

CIVIL FORFEITURE AS A REMEDY FOR CORRUPTION IN
PUBLIC AND PRIVATE CONTRACTING IN NEW YORK

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I. A LONG HISTORY OF PUBLIC CORRUPTION SCANDALS IN NEW YORK

As such things go in New York City, the scandal centering on James L. Marcus, the Commissioner of Department of Water Supply, Gas, and Electricity, which came to light in December 1967 fell into the middle range. It was certainly not the first public corruption scandal. That dubious distinction belongs to Willem Verhulst, the first Provisional Director of the New Amsterdam colony who was removed from office in the spring of 1626 on an accusation that he and his wife had misappropriated funds and cheated the Indians when New Amsterdam was not quite a year old.¹ The Marcus scandal also certainly lacked the bizarreness that was attributed to Edward Hyde, Lord Cornbury, the Colonial Governor of New York from 1702 to 1708, who was reputed to have not only pocketed £1,500 allocated for fortifying the Narrows but to have strolled the walls of the Battery wearing a dress.² Nor did the Marcus scandal involve the largest amount of graft. That title was presumably and hopefully, retired by the Tweed Ring, which is

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¹ EDWIN G. BURROWS & MIKE WALLACE, *GOHAM: A HISTORY OF NEW YORK CITY TO 1898* at 20–21 (1999); RUSSELL SHORTO, *THE ISLAND AT THE CENTER OF THE WORLD: THE EPIC STORY OF DUTCH MANHATTAN AND THE FORGOTTEN COLONY THAT SHAPED AMERICA* 46–47 (2004).

² See BURROWS & WALLACE, *supra* note 1, at 115. There is some historical dispute over whether Cornbury's reputation was entirely earned or was the result of purposeful transatlantic slander. See PATRICIA U. BONOMI, *THE LORD CORNBURY SCANDAL: THE POLITICS OF REPUTATION IN BRITISH AMERICA* 166–89 (1998). See generally Patricia U. Bonomi, *Lord Cornbury Redressed: The Governor and the Problem Portrait*, 51 WM. & MARY Q. 106, 106–18 (1994) (arguing that a famous picture now in the New York Historical Society of Cornbury wearing a gown was misattributed and was really “a rather plain woman”).

reputed to have stolen as much as \$200,000,000³ in 1860's and 1870's dollars.⁴

The Marcus scandal did not bring down a mayor in the way that massive Tammany Hall corruption forced Mayor Jimmy Walker to take a permanent European vacation in September 1932⁵ or in the manner that the conviction of James J. Moran⁶ led to the resignation of Mayor William O'Dwyer on September 2, 1950.⁷ Indeed, Governor Lindsay's biographer states that "[i]n the long run, the Marcus scandal did not tarnish the Lindsay administration. Lindsay himself was above reproach on the issue of honesty and integrity."⁸

II. THE MARCUS SCANDAL

What the Marcus scandal did do that none of its predecessors had done was to create a legal doctrine that has been consistently extended by the New York courts as a deterrent to corruption and

³ See ALEXANDER B. CALLOW, JR., *THE TWEED RING* 164–65 (1966) (quoting contemporaneous estimates of the amount stolen as between \$60,000,000 and \$200,000,000); Frank Lynn, *A Concise History of Municipal Malfeasance*, N.Y. TIMES, Mar. 30, 1986, at E5 (quoting an estimate of \$200,000,000). For a recent, relatively sympathetic biography of Tweed, see KENNETH D. ACKERMAN, *BOSS TWEED: THE RISE AND FALL OF THE CORRUPT POL WHO CONCEIVED THE SOUL OF MODERN NEW YORK* (2005). For information about the Tweed Ring in general, see DENIS TILDEN LYNCH, "BOSS" TWEED: THE STORY OF A GRIM GENERATION (Transaction Publishers 2002) (1927); SEYMOUR J. MANDELBAUM, *BOSS TWEED'S NEW YORK* (Elephant Paperbacks 1990) (1965); ERIC HOMBERGER, *SCENES FROM THE LIFE OF A CITY: CORRUPTION AND CONSCIENCE IN OLD NEW YORK 167–211* (1996) (relating the history of "Slippery Dick" Connolly, City Comptroller while the Tweed Ring was in control. Connolly, who died in exile, ultimately had a judgment for \$8,537,170.15 entered in the City's favor against him).

⁴ When the value of the amount stolen is approximated into current dollars, it becomes even more staggering. According to MeasuringWorth.com, \$200,000,000 in 1870 is the equivalent of \$3,390,000,000 in 2009 dollars. *Seven Ways to Compute the Relative Value of a U.S. Dollar Amount—1774 to Present*, MEASURINGWORTH, <http://www.measuringworth.com/> (last visited Jan. 7, 2012); see also S. Morgan Friedman, *Inflation Calculator*, WESTEGG, <http://www.westegg.com/inflation/> (last visited Jan. 7, 2012) (estimating \$3,405,573,952 in 2010 dollars).

⁵ Lynn, *supra* note 3, at E5. For scandals in the Walker Administration, see generally HERBERT MITGANG, *ONCE UPON A TIME IN NEW YORK: JIMMY WALKER, FRANKLIN ROOSEVELT, AND THE LAST GREAT BATTLE OF THE JAZZ AGE* 98–163, 167–73, 179–209 (2000); THOMAS KESSNER, *FIORELLA H. LA GUARDIA AND THE MAKING OF MODERN NEW YORK* 220–37 (1989).

⁶ See *United States v. Moran*, 236 F.2d 361, 361–62 (2d Cir. 1956); *cert. denied* 352 U.S. 909 (1956). Moran was convicted of running an extortion ring which brought in \$500,000 a year. Lynn, *supra* note 3, at E5. Moran remained silent as to where the money went while serving a ten year jail term, declaring: "I came into the world a man . . . and I'm going out a man." *Id.*

⁷ VINCENT J. CANNATO, *THE UNGOVERNABLE CITY: JOHN LINDSAY AND HIS STRUGGLE TO SAVE NEW YORK* 33 (2001).

⁸ *Id.* at 117.

illegality in public contracting.

This is not to say that the Marcus scandal was without interest aside from its legal progeny. It led to the jailing of a City Commissioner (Marcus), as well as a member of the Luchese Crime Family (Antonio “Tony Ducks” Corallo), Henry Fried, the corrupt contractor who owned S.T. Grand, Inc., several other corrupt contractors, a corrupt lawyer, the head of a union, and, most significantly, Carmine G. DeSapio, the former head of the legendary Tammany Hall.⁹ Yet another scheme using Marcus’s office led to the conviction of the former Law Chairman of the New York County Republican party.¹⁰

James L. Marcus was a self-made man in the sense that he made it all up. Marcus’s only real “qualifications” for high public office were that he had married the daughter of the former Governor of Connecticut and had developed a friendship with John Lindsay, a rising politician.¹¹ No one bothered to check Marcus’s claims as to his background before he was appointed as the Commissioner of the Department of Water Supply, Gas, and Electricity and later, after a municipal reorganization, the Commissioner of the new Environmental Protection Administration.¹² However, Marcus had not only lost money on “shady business deals,” but he also owed money to Corallo, a Luchese crime family loanshark.¹³

A solution to Marcus’s problems was arranged and Marcus issued

⁹ *Id.* at 116; *see* United States v. Corallo, 413 F.2d 1306, 1307, 1309, 1310–11, 1313 (2d Cir. 1969); S.T. Grand, Inc. v. City of New York, 38 A.D.2d 467, 468, 330 N.Y.S.2d 594, 595 (App. Div. 1st Dep’t 1972); *see also* United States v. DeSapio, 435 F.2d 272 (2d Cir. 1970). By way of comparison, the Wedtech scandal, which came to light in 1987, led to the conviction of, *inter alia*, two Bronx Congressmen, the Borough President of the Bronx, a General in the Army National Guard, and the New York Regional Director of the Federal Small Business Administration. *See generally* JAMES TRAUB, TOO GOOD TO BE TRUE: THE OUTLANDISH STORY OF WEDTECH 350 (1990) (chronicling the conviction of Stanley Simon, John Mariotta, Mario Biaggi, Bernhard Ehrlich, Peter Neglia, Richard Biaggi, and Ronald Betso); MARILYN W. THOMPSON, FEEDING THE BEAST: HOW WEDTECH BECAME THE MOST CORRUPT LITTLE COMPANY IN AMERICA 304–05 (1990) (examining the convictions of Biaggi, Baker, Simon, Mariotta, and Meese). Scandals in the Koch Administration led to the suicide of the Queens Borough President and the convictions of the Bronx County Democratic leader, as well as the former Commissioner of the Department of Transportation, the former Chairman of the Taxi and Limousine Commission, and the Director of the Parking Violations Bureau. United States v. Friedman, 854 F.2d 535, 543 (2d Cir. 1988). *See generally* JACK NEWFELD & WAYNE BARRETT, CITY FOR SALE: ED KOCH AND THE BETRAYAL OF NEW YORK 435–36, 449 (1988) (examining the scandals surrounding Koch and the ultimate consequences for his friends).

¹⁰ United States v. Ruggiero, 472 F.2d 599, 601–02 (2d Cir. 1973).

¹¹ *See* CANNATO, *supra* note 7, at 115–16.

¹² *Id.* at 116.

¹³ *Obituary: James Marcus, Ex-Water Chief*, N.Y. TIMES, Jan. 16, 1988, at 10; Arnold H. Lubasch, *Judge Edward Weinfeld, 86, Dies; On U.S. Bench Nearly 4 Decades*, N.Y. TIMES, Jan. 18, 1988, at A16.

an \$850,000 emergency contract to clean the Jerome Park Reservoir to S.T. Grand, a company whose principal was Henry Fried.¹⁴ Fried paid \$40,000 to Corallo, who in turn applied it towards Marcus's debt.¹⁵ The misuse of Marcus's authority worked so well that the principal perpetrators decided to add-in Carmine DeSapio, the former chief of Tammany Hall, and to extort money from the Consolidated Edison Company.¹⁶ On December 12, 1967, Marcus, who was under investigation, suddenly resigned and a week later Marcus, Corallo, Fried, and others were arrested.¹⁷

The Marcus scandal has had a continuing effect on the law in New York because Fried and S.T. Grand, despite having been convicted of conspiracy to use the telephone in an interstate conspiracy with intent to violate the New York bribery laws,¹⁸ could not leave bad enough alone. Instead, S.T. Grand sued for the \$148,736.78 contract balance as if it had obtained the contract legally.¹⁹

S.T. Grand was less guilty of chutzpah than now seems to be the case because the New York law was, and is, far more forgiving of dishonest and corrupt commercial behavior in the private sector than when public money was at stake.

III. PRIVATE SECTOR CIVIL COMMERCIAL BRIBERY CASES IN NEW YORK

The line of cases dealing with commercial bribery begins with the 1908 decision of the Appellate Division, First Department in *Sirkin v. Fourteenth Street Store*,²⁰ which, more than a half century later, was explicitly adopted by the Court of Appeals in *McConnell v. Commonwealth Pictures Corp.*²¹ In *Sirkin*, the plaintiff entered into

¹⁴ See CANNATO, *supra* note 7, at 116.

¹⁵ *Id.*

¹⁶ See *United States v. DeSapio*, 435 F.2d 272, 275, 277-78, 283-84 (2d Cir. 1970). DeSapio refused, for the rest of his life, to discuss the scandal. See Jonathan P. Hicks, *Tammany Hall's Last True Boss: DeSapio Remembers an Era of Leadership and Loyalty*, N.Y. TIMES, Mar. 12, 1997, at B1.

¹⁷ CANNATO, *supra* note 7, at 116; Richard Reeves, *Lindsey Asserts Marcus Betrayed Public If He Lied*, N.Y. TIMES, Dec. 20, 1967, at 1; see also Jay Maeder, *Public Relations The Fall of Carmine DeSapio, December 1969 Chapter 373*, DAILY NEWS (N.Y.), June 12, 2001, at 63 (discussing the convictions subsequent to the Marcus probe).

