

# A/E RISK REVIEW

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## *Why You Need to Avoid Fiduciary Duty*

*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.*

As a general rule, architects, engineers and other design professionals are not considered to owe a fiduciary duty to their clients. Recently, however, there has been an upswing in claims from clients and their attorneys that contend designers do indeed owe them such a duty. More important, some courts and other triers of fact have agreed with such contentions and have awarded large settlements to clients who claim that the design firms they hired did not properly protect them from property and/or financial losses.

Why is this trend important? And what exactly is a fiduciary and a fiduciary duty? Let's take a look at this growing liability concern.

### **What Is A Fiduciary?**

A fiduciary is an individual who has a business, legal or ethical responsibility to maintain a relationship of trust, faith, confidence, loyalty and duty to another individual or business. Fiduciaries are typically well-versed in a particular field and in a position of superiority over their clients

regarding the knowledge required to take care of their clients' assets and well-being.

Fiduciary relationships transcend the ordinary arm's-length business relationship between a service provider and a client. Fiduciary relationships can exist, for example, between a trustee and the beneficiary of the trust, between a physician and a patient, and between a financial advisor and an investor.

Many consider fiduciary duty to be, legally, the highest standard of care. A fiduciary is required to act in the interest of the client, first and foremost, even if it is to the detriment of the fiduciary. Conversely, under the prevailing standard of care applied to design firms, architects and engineers are only required to perform their services in a manner consistent with the degree of skill and care ordinarily exercised by members of the same profession currently practicing under similar circumstances and in the same or similar locale.

Why haven't fiduciary duties been historically applied to design professionals? While it is true that the designer likely has a superior level of design expertise beyond that of a client, it is not beyond the "expertise gap" associated with virtually any arms-length business transaction between a service provider and a client.

What's more, the project owner, the contractor and other parties to the design and construction project weigh in on design decisions. The designer is not calling all the shots and must typically bend

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to the wishes of the client and possibly the needs of the contractor in developing its final design. Indeed, there are many parties to the project and each has its needs and interests, including the designer, the contractor, subcontractors and subconsultants, government agencies and project occupants.

Still, depending on the particular circumstances of a project dispute, design professionals can be and have been deemed fiduciaries and held liable for breaching their fiduciary duties. Here are two well-noted court cases where fiduciary duty was applied to an architect and an engineer.

***Lake Merritt Plaza v. Hellmuth Obata & Kassabaum***

*Lake Merritt Plaza v. Hellmuth Obata & Kassabaum* (1997) was one of the first cases where a design professional was ruled to owe a fiduciary duty to its client. In this case, a large architectural firm entered into a contract to design a 27-story office tower in California. The architect and client used an AIA model contract (B-141) and, under the scope of services clause, the architect agreed to provide, among other things, construction observation services.

Soon after construction was completed, the building's curtain wall began to leak. The cost to repair the problem reached approximately \$8 million. The client settled with the contractor for \$700,000 and then began its pursuit of the architect to collect additional damages.

In court, the architect claimed it reported a variety of construction problems to the client, and insisted that the general contractor and curtain wall designer were liable for the damages. The client 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

installation of improperly sized and sealed building joints.

The client argued that the AIA contract made the architect a fiduciary to the building owner and, as such, the architect 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 to see to it that the problems were corrected, even if negligence was not shown.

A state court judge accepted the fiduciary responsibility argument and directed the jury to abide by it in determining liability for breach of fiduciary duty as well as assessing any damages. The jury responded by awarding \$7 million to the plaintiff.

***City of Victorville v. Carter & Burgess***

Another California ruling resulted in the largest fiduciary liability judgment against a design firm to date. In *City of Victorville v. Carter & Burgess* (2010), an engineering firm was hired to work on three city utility projects, including a cogeneration power plant. The engineering firm had recommended construction of the power plant (rather than purchasing power from a third-party utility). After performing a feasibility study, the engineer projected costs at \$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. Sure enough, 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. They also pointed to provisions in the contract that supported the notion that the relationship between the city and the engineering firm went beyond an arm's-length business relationship. The jury ruled in favor of the

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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 plaintiffs can successfully create a fiduciary duty on the part of design firms. In other cases, courts have ruled that a fiduciary liability can exist when design professionals:

1. fail to advise their clients of project problems they knew or should have known about
2. fail to represent their clients' interests in dealings with contractors, or
3. fail to disclose to clients a financial relationship with a contractor, or similar conflicts of interest.

