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50-Million-Plus Reasons to Fear Fiduciary Liability

The following material is provided for informational purposes only. Before taking any action that could have legal or other important consequences, speak with a qualified professional who can provide guidance that considers your own unique circumstances.

Most design professionals are aware they are exposed to professional liability claims due to their negligent acts, errors or omissions. If a trier of fact – arbitrator, judge or jury – can be convinced that a design professional failed to abide by the prevailing standard of care, and this failure causes damages, then the design professional would incur a negligence liability, typically on a proportionate basis. For example, if the design professional's negligent act, error, or omission was deemed to have caused 50% of a $100,000 loss, the design professional would be liable for $50,000 of damages.

What many design professionals don't realize is that they can also be exposed to fiduciary liability. This is a stricter type of liability and can apply even in the absence of negligence. Fiduciary liability imposes a much higher standard of care because a fiduciary is a party to whom another party entrusts property or money for safekeeping. The fiduciary is obligated to act for another's benefit. If the property is lost, damaged or otherwise loses value, the fiduciary can be held liable for the entire loss, regardless of whether negligence is shown.

Typically, an architect or engineer does not owe a fiduciary liability to a client or other party to a project. However, as the following cases demonstrate, such liabilities can arise for an unwary design firm.

A Landmark Case

The first major case where a design professional was ruled to owe a fiduciary responsibility to a client occurred in 1977 in California. In *Lake Merritt Plaza* v. *Hellmuth Obata & Kassabaum*, a major architectural firm used an AIA model contract in agreeing to provide construction observation services for a 27-story office tower. The building's curtain wall began to leak soon after construction was completed. The cost of final repair reached approximately $8 million. The developer settled with the contractor for $700,000 and then began its pursuit of the architect.

The architect claimed that it reported a variety of construction problems to the developer, and insisted that the general contractor and curtain wall contractor were liable. The developer claimed the architect did an inadequate job of reviewing shop drawings, observing contractors' performance and ensuring the curtain wall passed mock-up tests, thus failing to prevent the construction of improperly sized and sealed building joints.

Rather than simply filing a negligence claim, however, the developer argued that the AIA contract made the architect a fiduciary to the building owner and, as such, was legally obligated to preserve the owner's assets. The contract language stated that the architect agreed to "endeavor to guard the Owner against defects and deficiencies in the work of the Contractor." Thus, the plaintiff's attorney argued, the architect was required not only to report problems, but also to see to it that the problems were corrected, even if negligence was not shown.

In what was considered a frightening "first," the state court judge accepted the fiduciary responsibility argument and directed the jury to abide by it in

determining liability and assessing any damages. The jury responded by awarding $7 million to the plaintiff.

Unfortunately, this precedent-setting decision was not appealed. It was settled out of court after trial.

A $50 Million Nightmare

Another California ruling set the bar for the largest fiduciary liability judgment against a design firm to date. In *City of Victorville* v. *Carter & Burgess*, an engineering firm was hired to work on three city utility projects, including a cogeneration power plant project. The engineering firm had recommended construction of the power plant after performing a feasibility study and projected costs to be $22 million.

The project was soon behind schedule and grossly over budget and eventually had to be scrapped. The engineering firm sued the city for failure to pay fees (never a good idea.) Not surprisingly, the city countersued the engineering firm for its losses claiming that the engineer had misrepresented facts and made errors in projections which led to the city agreeing to the power plant construction rather than contracting with a local utility for electricity. The jury ruled in favor of the city finding the engineers guilty of professional negligence, misrepresentation and breach of contractual and fiduciary duty. The city was awarded $52.1 million!

The above two cases make it clear that plaintiff attorneys can successfully create a fiduciary duty on the part of design firms. In other cases, courts have ruled that a fiduciary liability exists when design firms fail to advise their clients of project problems they knew or should have known about, fail to represent their clients' interests in dealings with contractors, or fail to disclose to clients a financial relationship with a contractor.

Whether or not a claim asserting a breach of fiduciary duty prevails, such claims will have to be defended. Such a defense can be expensive and insuring such a claim will not always be simple. Professional liability insurance covers negligent acts, errors or omissions. It may not protect insureds from fiduciary liability or breach-of-contract claims, except when negligence is also alleged or shown.