¹⁸ *United States v. Corallo*, 413 F.2d 1306, 1307 (2d Cir. 1969).

¹⁹ *S.T. Grand, Inc. v. City of New York*, 38 A.D.2d 467, 468, 330 N.Y.S.2d 594, 595 (App. Div. 1st Dep't 1972).

²⁰ *Sirkin v. Fourteenth St. Store*, 124 A.D. 384, 388, 108 N.Y.S. 830 (App. Div. 1st Dep't 1908).

²¹ *McConnell v. Commonwealth Pictures Corp.*, 7 N.Y.2d 465, 469, 166 N.E.2d 494, 496,

a five percent kickback agreement with the defendant's purchasing agent.²² Plaintiff sued for the \$1,555.81 purchase price of the goods, which the defendant had received and for which the defendant had refused to pay.²³ The trial court²⁴ and Appellate Term²⁵ held that, while the kickback arrangement was unenforceable as against public policy, since the goods had been delivered, the defendant could not retain them and decline to pay.²⁶

The First Department concluded that the kickback arrangement was in violation of the Penal Code and the common law.²⁷ The Court then went on to address

[t]he question . . . presented now for the first time as to whether . . . the court may refuse its aid to the party obtaining the contract for the purchase or sale of property, or for work, in violation of the statute, upon the same ground that it leaves a party to a contract which is void as against public policy, or offends against good morals, where it finds him.²⁸

The *Sirkin* court went on to hold that

nothing will be more effective in stopping the growth and spread of this corrupting and now criminal custom than a decision that the courts will refuse their aid to a guilty vendor or vendee, or to any one who has obtained a contract by secretly bribing the servant, agent or employee of another to purchase or sell property or to place the contract with him. If the court should lend its aid to the enforcement of this contract, induced by a five per cent bribe of the purchase price of the goods, then to-morrow [sic] it may be called upon to enforce a contract induced by a bribe of twenty-five per cent or even fifty per cent of the purchase price, and it would thereby be indirectly compelling a master or employer to reimburse a party for moneys expended in bribing his

199 N.Y.S.2d 483, 485 (1960) (quoting *Stone v. Freeman*, 298 N.Y. 268, 271, 82 N.E.2d 571, 572 (1948)); see also *Bankers Trust Co. v. Litton Sys., Inc.*, 599 F.2d 488, 491 (2d Cir. 1979) (citations omitted) (discussing how an illegal bribe can render a contract that is not itself illegal unenforceable for the wrongdoer).

²² *Sirkin*, 124 A.D. at 385–86, 108 N.Y.S. at 831.

²³ *Id.*

²⁴ *Sirkin v. Fourteenth St. Store*, 54 Misc. 135, 105 N.Y.S. 638 (N.Y. City Ct. 1907).

²⁵ *Sirkin v. Fourteenth St. Store*, 55 Misc. 288, 105 N.Y.S. 179 (N.Y. App. Term 1907).

²⁶ *Sirkin*, 124 A.D. at 386, 108 N.Y.S. at 831–32.

²⁷ *Id.* at 388, 18 N.Y.S. at 833 (citations omitted).

²⁸ *Id.* at 389–90, 108 N.Y.S. at 834.

servant, agent or employee in violation of the law.²⁹

The *Sirkin* court refused to separate out the corruptly influenced portion of the contract, thereby aiding in the enforcement of the contract, instead remanding for a new trial for the defendant to prove the corrupt arrangement.³⁰ The decision left the defendant in possession of the goods but did not address what would happen if the defendant had already paid for the goods.

It would be a half century before the New York Court of Appeals would be willing to go even as far as *Sirkin*. Instead, the Court of Appeals issued a series of decisions, which had the effect of restricting the recovery available to the victims of private sector corruption and making it more difficult to prove the facts necessary to support such a recovery. In 1914, in *Schank v. Schuchman*, plaintiffs had purchased wagons from defendant.³¹ Payment for the wagons was contingent upon approval by plaintiff's inspectors, who were bribed by the defendants to issue certificates of approval in exchange for alleged commissions.³² Thus, there had been corruption in the performance, rather than the initiation, of the contract. Plaintiff discovered the corruption after the wagons' useful life was over and sought to void the entire transaction and recover all sums paid.³³ The Court of Appeals refused to order restitution since the plaintiffs had retained the services and could not show "some disparity between the value and the price."³⁴

In 1918, in *Merchants' Line v. Baltimore & Ohio R.R. Co.*,³⁵ the Court of Appeals refused to void an agreement which had been tainted by an ineffectual bribe because "there is no evidence to indicate that the employe[e] bribed by plaintiff had a thing to do with the making of the contract or that he influenced in any way the execution thereof."³⁶ The Court commented that "the plaintiff's representatives were lacking in sagacity as well as good morals and were thereby led into an attempt to corrupt the wrong man."³⁷

While the Court of Appeals seemed not to be willing to consider forfeiture of a contract because of illegal conduct standing alone, it

²⁹ *Id.*

³⁰ *Id.* at 392-94, 108 N.Y.S. at 837.

³¹ *Schank v. Schuchman*, 212 N.Y. 352, 355, 106 N.E. 127, 127 (App. Div. 2d Dep't 1914).

³² *Id.*

³³ *Id.* at 355-56, 106 N.E. at 128.

³⁴ *Id.* at 360, 106 N.E. at 129.

³⁵ *Merchs.' Line v. Balt. & Ohio R.R. Co.*, 222 N.Y. 344, 346, 118 N.E. 788 (1918).

³⁶ *Id.* at 346, 118 N.E. at 788.

³⁷ *Id.*

did impose *some* penalty for bribery. In *Donemar, Inc. v. Molloy*,³⁸ the Court held that, where a contractor bribes an employee, the contract amount “is loaded by the amount of the bribe,” and the victim can at least recover the amount of the bribe, although “[t]he law does not go so far as to nullify the entire transaction where the vendor has received and used the merchandise.”³⁹ The *Donemar* rule has since been applied by courts at all levels in other situations, including those where it is impractical to undo the original transaction.⁴⁰

In 1944, the Court of Appeals placed yet another obstacle in the path of a victim attempting to recover from private sector contract corruption. In *Hornstein v. Paramount Pictures*,⁴¹ stockholders sued derivatively to recover from the directors of the corporation sums paid to corrupt labor union officials to avoid a strike. There appeared to have been no dispute that the payments were coerced.⁴² The Court of Appeals held:

In that view, we are not ready to impute to section 380 of the Penal Law [prohibiting payments to union officials to avoid strikes] the meaning that one who is victimized by an extortion of the kind in question should on that account suffer loss of his liberty or property.⁴³

In 1960, the Court of Appeals finally extended the penalties applicable for commercial bribery in obtaining contracts. In *McConnell*, the plaintiff had sued for an accounting on an agreement between himself and the defendant pursuant to which he had obtained certain movie rights.⁴⁴ The defendant asserted that the plaintiff had obtained the movie rights through bribery and a

³⁸ *Donemar, Inc. v. Malloy*, 252 N.Y. 360, 169 N.E. 610 (1930).

³⁹ *Id.* at 364–65, 169 N.E. at 611.

⁴⁰ *See, e.g.*, *British Am. & E. Co. v. Wirth, Ltd.*, 592 F.2d 75, 79 (2d Cir. 1979); *Cont'l Mgmt., Inc. v. United States*, 527 F.2d 613, 617 (Ct. Cl. 1975); *Philip Morris, Inc. v. Grinnell Lithographic Co.*, 67 F. Supp. 2d 126, 130 (E.D.N.Y. 1999); *City of New York v. Citisource, Inc.*, 679 F. Supp. 393, 398 (S.D.N.Y. 1988) (following *Cont'l Mgmt.*, 527 F.2d at 616–17); *People v. Wolf*, 284 A.D.2d 102, 102–03, 726 N.Y.S.2d 83, 85 (App. Div. 1st Dep't 2001); *City of New York v. Liberman*, 232 A.D.2d 42, 43–44, 660 N.Y.S.2d 872, 873 (App. Div. 1st Dep't 1997); *Sears, Roebuck & Co. v. Kelly*, 1 Misc. 2d 624, 625, 149 N.Y.S.2d 133, 135 (Sup. Ct. N.Y. County 1956) (holding that an employee who received illegal gratuities must pay amount of gratuities to her employer); *see also* *Grace v. Kozin Co.*, 538 F.2d 170, 174–76 (7th Cir. 1976).

⁴¹ *Horenstein v. Paramount Pictures, Inc.*, 292 N.Y. 468, 55 N.E.2d 740 (1944).

⁴² *Id.*

⁴³ *Id.* at 471, 55 N.E.2d at 742.

⁴⁴ *McConnell v. Commonwealth Pictures Corp.*, 7 N.Y.2d 465, 468–69, 166 N.E.2d 494, 496, 199 N.Y.S.2d 483, 484–85 (1960).

promise of kickbacks.⁴⁵ The lower courts rejected that defense because the contract between the plaintiff and the defendant was not illegal in itself.⁴⁶ The Court of Appeals reversed, explicitly adopting the reasoning of *Sirkin* and extended the *Sirkin* doctrine from corruption in the initiation of contracts to the “corrupt performance of contracts . . . [that] are not illegal.”⁴⁷ However, while increasing the circumstances under which the New York courts could impose civil penalties for commercial bribery, the *McConnell* court left a substantial loophole. Addressing a concern “that the doing of any small illegality in the performance of an otherwise lawful contract [would] deprive the doer of all rights,” giving a “windfall” to the victimized party.⁴⁸ The Court of Appeals added yet another element of proof:

There must at least be a direct connection [to] the obligation sued upon. Connection is a matter of degree. Some illegalities are merely incidental to the contract sued on . . . We cannot now, any more than in our past decisions, announce what will be the results of all the kinds of corruption, minor and major, essential and peripheral. All we are doing here is labeling the conduct described in these defenses as gross corruption depriving plaintiff of all right of access to the courts of New York State. Consistent with public morality and settled public policy, we hold that a party will be denied recovery even on a contract valid on its face, if it appears that he has resorted to gravely immoral and illegal conduct in accomplishing its performance.⁴⁹

New York law with respect to corruption in private sector contracts has not significantly changed since *McConnell*, as is illustrated by two more recent cases in the First Department. In *Black v. MTV Networks, Inc.*,⁵⁰ the plaintiffs had entered into a

⁴⁵ *Id.*

⁴⁶ *Id.* at 470, 166 N.E.2d at 497, 199 N.Y.S.2d at 486. (“*Sirkin* is the case closest to ours and shows that, whatever be the law in other jurisdictions, we in New York deny awards for the corrupt performance of contracts even though in essence the contracts are not illegal. *Sirkin* had sued for the price of goods sold and delivered to defendant. Held to be good was a defense which charged that plaintiff seller had paid a secret commission to an agent of defendant purchaser. There *cannot* be any difference in principle between that situation and the present one where plaintiff (it is alleged) contracted to buy motion-picture rights for defendant but performed his covenant only by bribing the seller’s agent.”) (emphasis added).

⁴⁷ *Id.* at 470, 166 N.E.2d at 497, 199 N.Y.S.2d at 486.

⁴⁸ *Id.* at 471, 166 N.E.2d at 497, 199 N.Y.S.2d at 487.

