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Fiduciary Duty Claims Against Construction and Design Professionals

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Imagine that you are general counsel for a construction or design firm. A complaint arrives on your desk in which a client has accused your company of myriad failures, including significant cost overruns and defects in your work. You find the familiar line-up of claims in the complaint, such as breach of contract and negligence, but then you encounter something unexpected: a claim for breach of fiduciary duty. The plaintiff—a typical client who engaged your firm in an arm's length transaction—cannot possibly show that your company is its fiduciary, right? Well, not quite.

'City of Victorville v. Carter & Burgess'

Plaintiffs are testing the waters of fiduciary duty claims and, in some cases, with great success. Take, for example, the recent case of *City of Victorville v. Carter & Burgess*, which resulted in a $52 million settlement. Victorville hired Carter & Burgess to perform a feasibility study and design a power plant for the city, but after delays and cost overruns, Victorville cancelled the project. Carter & Burgess sued for the disputed final payment, but Victorville hit back with an enormous counterclaim for the costs of the unfinished job. Victorville brought, among other claims, a breach of fiduciary duty claim for Carter & Burgess' alleged poor-quality designs and failure to supervise the project's development.

Based in part on the parties' retention agreements, which referred to Victorville as the "city's engineer" and the "design engi-

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neer," Victorville's attorneys convinced a California jury that Carter & Burgess owed Victorville a fiduciary duty. At trial, they were able to use the size and experience of Carter & Burgess, which by that time had been acquired by the much larger Jacobs Engineering Group, to its advantage. The city's attorneys presented the picture of a small town taken advantage of by a "corporation with thousands of employees," and a "nationally-recognized design engineering and consulting company."[1] A jury awarded Victorville the full costs of the unfinished job, and thereafter, the parties settled for $52 million.

The (Inadvertent) Path to Fiduciary Duties

Most construction and design professionals know that they owe their clients a professional duty of care—meaning they must perform their services with the level of skill and care of their industry peers. Breach of that duty leads to a claim for negligence. Many professionals may be unaware, however, that under the right circumstances they may incur fiduciary obligations. Held to standards "stricter than the morals of the market place,"[2] the fiduciary owes to its beneficiary the utmost good faith and loyalty. In practical terms, a fiduciary duty is a constraint on the fiduciary's freedom to act in his own self-interest because he must set the beneficiary's well-being before his own.[3]

So, how does a national engineering firm find itself deemed the fiduciary of a seemingly ordinary client? The answer may lie in the scattered precedent and judicial uncertainty surrounding when and under what circumstances a construction or design professional becomes a fiduciary.

At a basic level, fiduciary relationships are created by fact or law.[4] Certain arrangements, such as that between a trustee and beneficiary or a lawyer and a client, are well recognized as fiduciary relationships. A handful of jurisdictions have concluded that the relationship between a client and construction or design professional is fiduciary as a matter of law,[5] but most appear to accept that these commercial arrangements do not warrant the legal presumption of a fiduciary relationship.[6]

The second path to a fiduciary relationship is marked by specific facts giving rise to a relationship of heightened trust and confidence beyond that typical of an arms-length transaction. As one court put it: "[A] fiduciary relationship is characterized by a 'fiduciary' who enjoys a superior position in terms of knowledge and authority and in whom the other party places a high level of trust and confidence."[7] Accordingly, a fiduciary relationship is necessarily one of dependence, where the fiduciary stands in a position superior to that of the beneficiary.[8] Thus, although ordinary business relationships involving professionals entail "a certain degree of trust and duty of good faith," a fiduciary "relationship transcends the ordinary business relationship."[9]

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Our general counsel of the above hypothetical can take some solace in the fact that courts are reluctant to infer fiduciary relationships, especially in the commercial context.[10] Unfortunately, however, the rather opaque standard governing the creation of a fiduciary relationship can cause unwary professionals to become unintended fiduciaries in seemingly ordinary circumstances, and the outcome may depend largely on the persuasiveness of the parties' respective narratives. For example, some savvy plaintiffs have relied successfully upon Article 3.1 of the AIA A111 Standard Form of Agreement Between Owner and Contractor, which speaks of a relationship of "trust and confidence," as evidence of a fiduciary relationship, while other courts have dismissed the language as a stock AIA contract provision.[11]

While contract language is crucial in determining the parties' relationship, there are other, less obvious facts that may give rise to a fiduciary relationship. As a general matter, the greater the professional's discretion and control over the project and the more the relationship resembles one of agency, the more likely the court will find a fiduciary relationship.[12] Likewise, the chance of a court finding a fiduciary relationship grows with the discrepancy in the sophistication and respective knowledge of the parties.[13] And if the parties had a relationship of trust that predates the business arrangement, the court will scrutinize more carefully whether the professional thereby assumed fiduciary obligations when the relationship took a commercial turn.[14]

Fiduciary Obligations: A Powerful Punctilio

Let's assume our general counsel, despite his diligence, finds himself on the receiving end of a court order concluding that his company indeed entered into a fiduciary relationship with the aggrieved client. What next? As any good attorney, he'll think of other ways to defeat the claim, including by asserting that even if his company owed such a duty it did not breach it through the failures the plaintiff alleges.

