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CRACKS IN THE FOUNDATION: UNDERSTANDING AND PREVENTING FRAUD IN MINNESOTA'S CONSTRUCTION INDUSTRY

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Introduction

We are navigating a volatile real estate and construction market. Interest rates remain high, public and private funding remain uncertain, labor shortages persist, and inflation continues to pressure margins. In times like these, stress fractures in the industry often begin to show. And while some of those cracks are the result of market conditions, others expose more troubling issues—poor oversight, questionable decision-making, and in some cases, fraud.

Fraud in the construction and real estate industries doesn't always look like fraud. It's not always about bad actors with malicious intent. Sometimes it's a careless misstatement. Other times it's a failure to speak up when disclosure is required. But regardless of intent, the legal consequences can be serious—destroying careers, collapsing businesses, and leaving long-term financial and reputational damage in their wake.

Recently, we've seen a rise in civil fraud claims in Minnesota's construction and real estate sectors come across our desks. That trend inspired this article. Our goal is to provide a practical overview of Minnesota's civil fraud laws, explain how fraud arises in real-world project settings, outline the legal consequences, and offer guidance on how to spot and prevent fraudulent conduct before it leads to irreversible harm.

The Three Types of Fraud

Fraud, in legal terms, is a misrepresentation or concealment of a material fact made with the intent to deceive another party and induce them to act to their detriment.[i]

Under Minnesota law, there are three primary types of civil fraud claims: intentional misrepresentation, negligent misrepresentation, and fraudulent omission. The legal elements of an intentional misrepresentation claim demonstrate that these cases often involve the most blatant examples of fraud and are rarely excusable. It's the other two types—negligent misrepresentation and fraudulent omission—that are more often misunderstood and deserve closer attention. Understanding them is key to avoiding fraud liability and to protecting yourself from becoming a victim.

To prevail on a claim of intentional misrepresentation, a plaintiff must prove: (1) a false representation of a material fact; (2) that the representation was made with knowledge of its falsity or with reckless disregard for the truth; (3) that the representation was made with the intent to induce reliance; (4) that the plaintiff actually and reasonably relied on the representation; and (5) that damages resulted from that reliance.[ii] Take a common example: a general contractor might submit a low bid for materials with the intention of later increasing the cost via change order and knowing the pricing is fabricated, in an effort to increase its profit margin. The owner relies on that bid and enters into a contract, only to suffer financial losses when the true costs come to light.

Negligent misrepresentation differs in that the party did not intend to deceive but failed to use reasonable care in ensuring the accuracy of the information provided. This is often the most concerning type of fraud because it's not uncommon for the misrepresenting party to be unaware they committed it. To succeed on a claim for negligent misrepresentation, a plaintiff must show: (1) that a duty of care was owed by the defendant; (2) that a false statement was made without reasonable grounds for believing it was true; (3) that the statement was made with the intent to induce reliance; (4) that the plaintiff justifiably relied on the statement; and (5) that the plaintiff suffered damages as a result.[iii] In the construction context, this duty is typically owed by parties who hold themselves out as having special knowledge or expertise—such as subcontractors, design professionals, engineers, surveyors, vendors, or consultants—when they provide information they know others will rely upon in making project decisions.

Here's a hypothetical situation that illustrates how a claim for negligent misrepresentation can arise: Imagine a subcontractor telling a general contractor that a specific material is in stock and can be delivered within two days—without actually confirming availability with the supplier. The subcontractor knows the project is on a tight timeline and that the general contractor is coordinating multiple trades based on that schedule. Relying on the subcontractor's statement, the general contractor schedules work and makes time-sensitive commitments. Days later, it turns out the material is backordered for several weeks, causing delays, added costs, and potential penalties. The subcontractor didn't intend to mislead, but the failure to verify the information—especially knowing the contractor was relying on it under time pressure—could be enough to support a claim for negligent misrepresentation.

