

A/E RISK REVIEW

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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.

The concept that a design professional owes a fiduciary responsibility to a client originated in Alameda County in California. 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 cost of repair was estimated at \$7 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 and observing contractors' performance, 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. Thus, the attorney argued, the architect was required not only to report problems, but also to see to it that the problems were corrected. This approach was significant because of the vast difference between negligence liability and fiduciary liability.

Negligence liability. Under common law, a design professional is obligated to abide by the standard of care, that is, to apply that degree of care and skill ordinarily exercised by the design professional's peers working on similar projects in the same design professional community at the same 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 caused 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 caused 30% of a \$100,000 loss, the design professional would be liable for \$30,000 of overall damages.

Fiduciary liability. 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. If the property with which the fiduciary is entrusted 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.

In this 1997 California case, the owner probably would have found it difficult to prove professional negligence on the architect's part. What's more, even if the jury concluded that the architect had committed a negligent act, error, or omission, it is extremely doubtful that the architect would have been held totally liable for the loss. Clearly, the contractor and subcontractors bore a major portion of fault.

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, you can expect other clients to seek recovery for breach of fiduciary responsibility, and not just in California. Plaintiff's counsel throughout the nation may regard this as an opportunity to seek damages without having to show negligence. Whether or not they prevail, any such claims will have to be defended. Insuring them will not be simple.

Professional liability insurance covers you for negligent acts, errors, or omissions. It does not protect insureds from breach of contract claims, except when the breach is caused by negligence. Assuming that a contract creates a fiduciary responsibility, a breach of that responsibility would imply a breach of contract, possibly without a negligent act or omission.

Protection for Consultants

As a prime consultant, one of your best defenses is to include a fiduciary responsibility provision in your contract with the owner. The provision might resemble the following sample:

Fiduciary Responsibility

The Client confirms that neither the Consultant nor any of the Consultant's subconsultants or subcontractors has offered any fiduciary service to the Client and no fiduciary responsibility shall be owed to the Client by the Consultant or any of the Consultant's subconsultants or subcontractors, as a consequence of the Consultant's entering into this Agreement with the Client.

Alternatively, you may wish to add fiduciary responsibility wording to another provision. The following sample is a modified "no warranty" provision:

No Warranty

The Consultant makes no warranty, either expressed or implied, as to the Consultant's findings,

recommendations, plans, specifications, or professional advice. The Consultant has endeavored to perform its services in accordance with generally accepted standards of practice in effect at the time of performance. The Client recognizes that neither the Consultant nor any of the Consultant's subconsultants or subcontractors owes any fiduciary responsibility to the Client.

Caution: While such a "coupling" of warranty and fiduciary-responsibility clauses seems simpler and likely to generate less need for explanation, it could be argued that you attempted to unilaterally rid yourself of liability that rightfully was yours by "hiding" a provision. Consult with your attorney. You may be advised not only to make the fiduciary liability provision stand alone, but also to somehow highlight it (through bold-facing, all capital letters, etc.) to call it to your client's attention.

Protection for Subconsultants

If you are acting as a subconsultant to another professional, one of your best protections would be to ensure that your client's agreement with the owner includes a provision that achieves the intent of the foregoing sample, and that the agreement has been signed. If you have any concerns in that respect, you might want to consider a provision something like the following sample:

Fiduciary Responsibility

The Client confirms that neither the Consultant nor any of Consultant's subconsultants or subcontractors owes a fiduciary responsibility to the Client or Owner. The Client shall, as a material element of the consideration the Consultant requires for performance of the services enumerated herein, require Owner to formally recognize this provision in Client's agreement with Owner.

Another, shorter approach is indicated by this sample:

Fiduciary Responsibility

The Client confirms that neither the Consultant nor any of Consultant's subconsultants or subcontractors owes a fiduciary responsibility to the Client or Owner. The Client also confirms that Owner has so agreed in Owner's agreement with the Client.

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.

Although an effective fiduciary responsibility provision will have no impact on projects you have already started or completed, it can at least protect you in the future. If you do receive a breach of fiduciary responsibility claim, notify for PLAN agent or broker at once.

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.

Sidebar

Addressing Performance Standards in Construction Documents

To our knowledge, there have yet to be subsequent court cases where design firms have been found to have fiduciary liability to the owner during the construction process. However, 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 contract or breach of warranty, the assumption of someone else's liability or a promise to perform to a higher standard of care than required by law.

If your client has drafted a contract that requires you to certify, guarantee or warranty anything, or has absolute declarations or statements, your first line of defense is to 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 (and should maintain it) to modify the form sufficiently to be insurable.