Managing Fraudulent Clients

A Contractor's Survival Guide

Imagine pulling up to a gas station, pumping $20 worth of gas, and after the tank is filled, telling the attendant you'll pay only $10 because that's all you thought it was worth. "Tell it to the judge," the attendant would say as he took your license number and called the police.

If this was a construction job, however, the contractor would probably take the $10. Often, the contractor will even believe that there must have been something wrong with the work, otherwise the client would pay the whole amount.

by Susan Edwards, Ph.D.

I've spent years studying fraud against builders, and have found that in many cases where contractors are cheated out of all or part of their final payment, their clients are pathological — people who planned from the beginning to get something for nothing. I call them "serial litigators," because they use lawsuits almost compulsively to get their way. They may complain about the quality of the work, but that's just a smokescreen. The issue is and always was money.

How much money? Fraudulent people cost the construction industry millions of dollars every year; in fact, I believe the statistics are underestimated because consumer fraud often masquerades as customer dissatisfaction. During a recent training session, I asked a group of Midwest builders and remodelers to complete a survey on the financial loss associated with customers who defrauded them. After reviewing their own personal histories, this group of about 125 honest builders came up with a total loss of some $5 million — an average of $40,000 each. Given their current margins, they estimated they would need an additional $50 million in sales — $400,000 each on average — to absorb the losses.

Unfortunately, there is no foolproof way to avoid being taken advantage of. To protect yourself, you need to reduce the chances that you can be fooled. You can learn to rescue yourself when you find that you're swimming with sharks, but it's easier to just stay out of the water. The problem is that fraudulent clients hide their true nature. The ominous appearance of a dorsal fin alerts everyone to a shark, but fraudulent people are more like piranhas dressed in goldfish suits. In this article, I'll give you some pointers to help you see these people coming.

One dishonest client can ruin your business. Here's how to see them coming.

They're Out There

First, however, I have to convince many of you that these people are real. If you're a builder, you've probably had clients like this, although you may not have guessed that they had set out deliberately to defraud you. Most builders are honest and they expect others to be honest in return. If a client complains about the quality of the work or claims not to understand that a change order costs extra, most builders take those statements at face value. They search for defects in their techniques, and discount their work to make amends for not explaining themselves more clearly. But this just plays into the hands of the pathological client.

A pathological person makes for a great movie villain, but it's not so entertaining to find one sitting across your desk. Just one customer intent on fraud can cause financial ruin. Take this character type seriously. My research has shown that pathological customers are responsible for everything from failures of small businesses to losses of more than $1 million on a single job for one East Coast builder. They're out there.

Warning Signs

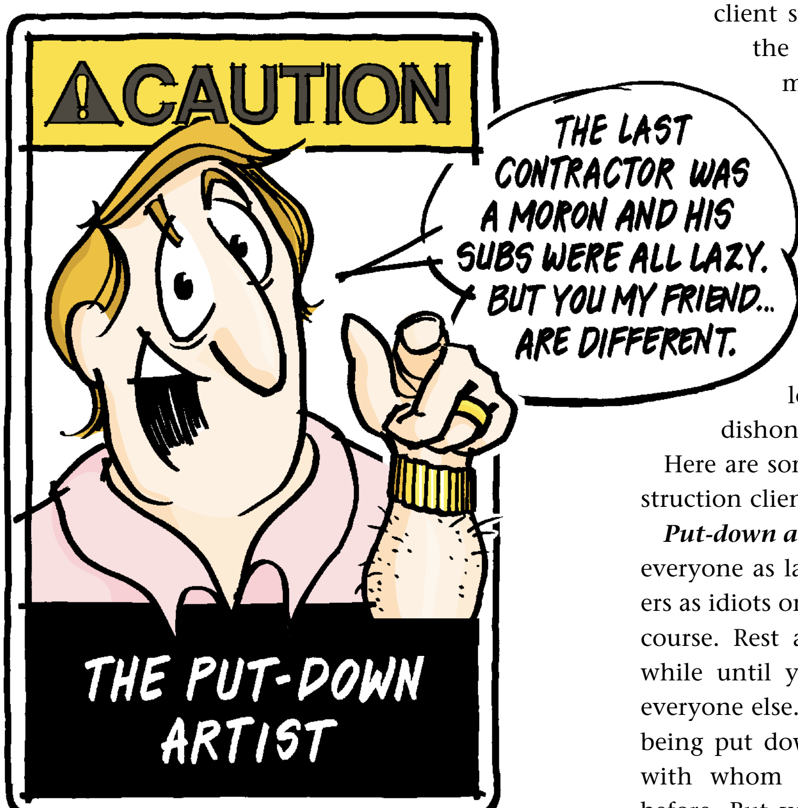
I've talked with hundreds of builders who have been defrauded. While none of them has discovered anything akin to a stud sensor for locating fraudulent people, their experiences show that pathological clients behave in predictable ways, not only during the construction process, but in the many contacts that take place before work even begins. There's usually plenty of time to extricate yourself, but the earlier you recognize potential trouble, the better off you'll be.

