RUSKINMOSCOUFALTISCHEK P.C.
Counselors at Law

Caveat Venditor: It's Seller Beware When Contracting With State

by Mark S. Mulholland and Robert F. Regan

Caveat emptor, the age-old Latin maxim that places the burden on the buyer to inspect the desired goods before making a purchase, is certainly sage advice. Even in this age of consumer protection laws, the buyer is well advised to do some investigating before entering into a binding agreement. The enactment of §112 of the New York State Finance Law has added a modern-day twist to the buyer-seller relationship, placing the onus on the seller to do some investigating of its own when the buyer is New York state.

In these situations, it is the seller who must beware: caveat venditor. Public Finance Law §112 (2)(a), which was originally enacted in 1940 and has its origins in the late 19th century, currently provides in pertinent part:

Before any contract made for or by any state agency, department, board, officer, commission, or institution, shall be executed or become effective, whenever such contract exceeds fifteen thousand dollars in amount, it shall first be approved by the comptroller and filed in his or her office.

Thus, a contract in excess of $15,000 is generally unenforceable against the State unless and until it has been approved by the state comptroller. The purpose of this statute is "to prevent State employees from making improvident or extravagant contracts and from creating liabilities for which there has been no appropriation."

Although a state agency or officer has a "ministerial duty" to submit covered contracts in excess of the statutory threshold to the state comptroller for approval, courts have held that this duty is not owed to the party contracting with the state. Thus, a state agency's failure to submit a covered contract to the state comptroller and obtain the necessary approval ordinarily will not give rise to any liability.

Instead, the party contracting "is chargeable with knowledge of the statutes which regulate its contracting powers and is bound by them." The fact that the state may have received and accepted all of the benefits furnished under a contract does not prevent the state from subsequently challenging the validity of the contract where the contract in question has not been approved by the comptroller. Accordingly, the vendor must ensure that the contract is submitted and approved by the comptroller and his only option "is to withhold his services unless an agreement is executed and approved as the statutes require."

While courts frequently acknowledge the seemingly unjust results of §112, they reason that "any other rule would completely frustrate statutes designed to protect the public from governmental misconduct or improvidence."

Accordingly, the requirements of §112 are generally strictly enforced and, although not new, the statute continues to have devastating consequences for unsuspecting vendors that enter into covered contracts with the state.

Commercial Building Lease

In *Rosefsky v. State*, for example, claimant Alec Rosefsky had leased the first floor of a commercial building to the state for use by the Education Department. The department subsequently sought to expand its operations into a portion of the second floor of the same building, and, after Mr. Rosefsky completed certain requested renovations for which the department agreed the state would pay, the department began occupying the second floor.

Although the lease for the first floor had expired, the state continued to pay the agreed upon rent for the first floor while the parties engaged in extended negotiations concerning the terms of a new lease that would cover both floors.

When the parties ultimately failed to reach an agreement on the terms of a new lease, the State informed Mr. Rosefsky that, because there was no signed lease for the second floor, it did not intend to pay (a) rent for the 25 months that it had occupied the second floor, or (b) for the renovations performed at the specific request of the Education Department. The court summarily dismissed Mr. Rosefsky's claims to recover both the cost of the renovations and rental value of the second floor, finding them barred by

State Finance Law §112 (2).

In *Rosefsky*, although there was no dispute that the Education Department had occupied the second floor and had agreed that Mr. Rosefsky would be reimbursed by the state for the cost of the requested renovations, the court concluded that "when, as here, the agreement under consideration involves payment of an amount greater than $5,000 [now $15,000], approval of the Comptroller is indispensable."

While the court acknowledged that the effect of the statute in this case "may indeed be harsh" and that those doing business with the state "may occasionally suffer what appears to be an unjust consequence of State Finance Law §112," the court concluded that the overall benefit accruing to the citizens of the state from its application has been determined, by the Legislature, to be worth the risk of such a casualty."

The result would almost certainly have been the same even if Mr. Rosefsky had signed agreements with the Education Department, if the State Comptroller had never approved those agreements.