Fraudulent omission arises when a party has a legal duty to disclose a material fact but fails to do so. Unlike a misrepresentation, where something false is said, omission liability is based on what was *not* said—when there was an obligation to speak. To establish a claim for fraudulent omission, the plaintiff must prove: (1) the existence of a legal duty to disclose; (2) the failure to disclose a material fact; (3) the intent to induce reliance through that silence; (4) justifiable reliance by the plaintiff; and (5) resulting harm or damages.[iv] Duties to disclose often arise in situations where there is a fiduciary or confidential relationship, a statutory or contractual obligation, or where one party has exclusive knowledge of a fact that would be material to the other party's decision-making.

A claim for fraudulent omission often arises in the sale or transfer of real property, particularly when hidden conditions or regulatory issues are involved. Consider a developer who knows that a commercial property contains asbestos but fails to disclose that fact to a buyer before closing. The buyer, relying on the seller's silence and assuming the building is compliant with environmental regulations, proceeds with the purchase. After the sale, the buyer discovers the asbestos and is forced to incur significant abatement costs and faces potential delays and penalties from regulatory authorities. Because the developer had knowledge of the condition and a duty to speak—and instead chose silence—their conduct may support a claim for fraudulent omission.

The Consequences of Engaging in Fraud

What makes fraud particularly dangerous is that its consequences often reach far beyond a typical breach of contract dispute. In addition to the potential for significant money damages, a finding of fraud can expose both companies and individuals to heightened legal, financial, and reputational risk. The judgment might not be dischargeable in bankruptcy, personal liability may be imposed, and corporate protections such as the "corporate veil" may be lost. Fraud findings also often snowball—triggering related claims, regulatory scrutiny, and lasting harm.

If a party prevails on a fraud claim, it may recover a range of damages. These typically include compensatory damages for the actual losses suffered, such as out-of-pocket costs or lost profits.[v] In particularly egregious cases, punitive damages may also be awarded to punish and deter fraudulent conduct.[vi] Courts may also allow rescission of a contract or other equitable remedies to undo the effects of the fraud.[vii]

In most civil cases, a prevailing party is limited to recovering against the entity that breached the contract. But in cases involving fraud, liability can extend beyond the company to the individuals involved. A plaintiff may sue both the business and the person who committed the fraud and seek to recover the full amount of damages jointly and severally from either or both.[viii] In other words, individual actors may find themselves personally on the hook.

In complex business structures—particularly those involving subsidiaries, shell entities, or affiliates—a fraud finding may support piercing the corporate veil. This doctrine permits a court to disregard the legal separateness of a corporation and hold its officers, directors, or shareholders personally liable. In Minnesota, courts consider several factors in deciding whether to pierce the veil, including commingling of funds, undercapitalization, failure to observe corporate formalities, and—critically—use of the entity to perpetrate a fraud.

In this context, courts assess whether the corporation functioned as an individual's "alter ego." Relevant factors include: (1) insufficient capitalization for corporate purposes, (2) nonpayment of dividends, (3) insolvency at the time of the transaction, (4) siphoning of funds by the dominant shareholder, (5) nonfunctioning of other officers and directors, (6) absence of corporate records, and (7) use of the corporation as a mere facade for individual dealings.[ix] Often, evidence of fraud is the tipping point. Often, evidence of fraud is the tipping point.

Even bankruptcy may offer little relief. While bankruptcy is a tool for businesses and individuals to reorganize or discharge debts, fraud judgments are often nondischargeable.[x] This means that if a court finds that the debt arose from fraudulent conduct, the responsible party may be stuck with it—even after bankruptcy.

Beyond the courtroom, a finding of fraud can attract unwanted attention from law enforcement agencies, regulatory bodies, and licensing boards. Even when no criminal charges are filed, the reputational fallout can be devastating. It may become harder to obtain financing, secure bonding, win bids, or maintain client relationships.

How To Prevent Fraud

Preventing fraud starts with education—but simply knowing what fraud is often isn't enough. While many professionals understand that intentional misstatements are wrong, they may not fully grasp the personal consequences of engaging in misconduct. Training should therefore go beyond definitions and include practical guidance on the legal and financial risks individuals may face. Someone found liable for fraud may not only expose the company to litigation, but also face personal liability, non-dischargeable debt, and even regulatory or criminal exposure. These risks are often far more persuasive deterrents than the abstract threat of corporate litigation.