Unfortunately, this argument faces a serious obstacle. If a plaintiff manages to convince the finder of fact that a fiduciary relationship exists, the chance of recovery is significant due to the high standard of conduct that a fiduciary relationship demands. In the canonical words of then-Judge Benjamin Cardozo: "Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior."[15] The fiduciary duty standard is as high as Cardozo made it sound: Conduct that might abide by the standards of negligence and fall within the parameters of the parties' contract nonetheless can constitute a breach of a fiduciary duty. In this regard, a breach of fiduciary duty in the design and construction realm might include an all-too-frequent

issue: failure to communicate cost overruns to the client in a timely manner.[16]

Protecting Against Fiduciary Liability

The line between an everyday business arrangement and a fiduciary relationship is anything but bright. While the specific facts of the case will determine the outcome, the best defense lies in ensuring that your contract does not include language suggesting the creation of a fiduciary relationship. Take care to avoid provisions that speak of a relationship of "trust and confidence," that create a duty to act only in the client's interest or as the client's agent throughout the project, or that suggest you "guarantee" the outcome or cost of the project. Additionally, you might also consider bargaining for a contract provision explicitly disavowing fiduciary duties.

If you do find yourself on the receiving end of a fiduciary duty claim, there are important strategic steps you can take to rebut such liability. For example:

- Scrutinize your contract for any potentially adverse language.
- Marshal facts to demonstrate the relative sophistication of your opponent.
- Gather evidence that you did not exercise the degree of discretion and control over the relationship necessary for the creation of fiduciary obligations and that your retention was an arms-length business transaction.
- Collect evidence demonstrating that you fulfilled any potential fiduciary obligations.
- Research your jurisdiction's precedent on your profession's fiduciary obligations.
- Ascertain whether any statutes may impose a fiduciary obligation.[17]
- Develop legal defenses to the claim, which may include assertion of the economic loss doctrine or similar defenses barring tort actions in contract disputes.[18]

As the Victorville case shows, underestimating the viability of a plaintiff's fiduciary duty claim can be an extremely costly error. Savvy plaintiffs can use rather typical design and construction contract language to paint the picture of a relationship of unique trust and fidelity. And they can bolster their claim that a fiduciary duty existed by pointing to a defendant's experience and expertise—accolades that all professionals would like to advertise without fear that such accomplishments later will be used against them. Anticipated risks, however, are the ones most easily defended. With a proper understanding of the legal nuances of fiduciary duty claims, a firm can defeat such claims through the presentation of a compelling narrative demonstrating that the relationship with the aggrieved client was a commercial interaction like any other.

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1. Yue Jiang and Richard Korman, "Special Report: How Jacobs Engineering Lost a Huge Verdict," Engineering News-Record, July 22, 2013, 2013 WLNR 18615776.

2. *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928) (Cardozo, C. J.)).

3. See *French v. Wachovia Bank, Nat'l Ass'n*, 800 F. Supp. 2d 975, 985 (E.D. Wisc. 2011), aff'd, 722 F.3d 1079 (7th Cir. 2013).

4. *Vikell Investors Pac. v. Hampden*, 946 P.2d 589, 596 (Colo. App. 1997) ("[C]ertain recognized relationships, such as the relationship between a trustee and a beneficiary, give rise to general fiduciary duties," while others "arise between individuals through a relationship of trust, confidence, and reliance").

5. See, e.g., *Palmer v. Brown*, 127 Cal. App. 2d 44, 59 (Cal. Ct. App. 1954) ("An architect owes to his client a fiduciary duty of loyalty and good faith") (citation omitted); *RCDI Constr. v. Spaceplan/Architecture, Planning & Interiors, P.A.*, 2001 WL 1013241, at *5 (W.D.N.C. Jan. 25, 2001) (under North Carolina statutory law an architect owes fiduciary duties to his client), aff'd, 29 F. App'x 120 (4th Cir. 2002); *Canton Lutheran Church v. Sovik, Mathre, Sathrum & Quanbeck*, 507 F. Supp. 873, 878 (D.S.D. 1981) (holding that the architect-client relationship is fiduciary under South Dakota law).

