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Dodd-Frank Act Presents More Questions Than Answers

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.

The Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law by President Obama in 2010. The intent of the Act was to provide additional financial protection for consumers following the Great Recession of the first decade of the 21st Century. Of utmost importance to architects, engineers and environmental consultants are provisions in the final rule of the Act regarding "municipals advisors," which the Securities and Exchange Commission (SEC) adopted in 2013. If deemed a municipal advisor under the final rule, a consulting firm must now register itself as such with the SEC. Further, being deemed a municipal advisor, whether or not a firm registers itself, can result in substantial liabilities that likely will not be covered by a professional liability insurance policy unless that policy specifically states such advisory services and resulting liabilities are covered.

The Dodd-Frank Act defines a municipal advisor as "a person (who is not a municipal entity or an employee of a municipal entity) that:

1. Provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms and other similar matters concerning such financial products or issues; or
2. Undertakes a solicitation of a municipal entity."

What is a municipal entity? Under Dodd-Frank, it includes virtually any non-Federal government entity, including any state or state political subdivision or municipal corporate instrumentality; any agency, authority or instrumentality thereof; any plan, program or pool of assets sponsored or established by a state or state political subdivision or municipal corporate instrumentality (or an agency, authority or instrumentality thereof); or any other issuer of municipal securities. The SEC notes that this broad definition includes public pension funds, local government investment pools and other state and local governmental entities (such as school districts) or funds, along with participant-directed investment programs or plans.

Under Dodd-Frank, a consultant will be deemed to have a fiduciary duty to any municipal entity for whom such person acts as a municipal advisor. (We'll focus on the fiduciary issue later in this newsletter.)

The question for design consultants, then, is whether they are ever in danger of being qualified as municipal advisors and therefore subject to the requirements of the Act. At first glance, it may appear that engineering firms in particular are not subject to the Act. Indeed, a provision of Dodd-Franks specifically states that "engineers providing engineering services" are excluded from the Act and do not need to be registered as municipal advisors. But the rules are not as black and white as they may first appear. For example, the Act does not absolutely define "engineering services." It does provide some examples of financially-related services to a municipality that would be considered engineering services, such as:

- Cash flow analyses
- Feasibility studies
- Funding schedules
- Financing of products and services

- Potential tax savings, discounts or rebates on materials
- Providing general information that is publicly available.

However, even these types of services may fall outside of the engineering exclusion if circumstances indicate that the engineer is providing recommendations or advice regarding, for example, the issuance of municipal securities.

Any recommendations or advice provided to a client that does not specifically address engineering issues of the project may be in a gray area that puts the engineer at risk of being considered a municipal advisor. And what about architects, surveyors or environmental consultants who fall outside of the definition of engineers providing engineering services? They are not specifically provided these exclusions and could be more exposed to possible municipal advisor requirements of the Dodd-Frank Act.

Even a year after the implementation of the final rule of the Act, there are more questions than answers regarding the impact of Dodd-Frank on design professionals. As the SEC releases additional detail on what does and does not constitute "engineers providing engineering services," and how these do or do not apply to architects and other design professionals, hopefully these gray areas will receive additional clarity.

The SEC has released FAQ notices that address some of the frequently asked questions of design firms. In one of the more recent FAQ releases (<http://www.sec.gov/info/municipal/mun-advisors-faq.shtml#section12>), the SEC provided a list of additional services that qualify for the engineering exclusion on projects that will be financed by municipal securities -- provided the advice does not address the structure, timing, terms and other issues concerning the issuance of the municipal securities. These qualified engineering services include:

- Project specifications
- Estimates of the overall cost of the project
- The development of a construction schedule
- Projecting the expected funding requirements of the project.

Design consultants are advised to tread carefully when providing financial and other information, projections, advice and recommendations to clients who are municipal entities. While we are certainly not experts in this field and recommend that all design firms seek

advice from their legal and financial counsel, we can provide some general guidelines to consider.