⁴⁹ *Id.*

⁵⁰ *Black v. MTV Networks Inc.*, 172 A.D.2d 8, 576 N.Y.S.2d 846 (App. Div. 1st Dep’t 1991).

service contract with MTV.⁵¹ In the course of litigating a breach of contract damages claim, it was discovered that the plaintiff had provided significant gifts to key MTV employees.⁵² The First Department held:

Thus, regardless of intent, motive, illicit purpose, or pecuniary loss, such secret payments improperly create interests for agents that are “adverse to that of their principal” and the principal’s complete knowledge and approval is required of “any substantial advantage received by an agent” from third persons. . . . And so, the concealment of such benefits from the principal, in and of itself, violates the covenant of fair dealing and good faith implied in every contract. . . . As a result, whether plaintiff’s payments were made to strangers or friends in need, the mere non-disclosure of those dealings served to permit the employer, MTV, to terminate the agreement at issue.⁵³

In *American Assurance Underwriters Group, Inc. v. MetLife General Insurance Agency, Inc.*,⁵⁴ stock payments valued at up to \$250,000 had been made by a contractor to employees of the defendant, who were making annual salaries of no more than \$50,000 per year.⁵⁵ When the payments were discovered, defendant terminated the agreement.⁵⁶ The First Department, citing to *Sirkin*, found that the plaintiff had eroded the employees’ duty of undivided loyalty to their employer and violated the implied covenant of fair dealing and good faith implicit in all contracts, and therefore the breach of contract complaint should be dismissed.⁵⁷

In both *Black v. MTV* and *American Assurance*, the remedy for the misconduct was rescission of the contract.⁵⁸ Notably, the remedy was not forfeiture of the contract sums already paid, even though the substantial payments made to the employees were highly suspicious.

Other cases decided in the last two decades seem to reach results consistent with the *Sirkin* and *McConnell* doctrine that the court

⁵¹ *Id.* at 9, 576 N.Y.S.2d at 846.

⁵² *Id.* at 9–10, 576 N.Y.S.2d at 846.

⁵³ *Id.* at 11, 576 N.Y.S.2d at 848.

⁵⁴ *Am. Assurance Underwriters Grp., Inc. v. MetLife Gen. Ins., Inc.*, 154 A.D.2d 206, 552 N.Y.S.2d 259 (App. Div. 1st Dep’t 1990).

⁵⁵ *Id.*

⁵⁶ *Id.* at 208, 552 N.Y.S.2d at 260.

⁵⁷ *Id.* at 208, 552 N.Y.S.2d at 260–61.

⁵⁸ *Black*, 172 A.D.2d at 11–12, 576 N.Y.S.2d at 847–48; *Am. Assurance*, 154 A.D.2d at 209, 552 N.Y.S.2d at 260.

will not enforce contracts tainted by illegality, but neither will it undo a completed transaction. In *Sutton v. Ohrbach*,⁵⁹ the First Department refused to order reimbursement for sums already paid to a party for unauthorized practice of profession of architecture while holding that the contract was unenforceable.⁶⁰ In *M. Farbman & Sons, Inc. v. Columbia University*,⁶¹ and *National Union Fire Insurance Co. of Pittsburgh v. Robert Christopher Associates*,⁶² the First Department restated the *McConnell* requirement of a direct connection between the illegal action and the obligation sued upon.⁶³ In *J. M. Deutsch, Inc. v. Robert Paper Co.*,⁶⁴ the First Department did not cite to *Hornstein* but held that a plaintiff might be excused from the consequences of an illegal agreement if the plaintiff could prove it entered into the agreement under duress.⁶⁵

Thus, based on the law in New York, then and now, with respect to *private* sector contract corruption, Fried and S.T. Grand were far from reckless in suing to recover the contract balance. After all, the contract work had actually been done, there was no evidence that the price was inflated or the work done improperly, and the \$40,000 bribe paid to Marcus was substantially less than the \$148,736.78 contract balance.⁶⁶ Since the City was apparently unwilling to pay any sum without being ordered to do so by a court and the courts had rarely, if ever, awarded restitution, Fried and S.T. Grand must

⁵⁹ *Sutton v. Ohrbach*, 198 A.D.2d 144, 603 N.Y.S.2d 857 (App. Div. 1st Dep't 1993).

⁶⁰ *Id.* at 144, 603 N.Y.S.2d at 857.

⁶¹ *M. Farbman & Sons, Inc. v. Columbia Univ.*, 280 A.D.2d 402, 720 N.Y.S.2d 787 (App. Div. 1st Dep't 2001).

⁶² *Nat'l Union Fire Ins. Co. v. Robert Christopher Assocs.*, 257 A.D.2d 1, 691 N.Y.S.2d 35 (App. Div. 1st Dep't 1999).

⁶³ *M. Farbman*, 280 A.D.2d at 402, 720 N.Y.S.2d at 787, *Nat'l Union Fire Ins. Co.*, 257 A.D.2d at 9, 691 N.Y.S.2d at 41; *see also* Day v. Meyer, No. 99-Civ.-10708(HB), 2000 U.S. Dist. LEXIS 13470, at *22-23 (S.D.N.Y. Sept. 19, 2000) (quoting *McConnell* and stating the rule); *FCI Grp., Inc. v. City of New York*, 54 A.D.3d 171, 177-79, 862 N.Y.S.2d 352, 356 (App. Div. 1st Dep't 2008) (applying *McConnell* to bribery attempt in public contract); *RAC Grp., Inc. v. Bd. of Educ.*, 21 A.D.3d 243, 248, 799 N.Y.S.2d 559, 563 (App. Div. 2d Dep't 2005) (applying *McConnell* to violation of New York City Charter ethics rule); *Ross Bicycles, Inc. v. Citibank, N.A.*, 178 A.D.2d 388, 390, 577 N.Y.S.2d 826, 828 (App. Div. 1st Dep't 1991); *Frohlich & Newell Foods, Inc. v. New Sans Souci Nursing Home*, 109 Misc. 2d 974, 977, 441 N.Y.S.2d 335, 338 (N.Y.C. Civ. Ct. 1981) (dismissing counterclaim judgment against plaintiff who partook in scheme whereby inflated bills were served on nursing home); *Pharm. Sales Consulting Corp. v. Accucorp Packaging, Inc.*, 231 F. App'x 110, 113 (3d Cir. 2005) (citing continuing viability of *McConnell*).

⁶⁴ *J.M. Deutsch, Inc. v. Robert Paper Co.*, 13 A.D.2d 768, 768, 215 N.Y.S.2d 939, 940-41 (App. Div. 1st Dep't 1961).

⁶⁵ *Id.*

⁶⁶ *S.T. Grand v. City of New York*, 32 N.Y.2d 300, 303, 298 N.E.2d 105, 106, 344 N.Y.S.2d 938, 940 (1973).

have thought they had nothing to lose by suing. Unfortunately for them and fortunately for the public, the New York Court of Appeals had been developing a more stringent rule with respect to public contracting and *Fried and S.T. Grand* would provide a perfect case to extend that rule even further.

IV. CORRUPTION IN PUBLIC SECTOR CONTRACTING IN NEW YORK

In *Jered Construction Corp. v. N.Y.C. Transit Authority*,⁶⁷ the Court of Appeals asserted that New York law had long recognized that:

a secret combination or collusive scheme by bidders for public work, whereby actual competition among bidders is prevented or diminished, renders void, or at least voidable, a contract for the work let to any participant in the combination or scheme and recovery was not permitted, even on a quantum meruit basis.⁶⁸

However, there seems to have been little, if any litigation in which this principle was actually tested in the context of public contracts.⁶⁹ What there was instead was a great deal of litigation in which the courts had refused to enforce contracts entered into in violation of the public bidding laws.⁷⁰

⁶⁷ *Jered Contracting Corp. v. N.Y.C. Transit Auth.*, 22 N.Y.2d 187, 239 N.E.2d 197, 292 N.Y.S.2d 98 (1968).

⁶⁸ *Id.* at 192, 239 N.E.2d at 200, 292 N.Y.S.2d at 102 (citations omitted).

⁶⁹ Thus, the *Jered* court only cited one case, *People v. Stephens*, 71 N.Y. 527, 26 Sickels 527 (1878) for this proposition. In *Stephens*, a bid-rigging scheme inflated prices on a canal project. *Stephens*, 71 N.Y. at 535, 26 Sickels at 535. Plaintiff sought to recover the difference between the rigged contract price and the price at which the work could have been performed but for the bid rigging. *Id.* The principal defense was that after discovering the fraud, the State continued with the contract and made payments at the contractual rate thereby legislatively waiving any claims. *Id.* The Court of Appeals ruled that the state had legislatively waived its claim. *Id.* at 537–40, 26 Sickels at 537–40.

⁷⁰ For cases discussing the enforceability of illegally executed government contracts decided prior to *Jered*, see *Smith v. Syracuse Improvement Co.*, 161 N.Y. 484, 488, 55 N.E. 1077, 1079 (1900); *Parr v. President & Trs. of Vill. of Greenbush*, 72 N.Y. 463, 471–72, 27 Sickels 463, 471–72 (1878) (holding contractor could not recover on illegally awarded contract); *Dickinson v. City of Poughkeepsie*, 75 N.Y. 65, 74–75, 30 Sickels 65, 74–75 (1878) (determining no recovery in contract or quantum meruit where contract was illegal); *McDonald v. Mayor of N.Y.*, 68 N.Y. 23, 23 Sickels 23 (1876); *Bonesteel v. City of New York*, 22 N.Y. 162, 168 (1860) (“It does not require any argument, to show that a contract made in violation of the requirements of the charter is null and void. It is equally clear, that a contract made in conflict with the authority granted, is equally null and void.”); *Brady v. Mayor of N.Y.*, 20 N.Y. 312, 319 (1859) (“It is not necessary to deny that one who has *bona fide* performed labor, under a contract which is void from a failure to comply with the statutes, may maintain an action against the city to recover a quantum meruit, where the work has been accepted by the city, and has gone into use for public purposes.”); *Donovan v. City of New York*, 33 N.Y. 291, 293 (1865) (contractor could not recover on debt illegally

In *Gerzof v. Sweeney* (“*Gerzof I*”),⁷¹ the Court of Appeals was confronted with a bid which, while not exactly rigged, had been manipulated so that only one bidder could apply.⁷² The Village of Freeport decided to acquire a 3,500 kilowatt generator and advertised for bids.⁷³ The Nordberg Manufacturing Company submitted a bid that was higher than the lowest bid by \$58,000.⁷⁴ When a new mayor and trustees were elected, the Village chose to award the contract to Nordberg, despite the fact that Nordberg’s bid was higher.⁷⁵ The low bidder sued and the court directed the Village to award the contract to the low bidder.⁷⁶ Instead, the Village Board of Trustees rebid the generator and colluded with Nordberg to draw up specifications that only Nordberg could meet.⁷⁷ A taxpayer sued challenging the new bid specifications.⁷⁸ The Court of Appeals held that the “unlawful manipulation” of the bidding process rendered the contract illegal and unenforceable, and the court remanded for a remedy.⁷⁹

In *Jered Construction Corp. v. N.Y.C. Transit Authority*,⁸⁰ the plaintiff contractor had refused to answer questions about bid rigging before a grand jury and the Transit Authority had subsequently terminated the contract.⁸¹ When the contractor sued for the contract balance, the Transit Authority asserted the “affirmative defense that the contract had been obtained by fraudulent and collusive bidding on the part of the plaintiff.”⁸² Plaintiff moved to dismiss the affirmative defense on the ground that the sum was “concededly due.”⁸³ Special Term struck the defense and the Appellate Division, First Department, affirmed over a dissent.⁸⁴

entered into by municipality). *Hodges v. Buffalo*, 2 Denio 110, 112 (N.Y. Sup. Ct. Jan. term 1846); *Cornell v. Guilford*, 1 Denio 510, 512 (N.Y. Sup. Ct. Oct. term 1845).

⁷¹ *Gerzof v. Sweeney*, 16 N.Y.2d 206, 211 N.E.2d 826, 264 N.Y.S.2d 376 (1965) [hereinafter *Gerzof I*].

⁷² *Id.* at 210, 211 N.E.2d at 828, 264 N.Y.S.2d at 380.

⁷³ *Id.* at 209, 211 N.E.2d at 827, 264 N.Y.S.2d at 379.