Early screening. Too many builders do business on the basis of a handshake and as a result, they don't always know who they're really dealing with. One way to find out is to see if a search of a computerized legal database like LEXIS turns up a trail of lawsuits. It worked for a builder who recently called to tell me he had just turned down a client who had previously sued 69 builders. The red flag will rarely be this obvious, but lawsuits are so costly and time consuming that anyone who's gone to the trouble to sue more than one builder is suspect. Computer searches aren't cheap, but for expensive jobs where the stakes are high enough, it's worth asking your attorney about the cost of doing a litigation search.

Similarly, a credit report may show a history of problems. In many states, a credit report is required prior to many common business transactions, including renting a $400-a-month apartment. It certainly makes sense to take the same precautions before accepting a job that will serve as your main or only source of income for the next three months or so.

Telltale behaviors. Most builders who've had bad experiences with clients have told me that they knew something was wrong, but they couldn't put their finger on it. This kind of intuition is another form of information, one we have difficulty measuring objectively, but that often picks up on subtle cues that the logical mind discovers later. Look for indirect signs. When the client calls your office or your home, does your spouse or office manager cringe? Pay attention — they may intuitively understand something that you have missed.

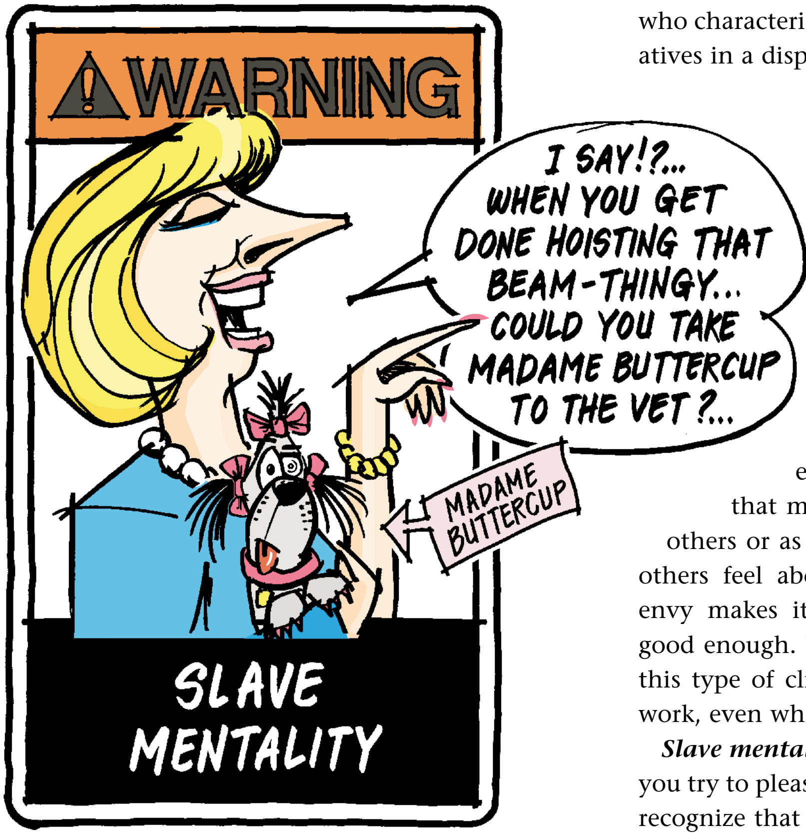
Another sign is a person who appears "slick." Such people are often skilled performers and appear believable while really pretending. Often your intuition is triggered and you get a sense that something is missing in this picture. It usually is. What you are seeing is not the person, but a facade.