Guarding Against Fiduciary Liability

One of your best defenses is to eliminate any language in your client contract that could create a fiduciary liability. This language might refer to the client placing the "highest degree of confidence, faith and trust" in the designer, or the designers "duty to act in the client's interest at all times" or the designers obligation to act as an "agent" of the client, or the client's right to "rely" on the client's services and representations.

When possible, go a step further and have your attorney draft language in your client contract that flatly states you do not owe a fiduciary responsibility to your client. The provision should confirm that neither you nor any of your subconsultants have offered any fiduciary service to the client and no fiduciary responsibility shall be owed to the client as a consequence of entering into an agreement to provide your design services.

Alternatively, you may add fiduciary-responsibility wording in a modified "no-warranty" provision. This provision should state that you make no warranty, either expressed or implied, as to your findings, recommendations, plans, specifications or professional advice. State that you have endeavored to perform your services in accordance with generally accepted standards of practice in effect at the time of performance. Add language stating that the client recognizes that neither you nor any of your subconsultants owe any fiduciary responsibility to the client.

While such a coupling of warranty and fiduciary-responsibility clauses seems simpler, it could be argued that you attempted to hide this added fiduciary provision. Consult with your attorney before drafting any fiduciary-liability language.

If you are acting as a subconsultant to another design professional, try to ensure that the prime's agreement with the project owner includes a no-fiduciary-liability provision. For added protection, in your agreement with the prime, seek confirmation that neither the prime nor any of its subconsultants owes a fiduciary responsibility to the owner and that the owner confirms such in its agreement with the prime.

Other tips for avoiding fiduciary liability:

- Don't raise your standard of care by describing your services as "best" or "expert" in your marketing materials, Website, etc.
- Include a clear scope of services in your client contract and also specify what services you are not contracted to perform.
- Document the fact that the client has been collaborative and active in decisions regarding the project and that it is not totally reliant on you for successfully completing the project.
- Demonstrate that you have an arms-length business relationship with your client where each party has equal bargaining power.
- Avoid any financial relationships with contractors or other parties to the project which could be perceived as not being in the best interest of the client.
- Include a limitation of liability clause that caps your total exposure to a set dollar amount or to your available insurance limits.

Remember, of course, that you should not implement any new contract wording unless and until it has been reviewed and approved by an attorney who is familiar with your practice, your risk management preferences, and the laws, precedents and judicial attitudes in the jurisdictions where your contract is likely to be enforced.

A Happy Ending

As shown in the court cases cited previously, fiduciary liability is real and substantial. Awards and legal fees can be astronomical and professional liability insurance coverage may not be there in all instances. Still, by taking the prescribed advice above, you can go a long way to avoiding the high cost of fiduciary liability.

Let's end on a happier note: In a 2007 case in Minnesota (*Carlson* v. *SALA Architects, Inc.*), a client hired an architectural firm to design a single-family home for a fee of approximately $300,000. Well into the design process, the client terminated the contract stating the project was behind schedule and design services were unsatisfactory. The client filed suit against the design firm for breach of contract and professional negligence. Later, the client amended the suit to include a statutory claim due to the fact that the architect's staff member working on the design was not licensed in Minnesota. The client reasoned that by assigning an unlicensed architect to the project, the architect firm deceived the client and breached a fiduciary duty.

Despite the fact the unlicensed architect was experienced in this type of residential design, having worked extensively in other states, the district court ruled in favor of the client. It held that the design services were negligent and that misrepresenting the status of the unlicensed designer breached a fiduciary duty owed to the client.

Fortunately, the architect's attorney filed for an appeal and an appellate court reversed the decision. The appellate court ruled that there was no fiduciary duty on the part of the architect firm. It reasoned that while it was unlawful to practice architecture without a license, it was legal for an unlicensed staff architect to engage in work as long as a licensed architect was heading the project. Further, the appellate court ruled that the relationship between an architect and client did not, per se, create a fiduciary duty on the part of architects.

Can We Be of Assistance?

We may be able to help you by providing referrals to consultants, and by providing guidance relative to insurance issues, and even to certain preventives, from construction observation through the development and application of sound human resources management policies and procedures. Please call on us for assistance. We're a member of the Professional Liability Agents Network (PLAN). We're here to help.