disregard *Drennan* and its progeny and follow the *Home Electric* decision.

The mutuality notions in the *Home Electric* decision support the common-law rule enunciated in *Baird*. At common law, the mere use of a subcontractor's bid was not an acceptance by the contractor. The subcontractor's offer envisions acceptance by promise, and therefore, the contractor may accept only by a promise. This article proposes that courts perform an analysis which has one additional prong. This prong is a basic tenet of contract law: that the parties must agree upon sufficient material terms in order to form a contract. If they do not, then the parties do not have a contract. This additional step in the analysis would virtually end bid shopping. Moreover,

under this approach, courts would be following basic contract law, which has often been ignored in the construction bidding context.

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# *HOME ELECTRIC V. HALL & UNDERDOWN HEATING & AIR CONDITIONING:* MUTUALITY REMAINS THE ONLY SOLUTION TO THE CONSTRUCTION BIDDING PROBLEM

STEVEN M. SIEGFRIED AND MARK LAWRENCE