If you pay close attention to what a potential client says during the first phone call or in the first meeting at his or her home, you may be able to detect people who intend to defraud you. These conversations are not idle chit-chat — they are reconnaissance missions. By listening carefully to what people say and how they say it, you can gain valuable information, not just about the job but about their character. If you know what to look for, you may be able to identify a dishonest client before it's too late.

Here are some common types of fraudulent construction clients.

Put-down artist. Beware of a client who describes everyone as lazy or incompetent, or describes others as idiots or imbeciles — everyone except you, of course. Rest assured that it will only be a short while until you're lumped into that group with everyone else. This is particularly true if the people being put down are contractors or subcontractors with whom the prospective client has worked before. But you should also be alert for someone

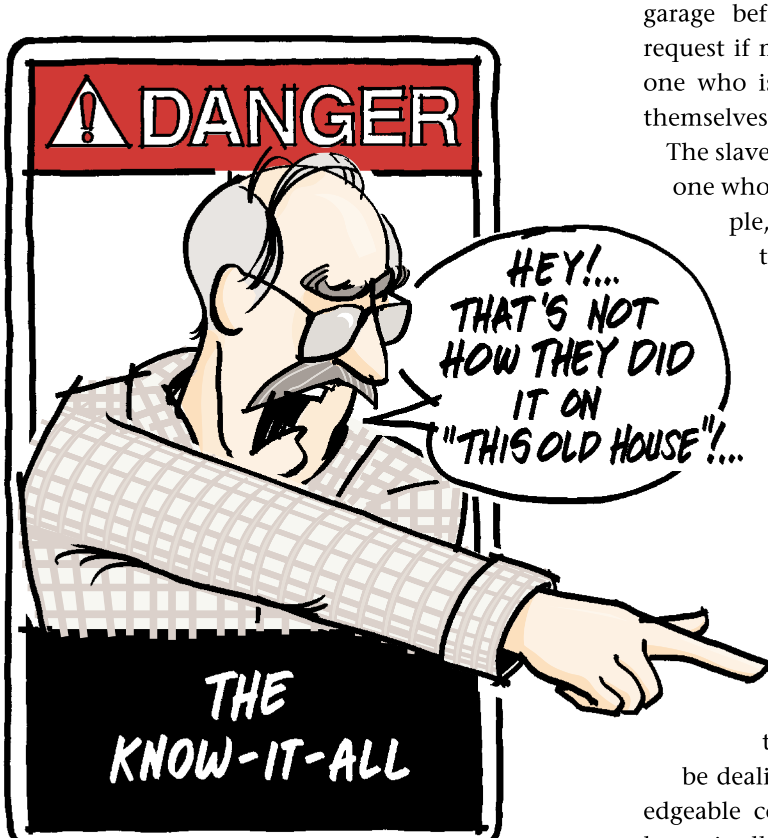


who characterizes his or her neighbors and even relatives in a disparaging way.