⁷⁴ *Id.*

⁷⁵ *Id.* at 209–10, 211 N.E.2d at 828, 264 N.Y.S.2d at 379.

⁷⁶ *Id.* at 208, 211 N.E.2d at 826–27, 264 N.Y.S.2d at 378.

⁷⁷ *Id.* at 210–12, 211 N.E.2d at 828–29, 264 N.Y.S.2d at 380–81.

⁷⁸ *Id.* at 208, 211 N.E.2d at 826–27, 264 N.Y.S.2d at 378.

⁷⁹ *Id.* at 209, 211 N.E.2d at 827, 264 N.Y.S.2d at 379.

⁸⁰ *Jered Contracting Corp. v. N.Y.C. Transit Auth.*, 22 N.Y.2d 187, 239 N.E.2d 197, 292 N.Y.S.2d 98 (1968).

⁸¹ *Id.* at 189–90, 239 N.E.2d at 198, 292 N.Y.S.2d at 100.

⁸² *Id.* at 190, 239 N.E.2d at 199, 292 N.Y.S.2d at 100.

⁸³ *Id.* at 191, 239 N.E.2d at 199, 292 N.Y.S.2d at 101.

⁸⁴ *Jered Contracting Corp. v. N.Y.C. Transit Auth.*, 28 A.D.2d 519, 279 N.Y.S.2d 821 (App. Div. 1st Dep’t 1967).

The Court of Appeals saw the prime issue in the case, as “whether a defense of fraudulent and collusive bidding is legally sufficient in a suit brought against a public authority for the reasonable value of work done.”⁸⁵ The Court of Appeals concluded in ringing language that it was indeed a defense:

The provisions of the statutes and ordinances of this State requiring competitive bidding in the letting of public contracts evince a strong public policy of fostering honest competition in order to obtain the best work or supplies at the lowest possible price. In addition, the obvious purpose of such statutes is to guard against favoritism, improvidence, extravagance, fraud and corruption. They “are enacted for the benefit of property holders and taxpayers, and not for the benefit or enrichment of bidders, and should be so construed and administered as to accomplish such purpose fairly and reasonably with *sole reference to the public interest.*” [emphasis in original] To this end, in a long line of cases . . . we have consistently held, primarily on public policy grounds, that, where the city fathers have deviated from the statutory mode for the expenditure of funds and letting of contracts, the party with whom the contract was made could not recover in *quantum meruit* or *quantum valebat*. The result should not differ where the due administration of the bidding statute is interfered with and competitive bidding thwarted by the unlawful collusion of the bidders themselves, resulting in a gross fraud upon the public. A contract procured through fraudulent and collusive bidding is void as against public policy and recovery cannot be had upon any theory.⁸⁶

The *Jered* Court expressed a second policy reason to support its conclusion:

The continuing growth of our cities and the expansion of governmental services on all levels has necessitated, over the years, the letting of greater numbers of public contracts. While the amount of money involved in these contracts was relatively small a few decades ago, today the amount is astronomical. It is, therefore, a matter of grave public concern that there be absolute honesty in the procuring of a public contract. If we are to effectively deter the

⁸⁵ *Jered*, 22 N.Y.2d at 192, 239 N.E.2d at 200, 292 N.Y.S.2d at 102.

⁸⁶ *Id.* at 192–93, 239 N.E.2d at 200, 292 N.Y.S.2d at 102–03 (citations omitted).

unscrupulous practice of fraudulent and collusive bidding on public contracts, we cannot look alone to existing penal sanctions. The nature of the wrong is such that it is not easily discovered but, when it is, we make it quite clear that courts of this State will decline to lend their aid to the fraudulent bidder who seeks recovery.⁸⁷

The *Gerzof* case returned to the Court of Appeals in 1968 on the issue of what was the appropriate remedy.⁸⁸ After the remand, the trial court conducted a hearing and directed the Village to retain the generator and recover from Nordberg the purchase price of \$757,625, which it had paid.⁸⁹ The Second Department of the Appellate Division modified the judgment by providing that, while Nordberg was to pay back the purchase price of the generator, it could retake the machine upon posting a bond of \$350,000 to secure the Village against any damages stemming from the removal and replacement of the equipment.⁹⁰

The Court of Appeals decided *Gerzof v. Sweeney*,⁹¹ (“*Gerzof II*”) a week after it issued its ruling in *Jered*. The Court began by observing that, while it had

not previously been called upon to fashion a remedy [for the situation] where an illegal and void contract for public work . . . [had] been performed in full on both sides, [it had] dealt with the situation, one step removed, in which the municipality has consumed or had the full benefit of illegally purchased goods or services but the vendor or supplier has not been paid . . . [and that it had] repeatedly refused . . . [to] allow the sellers to recover payment either for the price agreed upon or in quasi-contract.⁹²

Such a rule, the Court stated, had been adopted “to deter violation of statutes governing the spending of public moneys for goods and services” and “as a safeguard against the extravagance or corruption of officials as well as against their collusion with vendors.”⁹³ The Court expressed concern that:

⁸⁷ *Id.* at 193, 239 N.E.2d at 200–01, 292 N.Y.S.2d at 103.

⁸⁸ *Gerzof v. Sweeney*, 22 N.Y.2d 297, 239 N.E.2d 521, 292 N.Y.S.2d 640 (1968) [hereinafter *Gerzof II*].

⁸⁹ *Gerzof v. Sweeney*, 52 Misc. 2d 505, 508–09, 276 N.Y.S.2d 485, 488–89 (Sup. Ct. Nassau County 1966).

⁹⁰ *Gerzof v. Sweeney*, 29 A.D.2d 646, 646–47, 286 N.Y.S.2d 541, 543 (App. Div. 2d Dep’t 1968).

⁹¹ *Gerzof II*, 22 N.Y.2d at 297, 239 N.E.2d at 521, 292 N.Y.S.2d at 640.

⁹² *Id.* at 304, 239, N.E.2d at 523, 292 N.Y.S.2d at 643–44

⁹³ *Id.*

If we were to sanction payment of the fair and reasonable value of items sold in contravention of the bidding requirements, the vendor, having little to lose, would be encouraged to risk evasion of the statute; by the same token, if public officials were free to make such payments, the way would be open to them to accomplish by indirection what they are forbidden to do directly.”⁹⁴

However, despite concluding that there “should, logically, be no difference in ultimate consequence between the case where a vendor has been paid under an illegal contract and the one in which payment has not yet been made,” and that, “[i]n neither case can the usual concern of equity to prevent unjust enrichment be allowed to overcome and extinguish the special safeguards which the Legislature has provided for the public treasury,”⁹⁵ the Court, nonetheless, went on to fashion a far less punitive sanction than the forfeiture remedy which the trial court had ordered.

The Court found “justification—and precedent—for” the lower court’s remedy but concluded that “the sheer magnitude of the forfeiture” called for a different result.⁹⁶ After extensive discussion, the Court fixed as damages the difference between the amount the Village would have paid on the original low bid and the amount the Village actually paid after the manipulation of the bid, plus the additional costs to install the bigger generator for a total of \$176,636 plus interest.⁹⁷

Despite the strong language affirming public policy, the results in *Gerzof II* and *Jered* were not materially different from the *Sirkin*, *Schank*, and *McConnell* rule. In *Jered*, the Court held that it would not aid a corrupt bidder in recovering on the tainted contract.⁹⁸ In *Gerzof II*, the Village was essentially allowed to recover the difference between what it should have paid and what it actually paid.⁹⁹ This was essentially the same formulation as in *Schank*.¹⁰⁰ The result would be different in *S.T. Grand*.

When S.T. Grand sued the City for the unpaid balance of \$148,736, the City not only asserted as a defense that the contract was illegal by reason of the bribery of Marcus, but, somewhat

⁹⁴ *Id.* at 304, 239 N.E.2d at 523, 292 N.Y.S.2d at 644 (citations omitted).

⁹⁵ *Id.* at 305, 239 N.E.2d at 523–24, 292 N.Y.S.2d at 644.

⁹⁶ *Id.* at 305–06, 239 N.E.2d at 524, 292 N.Y.S.2d at 645.

⁹⁷ *Id.* at 307–08, 239 N.E.2d at 525, 292 N.Y.S.2d at 645–47.

⁹⁸ *Jered Contracting Corp. v. N.Y.C. Transit Auth.*, 22 N.Y.2d 187, 193, 239 N.E.2d 197, 201, 292 N.Y.S.2d 98, 103 (1968).

⁹⁹ *Gerzof II*, 22 N.Y.2d at 307–08, 239 N.E.2d at 525, 292 N.Y.S.2d at 646–47.

¹⁰⁰ *Schank v. Schuchman*, 212 N.Y. 352, 359, 106 N.E. 127, 129 (1914).

belatedly, asserted a counterclaim for the \$689,503 which it had previously paid under the contract.¹⁰¹ The City moved for summary judgment, pointing out the criminal convictions of S.T. Grand and its principal.¹⁰² Special Term denied summary judgment, finding no questions of fact but ruling that it would fashion a remedy at trial as had been done in *Gerzof II*.¹⁰³ The Appellate Division, First Department reversed over a dissent and directed judgment for the city on its counterclaim and dismissed the claim for the unpaid balance.¹⁰⁴

In *S.T. Grand, Inc. v. City of New York*¹⁰⁵ Justice Jasen, writing for a unanimous court, concluded there were two issues before the Court of Appeals.¹⁰⁶ The first issue was whether the criminal convictions were “conclusive proof” of the “underlying fact in a subsequent civil action.”¹⁰⁷ The second issue was “whether the equitable remedy fashioned” in *Gerzof II* was available to S.T. Grand.¹⁰⁸ S.T. Grand lost resoundingly on both issues.¹⁰⁹ The Court of Appeals had no difficulty holding that the criminal conviction collaterally estopped S.T. Grand from disputing liability.¹¹⁰

Turning to the remedy, the Court of Appeals cited *Jered* and *Gerzof II* and stated that “the rule is that where work is done pursuant to an illegal municipal contract, no recovery may be had by the vendor, either on the contract or in *quantum meruit*. We have also declared that the municipality can recover from the vendor all amounts paid under the illegal contract.”¹¹¹ Judge Jasen explained the public policy considerations at issue:

The reason for this harsh rule, which works a complete forfeiture of the vendor’s interest, is to deter violation of the bidding statutes. As we said in *Jered*: “The continuing growth of our cities and the expansion of governmental services on all levels has necessitated, over the years, the letting of greater numbers of public contracts. While the

¹⁰¹ *S.T. Grand, Inc. v. City of New York*, 38 A.D.2d 467, 468, 330 N.Y.S.2d 594, 595 (App. Div. 1st Dep’t 1972).

¹⁰² *Id.*

¹⁰³ *Id.*

¹⁰⁴ *Id.* at 472, 330 N.Y.S.2d at 598–99.

¹⁰⁵ *S.T. Grand, Inc. v. City of New York*, 32 N.Y.2d 300, 298 N.E.2d 105, 344 N.Y.S.2d 938 (1973), *reh’g denied*, 33 N.Y.2d 658, 303 N.E.2d 710, 348 N.Y.S.2d 1030 (1973).

¹⁰⁶ *Id.* at 302, 298 N.E.2d at 106, 344 N.Y.S.2d at 939.

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

¹⁰⁹ *Id.* at 305–07, 298 N.E.2d at 108–09, 344 N.Y.S.2d at 942–44.

¹¹⁰ *Id.* at 305, 298 N.E.2d at 108, 344 N.Y.S.2d at 942.

