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Understanding and Avoiding 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. Under common law, a design professional is obligated to abide by the prevailing standard of care. That is, an architect or engineer must apply the degree of care and skill ordinarily exercised by the design professional's peers working on similar projects in the same general local at the same period of time. If a trier of fact -- judge or jury -- can be convinced that a design professional failed to abide by the standard of care, and this failure causes damages, then the design professional would incur a negligence liability, typically on a proportionate basis. In other words, if the design professional's negligent act, error, or omission was deemed to have caused 30% of a \$100,000 loss, the design professional would be liable for \$30,000 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. While the instances of design firms being found to have fiduciary liability are somewhat rare, the exposure is real and penalties can be substantial. Being aware of fiduciary liabilities and taking appropriate steps to prevent them are key steps to avoiding a financial and professional nightmare.

Fiduciary liability imposes a much higher standard of performance because a fiduciary is a party to whom another party entrusts property for safekeeping. Failure to fulfill fiduciary responsibilities is determined not so much by the fiduciary's actions as it is by results -- i.e., damages. If the property with which the fiduciary is entrusted is damaged or otherwise loses value, it obviously was not kept safe and the fiduciary therefore failed to meet its obligations to the property's owner. As such, fiduciary liability is a form of strict liability, in that negligence does not necessarily have to be proved in order for the fiduciary to be liable.

A Landmark Court Case

The concept that a design professional owes a fiduciary responsibility to a client originated in 1977 in California (*Lake Merritt Plaza v. Hellmuth Obata & Kassabaum*). There, 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 not long after construction. The leaking continued despite the curtain wall subcontractor's repair efforts and the cost of final repair eventually 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 owner, and 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 construction of improperly sized and sealed building joints.

The twist: 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.

As it so happened, the owner did not have to prove professional negligence. In what appears to be 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 that may be owed. The jury responded by awarding \$7 million to the plaintiff.

Most regrettably, this precedent-setting decision was not appealed. It was settled out of court after trial. As such, it could be expected that other clients would seek recovery for breach of fiduciary responsibility, and not just in California. Plaintiff's counsel could regard this as an opportunity to seek damages without having to show negligence.

A Very Close Call

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 owner 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.

The above and similar cases make it clear that plaintiff attorneys are attempting to create a fiduciary duty on the part of design firms. 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 the breach is caused by negligence.

Guarding Against Fiduciary Liability

One of your best defenses is to include a fiduciary-responsibility provision in your contract with 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 with the client.

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, one of your best protections would be to ensure that the prime's agreement with the project owner includes a 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.

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.

Addressing Performance Standards in Construction Documents

The 1997 California case highlights the need to ensure you do not take on *any* type of extended performance standards in your contract language. Contractual terms you should watch out for include "certify," "warrant" and "guarantee."

By definition, words like certify, warrant or guarantee mean to assure the total accuracy of something or to confirm absolute compliance with a standard. Legally, these words and their derivatives are virtually synonymous. Therefore, if you certify or warrant something, you are guaranteeing that something is unequivocally true, correct or perfect.

By certifying or warranting something, you are assuming a level of liability well beyond the standard of care required by law. And these added liabilities are not likely insured. Your professional liability insurance is not intended to cover breach of warranty, the assumption of someone else's liability via contract language or a promise to perform to a higher standard of care than required by law.

If your client has drafted a contract that attempts to establish fiduciary responsibilities or requires you to certify, guarantee or warranty anything, or has absolute declarations or statements, delete those provisions. Explain why you cannot and should not be expected to expand your liability and

jeopardize your insurance coverage. If your client or a lender thrusts a certification form in front of you for signature, you have the right to modify the form sufficiently to be insurable.

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.