Pathological envy. Asking prospective clients why they want to remodel their home can elicit some revealing information. Many clients initiate remodeling projects to "keep up with the Joneses." This kind of envy toward neighbors or even toward you and your staff — is a normal part of the human condition. But some people exhibit pathological envy, which has a ruthless quality that may express itself as wishing harm to others or as a desire to take away the happiness others feel about their possessions. This type of envy makes it impossible to accept anything as good enough. Not being satisfied with themselves, this type of client is not pleased by anyone else's work, even when it is of high quality.

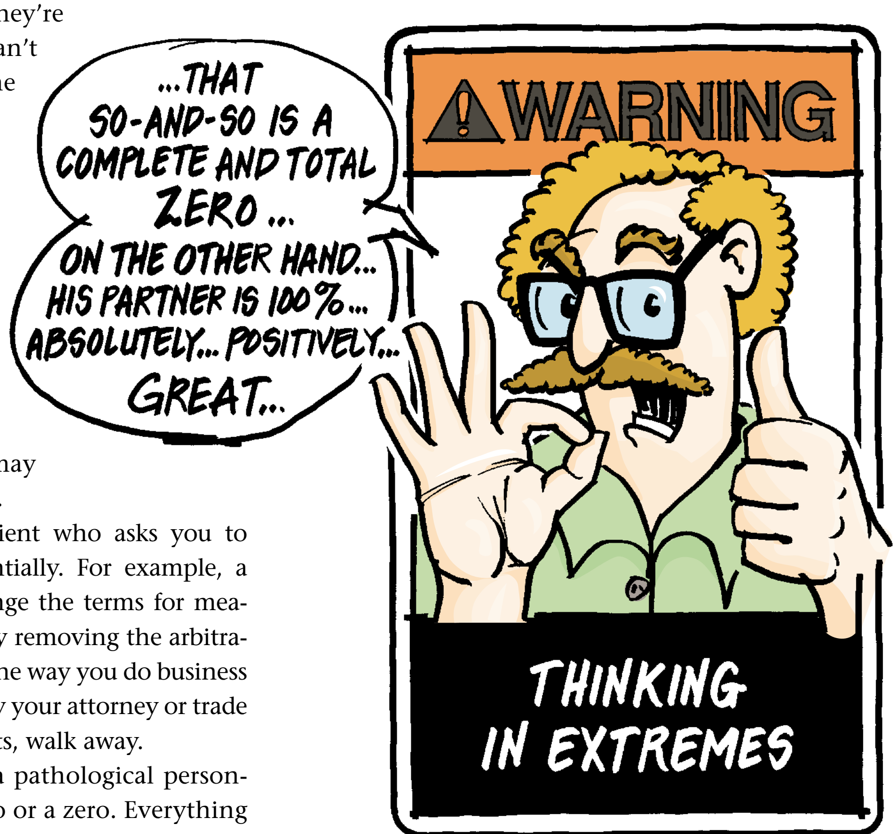
Slave mentality. Having a service business means you try to please your customer, and healthy people recognize that business involves competence. They will not ask you to perform tasks that do not square with your expertise. Fraudulent people, however, see you as some sort of special servant or as personal property instead of as a professional conducting your trade. They may ask you to do some seemingly innocent task, like clean their belongings out of the garage before work starts. This is a reasonable request if made by an elderly person, but in someone who is physically capable of doing the work themselves, it could be a sign of a secret agenda.

The slave mentality may also reveal itself in someone who acts as if everyone has a price. For example, when you go to the house to look over the job, a fraudulent client may try to impress you by offering to put down cash — say $2,500 on a $25,000 job. The cash is a small worm used to catch a big fish, so don't take the bait. In the end, they are planning to pay much less than the job is worth, so what may seem like a large amount of money to you is peanuts to them. If they withhold $10,000 after the work is done, they've quadrupled their initial investment.