¹¹¹ *Id.* (citations omitted)

amount of money involved in these contracts was relatively small a few decades ago, today the amount is astronomical. It is, therefore, a matter of grave public concern that there be absolute honesty in the procuring of a public contract. If we are to effectively deter the unscrupulous practice of fraudulent and collusive bidding on public contracts, we cannot look alone to existing penal sanctions. The nature of the wrong is such that it is not easily discovered but, when it is, we make it quite clear that courts of this State will decline to lend their aid to the fraudulent bidder who seeks recovery.”¹¹²

Justice Jasen characterized the *Gerzof II* result as “an exception to the general rule, based upon the unusual circumstances of that case.”¹¹³ The *Gerzof II* remedy was not available in *S.T. Grand* because, unlike *Gerzof II*, the damages could not reasonably be calculated because the contract had been tainted from its initiation.¹¹⁴

The decision of the Court of Appeals in *S.T. Grand* to impose such a severe sanction was, not only, a marked departure from the more cavalier attitude which the same court had historically shown in connection with private sector commercial bribery, but also, was in advance of much of the country.¹¹⁵ The *Gerzof II* court cited only two cases from the rest of the country as support,¹¹⁶ while

¹¹² *Id.* (quoting *Jerred Contracting Corp. v. N.Y.C. Transit Auth.*, 22 N.Y.2d 187, 193, 239 N.E.2d 197, 200–01, 292 N.Y.S.2d 98, 103 (1968), citing *Gerzof v. Sweeney*, 22 N.Y.2d 297, 239 N.E.2d 521, 292 N.Y.S.2d 640 (1968)).

¹¹³ *Id.*

¹¹⁴ *Id.* at 306–07, 298 N.E.2d at 109, 344 N.Y.S.2d at 943.

¹¹⁵ Since 1973, a number of courts have applied forfeiture. *See, e.g.*, *Supermex, Inc. v. United States*, 35 Fed. Cl. 29, 41–42 (1996); *K & R Eng’g Co. v. United States*, 616 F.2d 469, 472 (Ct. Cl. 1980) (involving conflict of interest and bribery); *United States v. A & C Invs., Inc.*, 513 F. Supp. 589, 590–91 (N.D. Ill. 1981); *Manning Eng’g, Inc. v. Hudson Cnty. Park Comm’n*, 376 A.2d 1194, 1209 (N.J. 1977) (determining that corruption, illegality, and favoritism barred contractor from recovering); *Thompson v. L.J. Voldahl, Inc.*, 188 N.W.2d 377, 381–82 (Iowa 1971); *c.f.* *Kellogg Brown & Root Servs., Inc. v. United States*, No. 09 351C, 2011 WL 2739776, at *14 (Fed. Cl. July 6, 2011) (refusing to apply forfeiture to fraud in performance); *S.F. Bay Area Rapid Transit Dist. v. Spencer*, No. C 04-04632 SI, 2006 U.S. Dist. LEXIS 88022, at *45 n.6 (N.D. Cal. Dec. 5, 2006) (finding no “strict forfeiture” rule to exist under California law or the RICO statute and declining to follow *S.T. Grand*); *County of Essex v. First Union Nat’l Bank*, 891 A.2d 600, 607 (N.J. 2006) (citing *S.T. Grand* with approval but holding “that when a public contract is obtained by bribing a public official, the public entity is entitled to the gross profits obtained by the wrongdoer.”); *Irwin R. Evens & Son, Inc. v. Bd. of the Indianapolis Airport Auth.*, 584 N.E.2d 576, 582–83 (Ind. Ct. App. 4th Dist. 1992) (holding that where contract is wrongfully awarded, contractor may not recover all his profits).

¹¹⁶ *Gerzof v. Sweeney*, 22 N.Y.2d 297, 305, 239 N.E.2d 521, 524, 292 N.Y.S.2d 640, 644–45 (1968) (citing *Shasta County v. Moody*, 265 P. 1032, 1035 (Cal. Dist. Ct. App. 3d Dist. 1928));

acknowledging that there was precedent to the contrary.¹¹⁷

In the thirty-nine years since *S.T. Grand*, the New York courts have not only shown no sign of backing away from the harsh remedy imposed by the doctrine but have broadened the reach of the doctrine to extend considerably beyond the bid rigging, bribery, and conspiracy in the initiation of the contract which was at issue in *S.T. Grand*.¹¹⁸ Now, not just criminality, but any form of illegality in the public contracting process is likely to have the gravest of consequences for a contractor.¹¹⁹

Relatively early, the courts began to apply the *S.T. Grand* forfeiture doctrine to situations where there was no criminal wrongdoing but rather a disregard of the public bidding process.¹²⁰ *Albert Elia Building Co., Inc. v. New York State Urban Development Corp.* ("*Albert Elia*")¹²¹ was the first such case to discuss this at length. In 1972, the City of Niagara Falls issued plans for a major development.¹²² As the project developed, the City Council became unhappy with some of the plans and decided in 1973 to eliminate a planned overpass and to substitute a tunnel.¹²³ Rather than go through the process of publicly bidding the tunnel, the City Council decided to issue a change order to the contractor who was performing the rest of the project.¹²⁴ Another contractor (*Elia*) brought an Article 78 proceeding, alleging that the issuance of the change order violated the public bidding laws, specifically General

McNay v. Town of Lowell, 84 N.E. 778, 782 (Ind. App. 1st Div. 1908)). The *Gerzof II* court could have also cited *Heese v. Wenke*, 73 N.W.2d 223 (Neb. 1955), *Beakley v. City of Bremerton*, 105 P.2d 40 (Wash. 1940), and *Town of Boca Raton v. Raulerson*, 146 So. 576, 577 (Fla. 1933). See also *United States v. Miss. Valley Generating Co.*, 364 U.S. 520, 564–65 (1961) (holding that federal contract was unenforceable because of conflict of interest).

¹¹⁷ *Gerzof II*, 22 N.Y.2d at 305, 239 N.E.2d at 524, 292 N.Y.S.2d at 644–45 (citing *Vincennes Bridge Co. v. Bd. of Cnty. Comm'rs*, 248 F. 93, 98–102 (8th Cir. 1917); *Grady v. City of Livingston*, 141 P.2d 346 (Mont. 1943); *Scott Twp. Sch. Dist. Auth. v. Branna Constr. Corp.*, 185 A.2d 320 (Pa. 1962)).

¹¹⁸ *N.Y. State Ass'n of Plumbing-Heating-Cooling Contractors, Inc. v. Egan*, 86 A.D.2d 100, 102–03, 449 N.Y.S.2d 86, 88 (App. Div. 3d Dep't 1982), *aff'd*, 60 N.Y.2d 882, 885, 458 N.E.2d 826, 826, 470 N.Y.S.2d 367, 367 (1983) [hereinafter *Egan*]; *Albert Elia Bldg. Co. v. N.Y. State Urban Dev. Corp.*, 54 A.D.2d 337, 345, 388 N.Y.S.2d 462, 468 (App. Div. 4th Dep't 1976) [hereinafter *Albert Elia*]; *S.T. Grand, Inc. v. City of New York*, 38 A.D.2d 467, 470, 330 N.Y.S.2d 594, 597 (App. Div. 1st Dep't 1972), *aff'd* 32 N.Y.2d 300, 298 N.E.2d 105, 344 N.Y.S.2d 938 (1973).

¹¹⁹ *Egan*, 86 A.D.2d at 102–03, 449 N.Y.S.2d at 88; *Albert Elia*, 54 A.D.2d at 345, 388 N.Y.S.2d at 468.

¹²⁰ *Albert Elia*, 54 A.D.2d at 345, 388 N.Y.S.2d at 468.

¹²¹ *Id.* at 344, 388 N.Y.S.2d at 468.

¹²² *Id.* at 338–39, 388 N.Y.S.2d at 464.

¹²³ *Id.* at 339, 388 N.Y.S.2d at 464–65.

¹²⁴ *Id.* at 339, 388 N.Y.S.2d at 465.

Municipal Law section 103.¹²⁵ The trial court dismissed the petition after a hearing and the work was completed and paid for.¹²⁶ The Third Department reversed, holding that the issuance of the change order was indeed a violation of General Municipal Law section 103 because the change order was, in reality, additional supplemental work.¹²⁷

The *Albert Elia* court then went on to consider an appropriate remedy.¹²⁸ It cited *S.T. Grand*, *Gerzof II*, and *Jered* for the principle that:

Where work is performed pursuant to such an illegal contract ordinarily no recovery may be had by the vendor either on the contract or in *quantum meruit*, even though the municipality has received the benefits of the performance The municipality is permitted to recover from the vendor all amounts paid under the illegal contract.¹²⁹

The Court of Appeals has also rejected “an innocent contractor”¹³⁰ defense to *S.T. Grand*.¹³¹ In *New York State Association of Plumbing-Heating-Cooling Contractors, Inc. v. Egan*,¹³² a contractor’s association challenged the award by the state of certain emergency contracts, which were not been made in compliance with N.Y. State Finance Law section 135.¹³³ The Third Department held that there was no legal authority for the state to let emergency contracts and cited *S.T. Grand*.¹³⁴ The Third Department further ordered that the contractors who had been awarded the contracts be joined as necessary parties.¹³⁵ The Court of Appeals affirmed.¹³⁶

On remand, Special Term denied the challenge of the contracting

¹²⁵ *Id.* at 338, 340, 388 N.Y.S.2d at 464–65.

¹²⁶ *Id.* at 340, 388 N.Y.S.2d at 465.

¹²⁷ *Id.* at 342–43, 345, 388 N.Y.S.2d at 466–68.

¹²⁸ *Id.* at 345, 388 N.Y.S.2d at 468.

¹²⁹ *Id.* at 344, 388 N.Y.S.2d at 468 (citing *S.T. Grand v. City of New York*, 32 N.Y.2d 300, 305, 298 N.E.2d 105, 108, 344 N.Y.S.2d 938, 942 (1973); *Gerzof v. Sweeney*, 22 N.Y.2d 297, 305, 239 N.E.2d 521, 523, 292 N.Y.S.2d 640, 644 (1968); *Jered Contracting Corp. v. N.Y.C. Transit Auth.*, 22 N.Y.2d 187, 193, 239 N.E.2d 197, 201, 292 N.Y.S.2d 98, 103 (1968)).

¹³⁰ *Hayes v. Gross*, 9 A.D. 12, 16, 40 N.Y.S. 1098, 1101 (App. Div. 3d Dep’t 1896).

¹³¹ *N.Y. State Ass’n of Plumbing-Heating-Cooling Contractors, Inc. v. Egan*, 86 A.D.2d 100, 102–03, 449 N.Y.S.2d 86, 88 (App. Div. 3d Dep’t 1982), *aff’d*, 60 N.Y.2d 882, 885, 458 N.E.2d 826, 470 N.Y.S.2d 367, 367 (1983).

¹³² *Id.* at 101, 449 N.Y.S.2d at 87.

¹³³ *Id.*

¹³⁴ *Id.* at 102–03, 449 N.Y.S.2d at 88.

¹³⁵ *Id.* at 105–06, 449 N.Y.S.2d at 89–90.

¹³⁶ *N.Y. State Ass’n of Plumbing-Heating-Cooling Contractors, Inc. v. Egan*, 60 N.Y.2d 882, 885, 458 N.E.2d 826, 826, 470 N.Y.S.2d 367, 367 (1983).

association for the return to the state of all sums paid on the contracts.¹³⁷ When the case came before it again, the Third Department declined to order forfeiture of the, by then, completed contracts because of laches on the part of the contracting association which brought the Article 78 petition.¹³⁸

The case went back to the Court of Appeals in 1985. The Court of Appeals reversed, finding no time bar. More importantly, the Court of Appeals ruled that:

Dismissal of the complaint against the respondent contractors on the papers alone was also error. Although the papers do not suggest that there was fraud or collusion on the part of the contractors, that fact does not foreclose recovery from them to the extent that petitioner can show after trial that the State paid more under these contracts than it would have had to pay had the bidding procedure mandated by State Finance Law § 135 been followed To hold otherwise is completely to undermine the legislative mandate.¹³⁹

Cases decided in the Court of Appeals¹⁴⁰ and below¹⁴¹ have

¹³⁷ N.Y. State Ass'n of Plumbing-Heating-Cooling Contractors, Inc. v. Egan, 102 A.D.2d 901, 901, 477 N.Y.S.2d 737, 738 (App. Div. 3d Dep't 1984), *aff'd as modified*, 65 N.Y.2d 793, 482 N.E.2d 908, 493 N.Y.S.2d 112 (1985).