Effective training should include seminars, workshops, and written materials that reinforce these consequences. While such materials can sometimes be used to show the company was aware of certain risks, they more often help establish that the individual acted in knowing disregard of clear guidance. In that context, well-documented training can demonstrate that the misconduct was the work of a "lone wolf," and that the company should not be held responsible for an employee's intentional wrongdoing.

Prevention also goes beyond simply warning people not to lie. Fraud can occur when individuals fail to act on legal duties they didn't realize applied. In addition to the obligation to be truthful, two other duties carry significant legal risk: the duty to exercise reasonable care when providing information, and the duty to disclose material facts when silence would be misleading or when disclosure is legally required. Training programs should address these duties directly—not just by outlining the law, but by walking through real-world examples of how negligent misrepresentation and fraudulent omission can arise in contexts such as financing, estimating, subcontractor coordination, contract negotiation, and project delivery.

Fraud also thrives where the wrong behaviors are tolerated or overlooked. It often starts small—getting away with something that doesn't seem like a big deal. But over time, those acts can escalate, especially if they go unchallenged. In some organizations, patterns of dishonesty or misrepresentation become cultural norms. That's why fostering a strong internal culture of ethics is just as important as training on legal definitions. A zero-tolerance policy toward fraud, backed by consistent enforcement and leadership accountability, helps ensure that shortcuts and deception are not normalized.

Finally, as the market becomes more volatile, so does the risk of being on the receiving end of fraud. Whether you're hiring a subcontractor, evaluating a bid, considering a partnership, or closing a deal, you should assume that the current environment demands a higher standard of verification. Ask for supporting documentation. Verify representations with third-party sources. Build due diligence into your project timelines and budgeting processes. The more aggressive or uncertain the deal, the more thorough your fact-checking should be. In short: in a high-risk market, protecting your company starts with doing your homework.

Conclusion

Fraud claims don't just spike in recessions. The also rise in times of pressure, uncertainty, and transition. That's exactly where the industry is today. And historically, when the market shifts, it tends to force out those who have been operating on unstable ground. The financial and legal fallout can be swift and unforgiving.

But fraud is preventable. Whether it's intentional misrepresentation, negligent miscommunication, or a failure to disclose material facts, the best protection is awareness, training, and a culture that values doing the right thing, especially when it's inconvenient. Equally important is staying vigilant when working with others. In today's environment, due diligence is not optional.

We hope this article helps you spot the warning signs early, educate your teams, and foster the kind of accountability that protects your business and your people.

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6/12/2025

[i] FRAUD, Black's Law Dictionary (12th ed. 2024); *see also Graphic Communications Local 1B Health & Welfare Fund A v. CVS Caremark Corp.,* 850 N.W.2d 682 695 (Minn. 2014).
[ii] *Hoyt Properties, Inc. v. Prod. Res. Group, L.L.C.,* 736 N.W.2d 313, 318 (Minn. 2007).
[iii] *Williams v. Smith,* 820 N.W.2d 807, 815 (Minn.2012).

[iv] *See Richfield Bank & Trust v. Sjogren*, 244 N.W.2d 648, 650 (Minn. 1976); *Williams v. Heins, Mills & Olson, PLC*, A09-1757, 2010 WL 3305017, at *3 (Minn. Ct. App. Aug. 24, 2010) (*citing Specialized Tours, Inc. v. Hagen,* 392 N.W.2d 520, 532 (Minn. 1986)).
[v] *Phelps v. Commonwealth Land Title Ins. Co.,* 537 N.W.2d 271, 275 (Minn. 1995)
[vi] Minn. Stat. Ann. § 549.20.
[vii] *Hemming v. Ald, Inc.,* 155 N.W.2d 384, 389-390 (Minn. 1967)
[viii] Minn. Stat. Ann. § 604.02; *Staab v. Diocese of St. Cloud*, 813 N.W.2d 68, 74 (Minn. 2012)
[ix] *Victoria Elevator*, 283 N.W.2d at 512.
[x] 11 U.S.C.A. § 523(a)(2), (4), and (6).