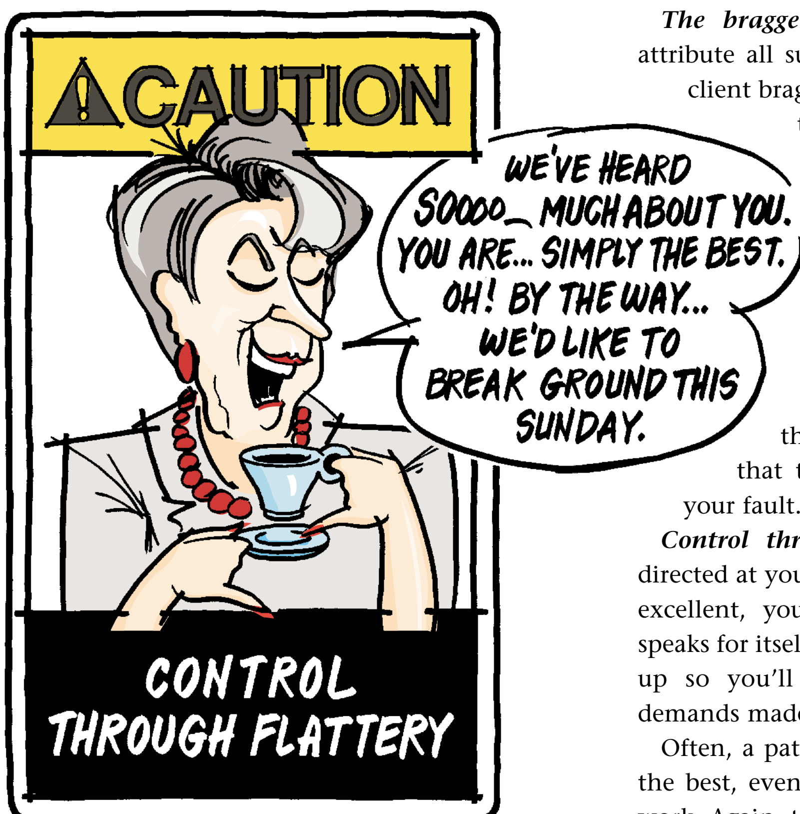
The know-it-all. If a potential client acts as if he or she knows more than you do about the project, you may be dealing with something other than a knowledgeable consumer. Problem clients often have a know-it-all attitude that shows in their unwillingness to accept evidence that they're wrong. As a result, they can't work on a team to make the job a success.

These types of people often ask to alter contract terms before they've seen the quality of your work. They may even ask you to fax your contract to them before they've met you. Beware: You could be dealing with serial litigators looking for a loophole they may have used successfully before.



A variation on this is a client who asks you to change your contract substantially. For example, a client who wants you to change the terms for measuring the quality of the job by removing the arbitration clause is trouble. Stick to the way you do business and to the contract designed by your attorney or trade association. If the client persists, walk away.

Thinking in extremes. To a pathological personality, everyone is either a hero or a zero. Everything and everyone is evaluated in black or white, with no gray areas in between. This is a problem because all people are a mixed bag of both good and bad traits. By thinking in extremes, the pathological person is wrong much of the time. You may start out as a hero, but the first time you disagree, you'll become a zero.



The bragger. Pathological personalities often attribute all success to their efforts alone. If your client brags about his or her success, pay attention to how the person attributes failure. If failure is always someone else's fault, this type of person will be difficult to work with. Unable to take responsibility for their own actions, they compensate by laying blame on others. If this type of client delays the job because he or she can't decide on the color of the tile, you can be sure that the missed completion date will be your fault.

Control through flattery. Excessive flattery is directed at your ego, not your work. If your work is excellent, you don't need flattery — the work speaks for itself. Flattery is an attempt to soften you up so you'll give in to the often outrageous demands made later.

Often, a pathological person will tell you you're the best, even though they have never seen your work. Again, this points up the importance of asking how the person was referred to you. If by a previous customer, backtrack in your records and memory about whether that past customer was pleased with you or not. After all, this referral could be someone's idea of revenge. Also find out as much as you can about why the prospective client thinks you're the best person for the job. If you push hard enough, their insincerity may eventually show through.