¹³⁸ *Id.* at 901–02, 477 N.Y.S.2d at 738–40.

¹³⁹ N.Y. State Ass'n of Plumbing-Heating-Cooling Contractors, Inc. v. Egan, 65 N.Y.2d 793, 796, 482 N.E.2d 908, 910, 193 N.Y.S.2d 112, 114 (1985) (citations omitted).

¹⁴⁰ D'Angelo v. Cole, 67 N.Y.2d 65, 70, 490 N.E.2d 819, 822–23, 499 N.Y.S.2d 900, 904 (1986) (involving an illegal road repair contract). *D'Angelo* has an interesting twist. There, the failure of a municipality to comply with the public bidding laws precluded the municipality from charging the costs of certain road improvement to the landowner. *Id.* at 67, 490 N.E.2d at 821, 499 N.Y.S.2d at 902. The municipality could, however, recover the sum at question from the contractor. *Id.* at 70, 490 N.E.2d at 823, 499 N.Y.S.2d at 904.

¹⁴¹ See, e.g., B.T. Skating Corp. v. County of Nassau, 204 A.D.2d 586, 586, 612 N.Y.S.2d 199, 200 (App. Div. 2d Dep't 1994) (involving an illegal licensing agreement for design, construction, and operation of temporary skating rink); Long Meadow Assocs. v. City of Glen Cove, 171 A.D.2d 731, 732–33, 567 N.Y.S.2d 287, 288 (App. Div. 2d Dep't 1991) (distinguishing *Gerzof II* and *Albert Elia*); Daily Bus & Truck Rental Corp. v. Bd. of Educ., 144 A.D.2d 669, 671, 535 N.Y.S.2d 50, 52 (App. Div. 2d Dep't 1988) (stating contractor could not recover in contract or *quantum meruit* on illegal contract to build mobile instructional units); H. Novinson & Co. v. City of New York, 53 A.D.2d 831, 385 N.Y.S.2d 317 (App. Div. 1st Dep't 1976); Prosper Contracting Corp. v. Bd. of Educ., 43 A.D.2d 823, 351 N.Y.S.2d 402 (App. Div. 1st Dep't 1974); Lance Investigation Serv., Inc. v. City of New York, 88 Misc. 2d 119, 119–20, 387 N.Y.S.2d 32, 32–33 (App. Term Sup. Ct. N.Y. County 1976) (stating rule); Spiritis v. Vil. of Hempstead Cmty. Dev. Agency, 12 Misc. 3d 1191(A), 824 N.Y.S.2d 770 (table case), 2006 N.Y. Slip Op. 51524(U) (Sup. Ct. Nassau County 2005); Cupid Diaper Serv. Corp. v. N.Y.C. Health & Hosps. Corp., 86 Misc. 2d 116, 119–20, 381 N.Y.S.2d 996, 999 (Sup. Ct. Queens County 1976) (holding plaintiff could not recover additional sums due on illegal contract modification, and defendant HHC entitled to recover additional sums paid on the modification).

consistently stated that *S.T. Grand* is applicable to government contracts which were illegal but which involved no fraud or criminality. Needless to say, the doctrine has continued to be applied full force to situations in which there was criminality or false representations.¹⁴²

The courts have also looked behind transactions to determine whether they violate the public bidding laws and then applied *S.T. Grand*. In *Albion Industrial Center v. Town of Albion*,¹⁴³ the Fourth Department concluded that what appeared to be a lease was, in reality, an illegal contract for the construction and purchase of a building.¹⁴⁴

S.T. Grand has been held to be applicable to situations where the contract is obtained through the making of false representations. In *Prote Contracting Co. v. N.Y.C. School Construction Authority*,¹⁴⁵ the plaintiff submitted a pre-qualification form to the New York City School Construction Authority (“SCA”), which did not disclose the prior criminal record of its president and sole owner.¹⁴⁶ After the contract was awarded and the work completed, the SCA discovered the omission of the convictions on its pre-qualification forms and alleged fraud in the inducement, claiming that had it been given the correct information during the bidding, it would have found Prote to be a non-responsible bidder and would have denied it the contract.¹⁴⁷ The Appellate Division held that the SCA had demonstrated fraud in the inducement and that the contract was thus null and void:

¹⁴² See, e.g., *Curiale v. Capolino*, 883 F. Supp. 941, 952 (S.D.N.Y. 1995) (awarding full amounts paid on corrupt contracts); *City of New York v. Liberman*, 232 A.D.2d 42, 49, 660 N.Y.S.2d 872, 876 (App. Div. 1st Dep’t 1997) (“Vendors that corrupt public officials forfeit their right to all payments due under the tainted transaction.”); *Citywide Factors, Inc. v. N.Y.C. Sch. Constr. Auth.*, 228 A.D.2d 499, 644 N.Y.S.2d 62 (App. Div. 2d Dep’t 1996); *Omni Contracting Co., Inc. v. City of New York*, No. 603812/08, 2009 N.Y. Slip Op. 32708 (Sup. Ct. N.Y. County Nov. 12, 2009); see also *Hutton Constr. Co. v. County of Rockland*, No. 93 CIV. 2465 (LAP), 87 CIV. 4027 (LAP), 1993 WL 535012, at *10 (S.D.N.Y. Dec. 22, 1993) (upholding sufficiency of pleading alleging that misrepresentations in qualifications and financial statement supported forfeiture claim); *City of New York v. Citisource, Inc.*, 679 F. Supp. 393 (S.D.N.Y. 1988).

¹⁴³ *Albion Indus. Ctr. v. Town of Albion*, 62 A.D.2d 478, 483–84, 405 N.Y.S.2d 521, 524 (App. Div. 4th Dep’t 1978).

¹⁴⁴ *Id.* at 484, 405 N.Y.S.2D at 525.

¹⁴⁵ *Prote Contracting Co. v. N.Y.C. Sch. Constr. Auth.*, 248 A.D.2d 693, 694, 670 N.Y.S.2d 562, 563 (App. Div. 2d Dep’t 1998); see also *Omni Contracting Co. v. City of New York*, 84 A.D.3d 763, 764, 922 N.Y.S.2d 795, 796 (App. Div. 2d Dep’t 2011) (granting defendant summary judgment and dismissing the complaint because evidence established that the plaintiff made false statements).

¹⁴⁶ *Prote*, 248 A.D.2d at 694, 670 N.Y.S.2d at 563.

¹⁴⁷ *Id.*

Here, not only did the SCA rely upon the false statements in awarding the contract to Prote, the statements prevented the SCA from conducting a thorough investigation into Prote's qualifications prior to the commencement or completion of the work. . . . Thus, we agree with the court's determination that the nature of the false statements was such that Prote is not entitled to recover any further sums under the contract.¹⁴⁸

In a different case involving the same contractor, *S.T. Grand* was applied to illegality in the *performance* of a public contract that had been obtained legally.¹⁴⁹ In *Prote Contracting Co. v. Board of Education of the City of New York*, Prote's president paid a \$10,000 bribe to the Board's Deputy Director for Maintenance to obtain a favorable ruling.¹⁵⁰ In reversing for a new trial, the Second Department held:

Without doubt, the conduct alleged on the part of plaintiff in offering a bribe to a key Board of Education employee as to a determination bearing on the issue of performance, if established, would be of a kind so gravely illegal and immoral and so inextricably connected with the contested question of performance under the contracts as to bar recovery thereunder as a matter of public policy.¹⁵¹

The decision of the Second Department in *Christ Gatzonis Electrical Contractor, Inc. v. New York City School Construction Authority*,¹⁵² when read together with the decision at Special Term, Supreme Court, Queens County, of Justice Milano,¹⁵³ represents an expansion of the *S.T. Grand* doctrine to apply forfeiture to sums earned on government contracts which had been obtained and performed legally but which were performed *after* the contractor had engaged in illegal conduct (i.e., bid-rigging, bribery, and conspiracy) on other unrelated contracts with the same governmental agency.

The *Christ Gatzonis* case arose from a novel bid-rigging scheme

¹⁴⁸ *Id.* at 696, 670 N.Y.S.2d at 564 (citations omitted).

¹⁴⁹ *Prote Contracting Co. v. Bd. of Educ.*, 230 A.D.2d 32, 34, 657 N.Y.S.2d 158, 160 (App. Div. 1st Dep't 1997).

¹⁵⁰ *Id.* at 38, 657 N.Y.S.2d at 162.

¹⁵¹ *Id.* at 41, 657 N.Y.S.2d at 164 (footnote omitted).

¹⁵² *Christ Gatzonis Elec. Contractor, Inc. v. N.Y.C. Sch. Constr. Auth.*, 297 A.D.2d 272, 745 N.Y.S.2d 914 (App. Div. 2d Dep't 2002).

¹⁵³ *Christ Gatzonis Elec. Contractor, Inc. v. N.Y.C. Sch. Constr. Auth.*, N.Y. L.J., Feb. 23, 2001, at 21 (Sup. Ct. Queens County Feb. 22, 2001).

created by Mark Parker, an employee of the SCA.¹⁵⁴ One of Parker's responsibilities was to open the bids.¹⁵⁵ On February 13, 1992, when Parker opened the bids for a contract for electrical work at several schools, he found that most of the contractors had bid in the vicinity of \$650,000.¹⁵⁶ The lowest bid was submitted by Christ Gatzonis Electrical Contractor, Inc. ("Christ Gatzonis") for \$340,000.¹⁵⁷ Parker had arranged for Gatzonis' bid to be opened last.¹⁵⁸ Instead of announcing the \$340,000 bid, Parker, announced Christ Gatzonis' bid to be \$621,900, thereby inflating it by approximately \$280,000 while still preserving its status as the low bid.¹⁵⁹ Shortly after the bid was announced, Parker met with an agent of Christ Gatzonis and told him that the company needed to provide him with a new page two of the bid package to reflect the increased bid amount.¹⁶⁰ The bid page was substituted and Christ Gatzonis was later awarded the project for the larger amount.¹⁶¹ In subsequent meetings, Parker received payments from Christ Gatzonis and promises of other payments.¹⁶² Parker came under investigation in August of 1992, and on January 27, 1993, he agreed to cooperate with law enforcement and wore a recording device during his conversations with dozens of contractors and SCA employees.¹⁶³ On or about April 20, 1993, fourteen individuals were arrested on a variety of federal charges.¹⁶⁴ Immediately after the arrests of the principals of Christ Gatzonis, the SCA suspended the company's work on its active contracts, rescinded those contracts and refused to make payments on nearly thirty contracts.¹⁶⁵

Substantial civil litigation ensued in a number of forums, all of it unsuccessful for Christ Gatzonis.¹⁶⁶ Plaintiff sued in Queens

¹⁵⁴ *Id.* Another decision arose from the same scheme but a different contractor. *Extech Indus., Inc. v. N.Y.C. Sch. Constr. Auth.*, N.Y. L.J., Nov. 9, 2000, at 22–23 (Sup. Ct. N.Y. County Nov. 8, 2000).

¹⁵⁵ *Christ Gatzonis*, N.Y. L.J., Feb. 23, 2001, at 21.