It should be noted that the fact these two rulings were both made in California is not coincidental. Some jurisdictions have shown to be more willing to extend fiduciary liability to design professionals than others. In addition to California, according to a report from the Claims and Litigation Management (CLM) Alliance, cases in Nebraska, North Carolina, South Carolina and South Dakota have upheld fiduciary relationships between design professionals and their clients. Jurisdictions that have rejected placing fiduciary duties on design firms include Connecticut, Indiana, Minnesota, Texas and Virginia.

Also, of note, courts in Canada have shown to be more willing to impose fiduciary duties on service providers than courts in the United States.

Whether or not a claim asserting a breach of fiduciary duty prevails, it will have to be defended. Such a defense can be expensive and perhaps uninsurable. Professional liability insurance may not cover the cost of defense nor any judgments against a design firm accused of breach of fiduciary duty unless negligence is also alleged or shown.

### **Avoiding Fiduciary-Related Liabilities**

Fortunately, design professionals have history on their side when it comes to avoiding fiduciary duty claims from their clients. Odds are, unless there is a specific incident related to the claim that has in some way raised the prevailing standard of care, there is no legal presumption of a fiduciary duty and a successful defense can be raised. But, as our two sample claims cases showed, there are no guarantees.

Your first line of defense is an equitable contract between you and your client. Contract terms and conditions are often used as the first step to establish the legal relationship of two parties.

Some clients go so far as to include a contract clause that flatly states that the design professional owes them a fiduciary duty. This is very likely a deal-breaker unless the client agrees to contractually limit your liability. Discuss with your attorney whether a fiduciary contract clause is tolerable, and, if so, the proper language for limitation of liability (LOL) and waiver of consequential damages clauses.

Other client contracts may include clauses that don't specifically mention the word fiduciary, yet can be almost as onerous as those that do. These contracts may state that the design professional will "make its best professional effort" and warrants that the client can put "the highest degree of confidence, faith and trust" in the design firm and its services. Or it may state that the design firm has a duty to "act solely for the benefit of the client in all matters," or that the client can "fully rely upon" the design professional's services and recommendations. Such language, or any similar clauses that require the design firm to warrant or guarantee its services, is very risky and should likely be stricken or at least offset with protections such as LOL and waiver of consequential damages contract clauses.

In addition to striking any onerous client contract language, design professionals and their attorneys should strive to include language that 1) clearly states that the design firm is not a fiduciary for the client and 2) clearly defines the prevailing standard of care to which the consultant agrees to perform. Such language might read:

***The design professional shall perform services in a manner consistent with the degree of care and skill ordinarily exercised by members of the same profession currently practicing under similar circumstances at the same time and in the same or similar locale. Nothing in this Agreement is intended to create, nor shall it be construed to create, a fiduciary duty owed by either party to the other.***

In addition to ensuring contract language between the design professional and client does not create a fiduciary duty, consider these actions you and your attorney can take to help avoid such liabilities:

- Investigate the history of fiduciary duty cases in your jurisdiction(s). If your state or province has imposed such a duty in the past, you'll want to make sure your contract addresses this issue.
- Whenever selecting a project, consider the experience and knowledge of the client. A project owner who has a long history of managing construction projects will likely be considered a sophisticated client and less apt to present fiduciary-duty issues to the designer. If you're dealing with a "newbie" with little or no design and construction business, avoid situations where you are put in a superior position with complete authority over design. This may persuade a judge or jury to invoke a fiduciary duty, concluding that the client lacked the capacity to provide proper oversight.
- Document the fact that your client has been collaborative and active in decisions affecting the design of the project.
- Avoid taking on job responsibilities that put you in the position of acting as an agent to your client. For

instance, make sure any construction observation duties are limited to reporting your concerns to the client, with the contractor remaining responsible for correcting errors and exercising complete control over construction means and methods.

- Avoid entering into any business relationships with others related to the project that may present a conflict of interest. For instance, don't specify or recommend the use of any material, system, contractor or consultant for which you receive any form of favor or compensation. Such conflicts can easily develop into charges against the design professional for breach of fiduciary duty or even fraud.
- If you must provide cost estimating services, do so as "estimates of probable costs." Include disclaimers which state that these are only estimates with limited value and costs may significantly vary.
- In your marketing materials, including your website, avoid present your firm as "the best," "experts," or other similarly glowing language that may raise your standard of care.

### **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.*