Seduction. Seduction is about power, not sex, so it can occur with a person of the same or opposite sex. If your prospective client treats you seductively when you're trying to discuss business, it has nothing to do with the sexual desirability of you or your crew. Rather, it reflects the person's view of how to handle people. Pathological people use power to control and abuse others; healthy people share power.

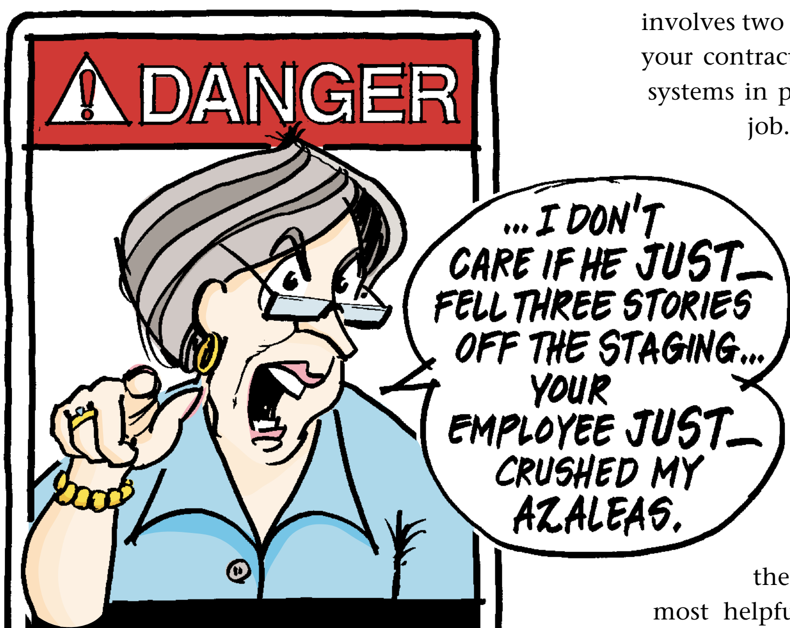
Missing compassion. Compassion is a sad feeling someone gets when bad things happen to good people. Pathological clients typically lack compassion altogether. One of the most amazing illustrations of this point I've ever heard was shared with me by a builder who realized too late that his client was without compassion. He had sent a carpenter over to a home as a special courtesy to help a difficult client. He soon received a phone call, with the client screaming on the other end: "This guy fell over with a heart attack. He's dead. Get him out of here — I'm having a dinner party in two hours."

Very few clients will send such a clear signal, but there are ways to uncover a lack of compassion. I know a builder who tells a true story about the death of a local child just to see how the client reacts. Another builder weaves in stories involving the vulnerabilities of the builder's own loved ones. Not all people show their feelings on the outside; some are very private. However, not showing feelings is different from not having them in the first place.

Educating the Client

If you haven't unmasked fraudulent clients before the job starts, you're sure to find them out once the job is underway. Typically, fraudulent clients will show their true colors once the contract is signed and work has begun. The first sign may be a sudden change in attitude — from being cooperative and lavishing you with compliments to working against you and attacking you with accusations. Take this change of mood seriously and consult with your attorney immediately. Chances are you're in for some rough sledding.

Of course, it's always best to avoid doing business with fraudulent people in the first place. If you weren't able to detect any of the characteristics of fraudulent intent mentioned earlier, there is one last line of defense: the paperwork treatment. This involves two steps, the first of which is to make sure your contract is in order and that you have paper systems in place to document every aspect of the job. The second step is to review all of these materials and procedures with the client before you sign the contract. If your client is honest, you will have set the stage for a successful project by setting the proper expectations. If, however, your client is intent upon fraud, your elaborate documentation system may scare them off and spare you the cost of trying to extricate yourself later.



Here are the elements builders and their attorneys have reported as being most helpful in reducing the success of clients intent on defrauding them.

Termination clause. Make sure your contract contains a termination clause. If the relationship breaks down and you and your clients are not able to work together, your contract should specify exactly how you can each go your separate ways. Like the ability to annul a marriage, this clause frees both parties to move on.