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ *Id.*

¹⁶⁴ *Id.*

¹⁶⁵ *Id.*

¹⁶⁶ On July 27, 1993, Christ Gatzonis entered into a stipulation with the United States in which it forfeited \$360,000 to the federal government and agreed to pay an additional lump sum of \$40,000. *See Colonia Ins. Co. v. United States*, 1996 U.S. Dist. LEXIS 20290, at *4 n.3 (E.D.N.Y. Jan. 25, 1996). Christ Gatzonis unsuccessfully sued the SCA in federal court, alleging the SCA's refusal to pay deprived the company of due process. *See Christ Gatzonis*

Supreme Court in 1994 seeking to recover \$1,325,376.23, which plaintiff had not been paid on some twenty-six contracts.¹⁶⁷ Tellingly, Christ Gatzonis did not sue on the contract for electrical work, which it and SCA employee Mark Parker had rigged.¹⁶⁸ The SCA asserted *S.T. Grand* as a defense and counterclaimed to recover all sums paid on all contracts after the date of the bid-rigging, even those contracts which had been obtained and performed legally.¹⁶⁹ In ruling on the SCA's summary judgment motion, Justice Milano found that there was no question of fact as to the bid-rigging and bribery and that *Jered* and *S.T. Grand* thus barred Christ Gatzonis from recouping on the contracts.¹⁷⁰ Justice Milano then went a step further and held that the SCA should recover \$4,710,331.60, the total amount it had paid Christ Gatzonis after the date of the bid-rigging.¹⁷¹

On appeal, the Second Department affirmed, agreeing with the Supreme Court that there was "no issue of fact as to whether the plaintiff engaged in a bid-rigging and bribery scheme."¹⁷² Therefore, the Second Department ruled that the SCA "was entitled to rescind the contracts at issue and seek recoupment for moneys already paid under such contracts."¹⁷³ Thus, the decision of Christ Gatzonis to go along with Parker's scheme in order to get an extra \$300,000 on one contract, cost the contractor \$1,325,376.23 it would have otherwise received and in addition, lead to a huge verdict against the contractor.¹⁷⁴ Since none of the principals or Christ Gatzonis were ever convicted of crimes, the civil penalties were the sole punishment imposed.¹⁷⁵

Elec. Contr., Inc. v. N.Y.C. Sch. Constr. Auth., 23 F.3d 636, 637 (2d Cir. 1994) (affirming *Christ Gatzonis Elec. Contractor, Inc. v. N.Y.C. Sch. Constr. Auth.*, No. CV-93-2418, 1993 WL 262715 (E.D.N.Y. July 2, 1993)). In two opinions, both issued on January 13, 1997, the Second Department of the Appellate Division denied summary judgment to Christ Gatzonis' surety on its claim to recover sums, which the SCA had refused to pay Christ Gatzonis because of the corruption. See *Avon Elec. Supplies, Inc. v. Christ Gatzonis Elec. Contractor, Inc.*, 235 A.D.2d 380, 380, 652 N.Y.S.2d 72, 72-73 (App. Div. 2d Dep't 1997); *Kennedy Elec. Supply Corp. v. Christ Gatzonis Elec. Contractor, Inc.*, 235 A.D.2d 398, 398, 652 N.Y.S.2d 550, 550 (App. Div. 2d Dep't 1997).

¹⁶⁷ *Christ Gatzonis*, N.Y. L.J., Feb. 23, 2001, at 21.

¹⁶⁸ *Id.*

¹⁶⁹ *Id.*

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Christ Gatzonis Elec. Contractor, Inc. v. N.Y.C. Sch. Constr. Auth.*, 297 A.D.2d 272, 272, 745 N.Y.S.2d 914, 914 (App. Div. 2d Dep't 2002).

¹⁷³ *Id.*

¹⁷⁴ *Christ Gatzonis*, N.Y. L.J., Feb. 23, 2001, at 21.

¹⁷⁵ *Christ Gatzonis*, 297 A.D.2d at 272, 745 N.Y.S.2d at 914.

V. UNSETTLED ISSUES IN *S.T. GRAND*

Despite the considerable development of the *S.T. Grand* doctrine, several issues still remain unresolved. One issue is whether the forfeiture and reimbursement remedy set out in *S.T. Grand* must be applied to all instances of illegality in the formation or performance of governmental contracts. Put another way, the question is how much vitality is left to the *Gerzof II* doctrine whereby the court crafts the remedy. It would appear that, while the Court of Appeals has not overturned *Gerzof II*, forfeiture and reimbursement remain the general rule.

In two post-*S.T. Grand* cases, the courts have imposed a remedy less harsh than forfeiture or even nonpayment. In each of these cases, however, there were significant equities on the side of the plaintiff. In *Albert Elia*, the court noted “there was neither allegation nor proof of fraud, collusion or other wrongdoing on the part of the respondents, rather the change order was granted only after valid and appropriate factors were considered,”¹⁷⁶ and that, “[w]hile such evidence of good faith on the part of respondents does not legitimize the contract, it mitigates against imposing the harsh remedy of full forfeiture.”¹⁷⁷ The remedy imposed by the court was to order the contractor “to refund the difference between the contract price for work done under [the change order] and the price for which a bidding general contractor would have agreed to construct [the tunnel].”¹⁷⁸

In *New York State Association of Plumbing-Heating-Cooling Contractors, Inc. v. Egan*,¹⁷⁹ the Court of Appeals remanded to the lower court, stating that damages would be measured by determining whether “the State paid more under these contracts than it would have had to pay had the bidding procedure mandated by State Finance Law § 135 been followed.”¹⁸⁰

Albert Elia and *Egan* appear, however, to be anomalous decisions, decided as they were because of the overwhelming equities favoring the contractors who faced substantial losses without having done anything wrong.¹⁸¹ In both cases, the departure from the public

¹⁷⁶ *Albert Elia Bldg. Co. v. N.Y. State Urban Dev. Corp.*, 54 A.D.2d 337, 345, 388 N.Y.S.2d 462, 468 (App. Div. 4th Dep’t 1976).

¹⁷⁷ *Id.*

¹⁷⁸ *Id.*

¹⁷⁹ *N.Y.S. Ass’n of Plumbing-Heating-Cooling Contractors, Inc. v. Egan*, 65 N.Y.2d 793, 482 N.E.2d 908, 493 N.Y.S.2d 112 (1985).

¹⁸⁰ *Id.* at 796, 482 N.E.2d at 910, 493 N.Y.S.2d at 114.

¹⁸¹ *Albert Elia*, 54 A.D.2d at 345, 388 N.Y.S.2d at 468; *Egan*, 65 N.Y.2d at 796, 482 N.E.2d

bidding laws had been initiated by the governmental entity and the entire process had been entirely open and above board.¹⁸² In every reported case decided since *S.T. Grand* in which not just illegality, but criminal or fraudulent conduct was alleged, the courts have consistently applied the *S.T. Grand* forfeiture doctrine.¹⁸³ As already discussed, even in cases involving non-criminal violations of the public bidding laws, the Courts have generally imposed *S.T. Grand* forfeiture. Thus, *Gerzof II* is, as the *S.T. Grand* court called it, the “exception to the general rule.”¹⁸⁴

A second issue, which the Court of Appeals has yet to decide, is whether the stronger public policy considerations that are applicable to public, as opposed to private, contracting would render the *Hornstein*¹⁸⁵ extortion defense unavailable in the public sector. This issue was raised in litigation arising out of the criminal activities of Alex Liberman, formerly Director of Negotiations for the New York City Department of General Services’ Bureau of Leasing.¹⁸⁶ In *City of New York v. Corwen*,¹⁸⁷ the First Department wrote:

While the city contends that defendants’ extortion defense would be applicable only in criminal prosecutions, not in this civil proceeding, one who is victimized by an extortion will not be held civilly liable for the amount of such payments Thus, while the present posture of this action furnishes no definitive answer at this time, such an affirmative defense may be available to defendants, in the event defendants are able to establish they were the victims of Liberman’s extortion.¹⁸⁸

When the *Liberman* case appeared before it again after trial, the

at 910, 493 N.Y.S.2d at 114.

¹⁸² *Albert Elia*, 54 A.D.2d at 339, 388 N.Y.S.2d at 465; *Egan*, 65 N.Y.2d at 796, 482 N.E.2d at 910, 493 N.Y.S.2d at 114.

¹⁸³ *See, e.g.*, *Curiale v. Capolino*, 883 F. Supp. 941, 951 (S.D.N.Y. 1995); *Christ Gatzonis Elec. Contractor, Inc. v. N.Y.C. Sch. Constr. Auth.*, 297 A.D.2d 272, 272, 745 N.Y.S.2d 914, 914 (App. Div. 2d Dep’t 2002); *City of New York v. Liberman*, 232 A.D.2d 42, 49, 660 N.Y.S.2d 872, 876 (App. Div. 1st Dep’t 1997); *Prote Contracting Co. v. N.Y.C. Sch. Constr. Auth.*, 248 A.D.2d 693, 696, 670 N.Y.S.2d 562, 564 (App. Div. 2d Dep’t 1998); *Prote Contracting Co. v. Bd. of Educ.*, 230 A.D.2d 32, 41, 657 N.Y.S.2d 158, 164 (App. Div. 1st Dep’t 1997).

¹⁸⁴ *S.T. Grand, Inc. v. City of New York*, 32 N.Y.2d 300, 305, 298 N.E.2d 105, 108, 344 N.Y.S.2d 938, 942 (1973).

¹⁸⁵ *Hornstein v. Paramount Pictures, Inc.*, 292 N.Y. 468, 471–72, 55 N.E.2d 740, 742 (1944).

¹⁸⁶ *City of New York v. Corwen*, 164 A.D.2d 212, 214–15, 565 N.Y.S.2d 457, 458 (App. Div. 1st Dep’t 1990).

¹⁸⁷ *Id.* at 212, 565 N.Y.S.2d at 457.

¹⁸⁸ *Id.* at 218, 565 N.Y.S.2d at 460 (citations omitted).

First Department cited the above language and added: “Since the distinction between bribe and extortion is a fine one, a determination as to the nature of the payments to Liberman requires analysis of the facts and circumstances surrounding each payment.”¹⁸⁹

The Second Circuit has taken exactly the opposite position, noting that: “[t]he proper response to coercion by corrupt public officials should be to go to the authorities, not to make the payoff.”¹⁹⁰

The Second Circuit’s position seems to be the better public policy for a number of reasons. First, when a contractor has been caught red-handed, paying money to a public servant, a claim of extortion is the only criminal defense and the only escape from forfeiture and, accordingly, it creates a huge incentive for perjury by parties already known to be dishonest. Thus, in *Extech Industries, Inc. v. New York City School Construction Authority*,¹⁹¹ the contractor had sworn at his deposition that he had no memory of the transactions leading up to and including the payment of money to an employee of the SCA.¹⁹² When confronted on a summary judgment motion with the evidence of the bribery and bid-rigging, the contractor suddenly remembered that he had been extorted and thereby avoided summary judgment.¹⁹³

Second, the extortion defense is anomalous and unfair. The courts have consistently applied the *S.T. Grand* rule of forfeiture to penalize public contractors who inadvertently and unintentionally violate public bidding laws.¹⁹⁴ In that context, the New York courts have always warned contractors “that those seeking to deal with a municipal corporation through its officials, must take great care to learn the nature and extent of their power and authority,”¹⁹⁵ and

¹⁸⁹ *City of New York v. Liberman*, 232 A.D.2d 42, 44, 660 N.Y.S.2d 872, 873 (App. Div. 1st Dep’t 1997).

¹⁹⁰ *United States v. Kahn*, 472 F.2d 272, 278 (2d Cir. 1973); *see also* *City of New York v. Balkan, Inc.*, 656 F. Supp. 536, 546–48 (E.D.N.Y. 1987) (refusing to dismiss civil RICO bribery claims against sewer contractors despite the conviction of City sewer inspectors for federal extortion).

¹⁹¹ *Extech Indus., Inc. v. N.Y.C. Sch. Constr. Auth.*, N.Y. L.J., Nov. 9, 2000, at 21 (Sup. Ct. N.Y. County Nov. 8, 2000).

¹⁹² *Id.* at 23.