Develop Company Policy

Developing a company policy to address the Dodd-Frank Act is the first step to ensure compliance with the provisions regarding municipal advisors. Read up on the Act as well as prevailing opinions being expressed in the trade press. Ask your legal counsel and accountant for information and advice. Request information from trade associations such as the ACEC, EJCDC and AIA.

Note that this municipal advisor issue raised by the Dodd-Frank Act is a moving target as the SEC will likely continue to provide additional guidelines, rules and FAQs as history develops. As engineers and other design firms find themselves at odds with the SEC regarding their classification as a municipal advisor the courts will undoubtedly become involved as well.

Municipal entities who find themselves short on revenue streams or long on operating costs on their projects may file a demand against a design firm claiming they were provided prohibited advice.

Assuming your firm does not want to conduct business as a municipal advisor, create a company policy regarding how to deal with client and prospect municipalities. Of particular importance is establishing company guidelines regarding giving advice to a municipal entity on financial matters. For example, how should your staff respond when clients inquire about project funding options?

As a rule of thumb, services provided should be limited to those that are unquestionably "engineering services" or those that the SEC specifically lists as examples of services that fall within the scope of the engineering exclusion. Seek the advice of legal counsel as issues pertinent to your firm arise.

Publish and share your municipal advisor policy with all employees. Training is especially critical for firms with a large portion of clients who are municipalities.

Contract Language

Work with your legal counsel to develop language that addresses the municipal advisor issue in your contracts with clients who are municipal entities. This language might include:

- A clear statement that your firm is not acting as a municipal advisor as defined by the Dodd-Frank Act.

- A statement that you will not offer advice regarding any municipal financial products or securities.
- A statement that any advice or recommendations you provide to your client is intended as engineering (or architectural) services and not to be interpreted as advice regarding municipal financial products or services.
- A statement that the client must, via contract, retain the services of a registered municipal advisor for any advice it seeks regarding municipal financial product and securities.
- A statement that you do not owe your clients a fiduciary duty in the delivery of your design services.

Such language in your contract will not provide ironclad protection against a claim being brought, successful or otherwise, against your firm. However, it does demonstrate your knowledge of the municipal advisor issue and your clear intent to avoid classification as such. Always remember that regardless of what your contract states, your actions on a project can erode your protection.

Insurance

Suppose you have no intention to provide services as a municipal advisor, yet a municipality alleges that your firm did indeed act as such and provided faulty advice. Will your firm be covered by its professional liability policy?

That, unfortunately, remains to be seen and is dependent on the wording of the PL policy. The 2013 ACEC Survey of Carriers indicated nearly all PL carriers have no intention of covering these services under their policies. It is possible that a PL carrier would deny covering the claim stating that it applies to services performed outside the definition of the professional services covered by the insurance policy. In addition, the insurer may refuse to cover any fines or penalties imposed by the SEC for performing as an unregistered municipal advisor.

Then there is the issue of fiduciary liability, which could come into play if a client loses money based on alleged faulty financial advice. Fiduciary liability is a stricter type of liability than professional 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. The insurance issue here is that PL policies typically do not cover fiduciary liability where no negligence is shown. So, even if a PL carrier was to endorse its policy to include municipal advisory services, it would still likely exclude any fiduciary liability resulting from those advisory services.

While we're on the subject, here are 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.

As an insurance agency or brokerage that specializes in serving the needs of design professionals, we can assist you in searching for answers to the questions raised by Dodd-Frank. Know, however, there are very few clear cut answers available, particularly regarding the insurance issues. Insurance carriers are grappling with the liabilities the Act presents and whether they are covered by a professional liability policy or whether an alternate coverage, possibly a stand-alone policy to address issues regarding municipal advisors, is necessary.

Finally, recognize that certain mega design firms already provide these types of financial advisory services and have done so for years. They will register themselves as municipal advisors with the SEC, and

their size and financial wherewithal grant them the unique ability to handle these types of exposures and the claims that may come.

For the rest of design firms, stay tuned and act prudently.

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.