Although the failure of a state agency to obtain the comptroller's approval is often fatal to any claim against the state based on a covered contract, there are situations in which the courts have found that §112 does not apply. By its own terms, §112 "does not preclude enforcement of a contract in an amount less than or equal to [$15,000], nor a recovery in tort in any amount."

In addition, if at the time that the parties enter into an agreement, "the agreement is not susceptible to valuation," then there is "no requirement that it be approved by the state comptroller under State Finance Law §112(2) and the absence of such approval does not require the dismissal of the plaintiff's claims."

Thus, in *Pixel International Network Inc. v. State*, where the state had authorized the plaintiff to install and operate an electronic message center and illuminated billboards on state grounds in exchange for a share of the revenue, the court held that a modification agreement between the parties was not subject to approval by the comptroller because that agreement did not clearly involve a liability to New York in excess of the $10,000 threshold necessary to trigger the provisions of §112.

The court's decision was based in part on the fact that the record was "devoid of any evidence" of the value of the contract. Accordingly, where the state agrees to perform an act that is not susceptible to valuation, such as an agreement to issue a Medicaid provider number to a medical laboratory, then §112 is not implicated.

Similarly, the Court of Appeals in *Parsa v. State* held that a claim based on a contract "implied in law," which is not a true contract and is instead an obligation which the law creates in the absence of agreement when one party possesses money that in equity and good conscience belongs to another, is not subject to §112(2) because it is not an action founded on contract. In *Parsa*, the Courtspecificallyheld that an action for money had and received was such a contract implied in law and would not be barred by §112.

Landlord Recovery
Relying on *Parsa*, the court in *230 Park Ave. Associates v. State* held that the landlord could recover from the state for the "reasonable use and occupancy" of the leased premises, despite the fact that the relevant lease was invalid for failure to obtain the comptroller's approval.

Although, as in *Rosefsky*, the court dismissed the landlord's claim for breach of contract based on §112, the court noted that "[f]or at least a century it has been the common law rule that a landlord could recover reasonable use and occupation from a tenant who went into possession under an invalid lease."

Accordingly, the court allowed the landlord's claim for unjust enrichment and held that the landlord could recover under a quasi-contract theory for use and occupancy – "not as rent, but as damages for trespass" based on the resulting tenancy at will.

Finally, as the courts frequently note, principles of "equitable estoppel" could ordinarily be invoked to preclude one in the state's position from avoiding liability.

Ruskin Moscou Faltischek, P.C.
East Tower, 15th Floor
1425 RXR Plaza, Uniondale, NY 11556-1425
516.663.6600
www.rmfpc.com

While the doctrine of equitable estoppel traditionally is not applicable to the state, under the appropriate circumstances it should be estopped from raising §112 as a defense. Specifically, the Court of Appeals has established that "where [1] a governmental subdivision acts or comports itself wrongfully or negligently, [2] inducing reliance by a party who is entitled to rely and [3] who changes his position to his detriment or prejudice, that subdivision should be estopped from asserting a right or defense which it otherwise could have raised."

The equitable bar to a defense may arise by virtue of positive acts, or omissions where there was a duty to act and is intended to ensure that statutes like §112 "do not become 'a trap to catch the unwary or the ignorant.'"

Thus, in *Bender v. New York City Health and Hospitals Corp.*,the Court of Appeals held that the plaintiff's allegations concerning the inaction of the city and the inability of the public to discover relevant information required further elucidation in order to determine whether the city was estopped from raising the statutory notice of claim requirement as an affirmative defense.

As set forth above, there are a number of situations in which the state will be held liable for amounts in excess of the statutory threshold (currently $15,000) despite the fact that the comptroller has not approved the relevant contract or agreement. Such cases, however, are the exception.

There are far more examples in which §112 was found to be a complete bar to any recovery despite the fact that the state unquestionably received the full benefit of the agreement. As suggested by the court in *Parsa*, the most prudent course of action for any vendor contracting with New York "is to withhold his services unless an agreement is executed and approved [by the Comptroller] as the statutes require." The consequences of failing to heed this advice are frequently devastating.