¹⁹³ *Id.*

¹⁹⁴ *See, e.g.*, *B.T. Skating Corp. v. County of Nassau*, 204 A.D.2d 586, 586, 612 N.Y.S.2d 199, 200 (App. Div. 2d Dep’t 1994); *N.Y. State Ass’n of Plumbing-Heating-Cooling Contractors, Inc. v. Egan*, 86 A.D.2d 100, 103, 449 N.Y.S.2d 86, 88 (App. Div. 3d Dep’t 1982); *Albert Elia Bldg. Co. v. N.Y. State Urban Dev. Corp.*, 54 A.D.2d 337, 345, 388 N.Y.S.2d 462, 468 (App. Div. 4th Dep’t 1976).

¹⁹⁵ *McDonald v. Mayor of New York*, 68 N.Y. 23, 27, 23 Sickels 23, 27 (1876) (citations omitted); *see also* *Parsa v. State*, 64 N.Y.2d 143, 146–47, 474 N.E.2d 235, 236, 237, 485

that they proceed at their own risk. Anyone who pays money to a public servant knows to a certainty that he or she is engaging in illegal and criminal conduct. It makes no sense to deter misconduct by penalizing those who unintentionally violate the public bidding laws, while providing a defense to those who engage in conduct which they know is improper.

Finally, it should be considered that the extortion defense is of limited utility. It will not be available in cases where the contract was obtained through some sort of fraud or misrepresentation or where there was fraud in the performance of the contract. Moreover, since the defense is imported directly from New York criminal law, it is unclear what happens when the illegality at issue is violative of New York statutes other than bribery¹⁹⁶ or of federal criminal law¹⁹⁷ to which extortion is not a defense.

A third unresolved issue is whether illegal conduct by subcontractors and other agents triggers *S.T. Grand* forfeiture. Most

N.Y.S.2d 27, 28–29 (1984) (denying further compensation for services rendered when a contract was not approved by the State Comptroller as required by statute); *Hodges v. City of Buffalo*, 2 Denio 110, 112–13 (Sup. Ct. Jan. term 1846) (holding that a contractor could not recover on debt illegally entered into by municipality); *Cornell v. Town of Guilford*, 1 Denio 510, 512 (Sup. Ct. Oct. term 1845).

¹⁹⁶ The New York Penal Law criminalizes not merely bribery of a public servant, but also the rewarding of official misconduct and the giving of unlawful gratuities. See N.Y. PENAL LAW § 200.00 (McKinney 2011) (criminalizing bribery of a public servant as a class D felony); see also *id.* § 200.20 (criminalizing the reward of official misconduct as a class E felony); *id.* § 200.30 (criminalizing the giving of unlawful gratuities as a Class A misdemeanor). Submitting or preparing false documents is penalized under New York Penal law as well. See *id.* § 175.10 (criminalizing the falsification of business records in the first degree as a Class E felony); see also *id.* § 175.05 (criminalizing the falsification of business records in the second degree as a Class A misdemeanor); *id.* § 175.25 (criminalizing the tampering with public records in the first degree as a Class D felony); *id.* § 175.20 (criminalizing the tampering with public records in the second degree as a Class A misdemeanor). Depending on the circumstances, submission of false statements to the government constitutes the crimes of “Offering a False Statement for Filing” in the first or second degree, and “Obstructing Governmental Administration.” See *id.* § 175.35 (criminalizing the offering of a false instrument for filing in the first degree as a class E felony); *id.* § 175.30 (criminalizing the offering of a false instrument for filing in the second degree as a class A misdemeanor); § 195.05 (criminalizing the obstruction of government administration in the second degree as a class A misdemeanor). Conspiratorial conduct is criminal in New York under the general conspiracy statutes and a specific statute criminalizes bid-rigging conspiracies. *Id.* §§ 105.00–105.35; see also N.Y. GEN. MUN. LAW § 103-e. Of all those statutes, extortion is a defense only to section 200.00. PENAL § 200.05.

¹⁹⁷ Federal law criminalizes theft or bribery concerning programs receiving federal funds, and includes the crime of structuring currency transactions. See 18 U.S.C. § 666(a)(2) (2006); see also 31 U.S.C. § 5324. The federal crimes of mail fraud and wire fraud, and the crime of fraud and false statements, are implicated in false filings and the use of the mails and the interstate wires to further a fraudulent scheme. See 18 U.S.C. § 1341 (2006 & Supp. II 2008); see also 18 U.S.C. § 1343 (2006 & Supp. II 2008); *id.* § 1001. Federal law also criminalizes the concealment of a crime as the federal offense of misprision of felony. See *id.* § 4.

sizable government contracts are performed by multiple tiers of subcontractors. In *Babylon Associates v. County of Suffolk*,¹⁹⁸ a second-tier subcontractor fraudulently installed defective concrete pipes in a massive sewer project, thereby substantially increasing the cost of the project and delaying it.¹⁹⁹ When the general contractor sued, the County of Suffolk counterclaimed to hold the general contractor liable contractually for the increased costs and sought to recover all sums paid on the project.²⁰⁰ The Second Department held that the general contractor might be liable contractually for the actions of the subcontractor but distinguished *McConnell* and *S.T. Grand*, stating that “the harsh remedy of total forfeiture should, in our opinion, be limited to situations where the party seeking to enforce the contract was directly involved in or had knowledge of the illegal activity.”²⁰¹

The Second Department’s reasoning seems superficially fair since the general contractor obviously cannot be deterred from illegal conduct that it does not itself commit or know about. The difficulty with the Second Department’s rule is that it does not give the general contractor much incentive to monitor its subcontractors and it apparently allows the general contractor to recover for the subcontractor’s work and presumably even to pay the subcontractor. A better rule would be that the subcontractor forfeits all entitlements to be paid and must reimburse the government as under the ordinary operation of *S.T. Grand*. A somewhat harsher rule would be to apply forfeiture against the general contractor unless the general contractor can show it could not have known of or prevented the illegal conduct with due diligence.

VI. CONCLUSION

In conclusion, the line of cases beginning with *Jered* and continuing through to *Christ Gatzonis* has indeed created a serious deterrent to illegal conduct in governmental contracting where the civil penalties can far outweigh the criminal penalties.²⁰² However, New York law, as it has developed over the past century, treats criminal wrongdoing in the private sector contractual context so

¹⁹⁸ *Babylon Assocs. v. County of Suffolk*, 101 A.D.2d 207, 475 N.Y.S.2d 869 (App. Div. 2d Dep’t 1984).

¹⁹⁹ *Id.* at 210, 475 N.Y.S.2d at 871.

²⁰⁰ *Id.* at 211, 475 N.Y.S.2d at 872.

²⁰¹ *Id.* at 216, 475 N.Y.S.2d at 874.

²⁰² For example, the contractors involved in the corrupt activity in *Prote*, *Extech*, and *Christ Gatzonis* never went to jail.

laxly as to almost encourage it.

Those differences are striking. In a private sector case, the victim of commercial bribery who does not discover it until after the transaction is complete, must prove not only the illegal conduct but that the illegal conduct was directly connected to “the obligation sued upon,”²⁰³ and that there is “some disparity between the value and the price.”²⁰⁴ Otherwise, the victim’s damages are limited to the amount of the bribe.²⁰⁵ An ineffectual bribe carries with it no penalty.²⁰⁶ In the public sector, *any illegality* discovered *at any time* provides not just the basis for a defense against any sums still owed but for an affirmative recovery of all sums paid not only on the tainted contract, but on any other contracts preformed after the illegality.²⁰⁷

It is not that the public sector rules are too harsh but that the private sector rules are too lenient. Leaving the parties as they are when the corrupt conduct is discovered places a premium on successful concealment.²⁰⁸ Requiring the victimized party to prove that the contract price was inflated places the burden of proof on the wrong party. The *Donemar* rule is plainly unrealistic and inadequate as a damage remedy, not only because it places on the burden of proof on the victim when both parties involved in the bribe transaction have a substantial interest in minimizing the amount of the bribe, but most fundamentally, because there is no reason to believe that the bribe amount represents the true economic damage to the victim of the corrupt transaction. After all, if the contractor had been willing and able to perform the contract for the amount of its bid minus the bribe, it would have offered to do so at that price, thereby sparing itself the risk of having to make a bribe.²⁰⁹

²⁰³ *McConnell v. Commonwealth Pictures Corp.*, 7 N.Y.2d 465, 471, 166 N.E.2d 494, 497, 199 N.Y.S.2d 483, 487 (1960).

²⁰⁴ *Schank v. Schuchman*, 212 N.Y. 352, 360, 106 N.E. 127, 129 (1914).

²⁰⁵ *Donemar, Inc. v. Molloy*, 252 N.Y. 360, 364–65, 169 N.E. 610, 611 (1930).

²⁰⁶ *Merchs. Line v. Balt. & Ohio R.R. Co.*, 222 N.Y. 344, 346, 118 N.E. 788, 788 (1918).

²⁰⁷ *Christ Gatzonis Elec. Contractor, Inc. v. N.Y.C. Sch. Constr. Auth.*, 297 A.D.2d 272, 272, 745 N.Y.S.2d 914, 914 (App. Div. 2d Dep’t 2002).

²⁰⁸ Disclosure of the underlying criminal or illegal conduct may come years after the conclusion of the project. In *Manning Engineering*, the contractor’s role in the project was completed in 1968 and the corruption was not disclosed until 1971 as part of an unrelated investigation. *Manning Eng’g, Inc. v. Hudson Cnty. Park Comm’n*, 376 A.2d 1194, 1197 (N.J. 1977). In *Prote*, the contract work was performed in the mid-1980s, but the corrupt arrangement was not discovered until 1994, again as part of an unrelated criminal investigation. *Prote Contracting Co. v. Bd. of Educ.*, 230 A.D.2d 32, 33–35, 657 N.Y.S.2d 158, 159–62 (App. Div. 1st Dep’t 1997).

²⁰⁹ In the context of construing a federal anti-kickback statute, the Supreme Court rejected

While the public interest in assuring integrity in private sector contracting is clearly not as great as it is in the public sector, that is not to say that there is no public interest in deterring commercial bribery in the private sector. The effective enforcement of the forfeiture and reimbursement remedy for public sector contract corruption suggests that it is time for the Court of Appeals to revisit the same issue in the context of private sector contract corruption. The present system all but encourages such corruption by placing the evidentiary burden on the victim and by assuring that the damages will generally be no more than having the corrupt party pay the bribe a second time, this time to the victim. To add a significant deterrence, the Court of Appeals need not even go as far as it has done in *S.T. Grand*. It could accomplish much the same goal merely by shifting the burden of proof onto the party that committed the illegality by making that party prove that the illegal transaction did not infect the whole contract.

the argument “that the express provision for recovery of kickbacks is enough to protect the Government from increased costs attributable to them.” *United States v. Acme Process Equip. Co.*, 385 U.S. 138, 144 (1966). That argument, the Court held, was based upon “two false assumptions.” *Id.* The first false assumption “is that kickbacks can easily be detected and recovered.” *Id.* The second “is that the increased cost [to] the Government is necessarily equal to the amount of the kickback which is recoverable.” *Id.* The Court noted realistically that a contractor

will be tempted to inflate that proposal by more than the amount of the kickback. And even if the Government could isolate and recover the inflation attributable to the kickback, it would still be saddled with a subcontractor who, having obtained the job other than on merit, is perhaps entirely unreliable in other ways.

Id.; see also *Curiale v. Capolino*, 883 F. Supp. 941, 952 (S.D.N.Y. 1995). (“If the vendor were liable only for the difference between the fair market value of what it provided and the inflated price made possible by its corruption, the economic incentives would tilt in favor of corruption. The vendor would keep a super-competitive profit if the corruption went undetected and make a normal profit if the fraud were detected and the difference disgorged. Putting aside, for the moment, the deterrent effect of criminal sanctions, such a rule of damages would put the vendor in the position of standing to profit from successful corruption while risking no economic loss if the corruption were found out.”).