Bidding and billing. Make sure your payment schedule covers all of your costs plus your overhead and profit and, if your state allows it, stay ahead of your clients. Above all, don't show your overhead and profit as a separate item and leave it to be paid as the final payment. Fraudulent clients have a way of discounting the value of a job by withholding payments for overhead and profit. They may argue, for example, that your margin is like a gratuity at a restaurant. If you fail to pay for the food you order in a restaurant, the police would be called. But if you don't leave a tip, nothing happens.

But your margin is not a gratuity — it's part of your cost of doing business. You can tell your customers your margin if they ask — most will know it anyway — but structure your bidding and billing so that your margin can't be construed as an "extra" cost. By folding your margin into each item involved in the work, you will avoid losing money to a fraudulent client.

Change orders. It will come as no surprise to contractors that my research shows that more than half of all successful fraud against builders involves "change order confusion." In other words, pathological people pretend they don't understand that change orders involve money. They use this ruse so frequently because it is a weak, "he said, she said" area of the law that involves a difference of opinion or interpretation. Opinions are subjective and therefore more open to manipulation.

Work with your attorney to develop a system for handling change orders that includes four essential pieces of documentation: a written explanation of the change, a drawing of the change, the dollar amount associated with the change, and the effect of the change on the schedule. Have the customer sign and initial each of the four, and send followup memos summarizing all four elements. (Some builders even use videos or tape recordings.) Remember, it is your responsibility as the contractor to show that the change and its cost was agreed to by everyone, and that the change will alter the appearance of the original project and delay its completion. When the documentation shows that everyone had the same awareness, it is harder for pathological people to convince others they were "confused" and didn't understand that a marble countertop would cost more than plastic laminate.

Allowances. This is another area where fraudulent clients have a field day. To counter their strategy, design a standard form for allowances that explains, in simple terms and illustrated by drawings, what allowances are and how they work. Include a before and after case example, such as a "before" description and illustration showing a 4-inch plain glazed tile backsplash and an "after" version showing a 6-inch hand-painted tile backsplash with contrasting border tile. Leave room at the bottom of the form to list all of the allowances for the job at hand. Review the form with clients before the job begins, and have them initial that you've discussed this prior to starting the job.

Then when you are working on the kitchen and they choose a cabinet set that costs $2,000 more than you allowed, write a change order that describes and illustrates this change in a style identical to the sample on the allowance form. Include a line that spells out the extra cost and, again, have them initial that you have reviewed the change with them and that they understand the extra cost. This may seem tedious, but it will establish a paper trail that makes it absolutely clear that the clients owe you an extra $2,000. Since you presented them with the information sheet at the beginning, they can't claim to be surprised.

Hidden conditions. As with allowances, your best defense against a client who claims to be confused by extra costs for unexpected or hidden problems in the work is to educate them before the job starts. Use an information sheet to explain hidden conditions, using common examples such as wiring hidden behind wall finishes or decayed lumber concealed under flooring. Use illustrations if necessary, and be sure to attach a dollar amount to each example. As always, have the clients sign the information sheet to show that you have explained — and they have understood — its contents.

Scheduling costs. You should also create an information sheet to explain how a delay in one part of the work both increases costs and delays completion. It's especially important with fraudulent clients to include an "owner delay" clause in your contract. Pathological people will attempt to undermine your schedule at every turn, then use it as an excuse to withhold payment.

Quality standards. Attach industry standards to your contract. This will go a long way toward preventing a fraudulent customer from using dissatisfaction — real or pretended — to get something for nothing. If someone wants a $5,000 discount from you, make them negotiate that up front, not as a condition of your final payment.

Susan Edwards, *Ph.D., is a nationally recognized speaker and writer on consumer issues in custom building. A psychologist in Princeton, N.J., she is author of* Dangerous Clients: How to Protect Yourself *(Miller Freeman Books; 800/444-4881; also available at www.amazon.com).*