



FRAUD – A Public Owner Explores a New Shield Against Construction Claims. Will it Become a Sword?

Public owners are always looking for ways to dismiss contractors' claims without reaching the merits. Recent New York court cases indicate that the City of New York has revived an old legal theory to shield itself from legitimate claims and perhaps recover payments made for completed and accepted contract work.

Three cases were recently decided involving the same general contractor. The contractor was litigating three different delay claims against the City on three separate projects. In total, the contractor sought more than \$1.7 million. During the litigation, the City's attorneys learned that before the contractor was awarded the three contracts, it had received notices of investigations of prevailing wage violations on prior unrelated projects but failed to disclose the investigations on its VENDEX (the City's form of contractor questionnaire). At least one of the investigations was of a subcontractor.

The City filed an identical motion in each action asking the court to dismiss the contractor's claims. The City argued that the contracts were unenforceable because the contractor had fraudulently induced the City to award them. The City said that it relied on the contractor's VENDEX forms in deciding that the contractor was a responsible vendor. The City also sought to assert a counterclaim to offset or recoup the amount of the contractor's claim.

The contractor argued, among other things, that the City had waived the fraudulent inducement argument because the City had allowed the contractor to keep working, and paid it, after becoming aware of the prevailing wage violations.

The first court to decide the City's motion rejected the contractor's arguments and dismissed the action holding that the contractor had fraudulently induced the City to award the contract. The court noted that because the City was only seeking to recoup or offset the value of the contractor's claim, and the claim was dismissed, there was nothing to recoup or offset.

One month later, a second court dismissed the contractor's other claim for exactly the same reasons. In its decision, the court wrote that a "municipality can recover from the vendor all amounts paid under" a fraudulently induced contract. However, the City had only sought to recoup the contractor's claim amount, which had been dismissed, so the court held there was nothing to recoup.





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A third court disposed of the last case a few months later. It held that the contract had been fraudulently induced and cited the two prior cases as binding precedent.

None of the courts carefully considered whether the fraud was truly interwoven with the contract or was a fraud extraneous to the contract. The courts accepted the City's position that it had relied on the VENDEX in deciding to award the contracts.

This new found fraud defense has the potential to not only give the City a way to defeat a claim, but to also recover monies that were paid on account of completed contract work.

In other recent construction cases the City's attorneys have asserted both fraud in the inducement and fraud in the performance of contract as defenses and counterclaims, and sought to recoup the money that the City paid the contractor for completed and accepted work. Lower courts have accepted the City's arguments and allowed the City to pursue recoupment even though the City contract provides for specific alternative penalties for the purported fraud.

Public Contractors Beware

Fraud in the inducement and fraud in the performance of a contract are old legal theories. What is new and troubling is the City's use of these theories to defeat contractor's claims, and the willingness to do so in cases that do not involve traditional criminal acts or frauds. Non-compliance with seemingly benign statutory or regulatory requirements may give the City and other public owners another shield against legitimate claims, and a sword to recover monies already paid.

Make certain you use extreme care in completing your pre-bid questionnaires. And during the contract's performance, make certain you disclose any potential irregularities to the public owner. A robust ethics code and compliance program can help.

If you have any questions,
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