6. See, e.g., *Todd Cnty. v. Barlow Projects*, 2005 WL 1115479, at *10 (D. Minn. May 11, 2005) (holding that no fiduciary relationship exists as a matter of law between engineer and design professionals and their clients); *Munn v. Thornton*, 956 P.2d 1213, 1220 (Ala. 1998) ("As fiduciary duties are reserved for relationships involving heightened levels of trust, we decline to create a fiduciary relationship between contractor and owner under a cost-plus contract"); *Routh v. Preusch*, 2004 WL 2165906, at *2 (Conn. Super. Ct. Sept. 1, 2004) ("The relationship of client and architect does not impose on the defendant the unique level of loyalty or trust which characterizes a fiduciary relationship"); *Strauss Veal Feeds v. Mead and Hunt*, 538 N.E.2d 299, 303 (Ind. Ct. App. 1989) ("An architect does not owe a fiduciary duty to its employer; rather, the architect's duties to its employer depend upon the agreement it has entered into with that employer") (citation omitted); *Carlson v. Sala Architects*, 732 N.W.2d 324, 331 (Minn. Ct. App. 2007) (holding that "the relationship of architect and client is not a fiduciary one"); *Getzschman v. Miller Chem.*, 443 N.W.2d 260, 270 (Neb. 1989) (upholding trial court's refusal to instruct jury on fiduciary duty claim against architect and noting that an architect's duties to its clients are governed by the terms of the contract and the reasonable standards of care of the profession); *Sheffield Dev. v. Carter & Burgess*, 2012 WL 6632500, at *10 (Tex. Ct. App. Dec. 21, 2012) ("We have found no cases recognizing a fiduciary duty as a matter of law of engineers to their clients").

7. *Carlson*, 732 N.W.2d at 330-31 (citation omitted).

8. See *Biller Assocs. v. Peterken*, 849 A.2d 847, 852 (Conn. 2004) (noting that the court typically refused to recognize fiduciary relationships where "the parties were either dealing at arm's length, thereby lacking a relationship of dominance and dependence, or the parties were not engaged in a relationship of special trust and confidence") (internal quotation marks and citation omitted).

9. *Carlson*, 732 N.W.2d at 331. See also *Hi-Ho Tower v. ComTronics*, 761 A.2d 1268, 1280 (Conn. 2000) ("The fact that one business person trusts another and relies on the person to perform its obligations does not rise to the level of a confidential relationship for purposes of establishing a fiduciary duty") (internal quotation marks, citation, and brackets omitted).

10. *Thanksgiving Tower Partners v. Anros Thanksgiving Partners*, 64 F.3d 227, 231 (5th Cir. 1995) (Under Texas law, a fiduciary relationship is an "extraordinary one and will only be established in exceptional cases") (internal quotation marks and citation omitted); *Pokorne v. Gary*, 281 F. Supp. 2d 416, 422 (D. Conn. 2003) (Under New York law, a fiduciary relationship does not arise between parties to a business transaction "absent extraordinary circumstances") (internal quotation marks and citation omitted); *Johnson v. Reiger*, 93 P.3d 992, 999 (Wyo. 2004) ("Fiduciary relationships are extraordinary and not easily created") (citation omitted).

11. *Compare Eastover Ridge v. Metric Constructors*, 533 S.E.2d 827, 831-32 (N.C. Ct. App. 2000) (dismissing as "standard" the language of Article 3 and noting that the architect's close involvement in the project belied a fiduciary relationship between the plaintiff and the contractor); *Avon Bros. v. Tom Martin Constr.*, 2000 WL 34241102, at *4-*5 (N.J. Super. Ct. Law Div. Aug. 30, 2000) (finding that although Article 3.1 "includes words of art…consistent with the description of a fiduciary relationship" the specific facts of the case, including the significant involvement of the plaintiff in the construction process, rebutted such a relationship) with *Jones v. J.H. Hiser Constr.*, 484 A.2d 302, 304-05 (Md. Ct. Spec. App. 1984) (finding that Article 3 and the superior knowledge of the contractor created a fiduciary relationship).

12. See *What 4 v. Roman & Williams*, 2012 WL 1815629, at *5 (N.D. Cal. May 17, 2012) (finding plaintiff's breach of fiduciary duty claim sufficient to defeat motion to dismiss where plaintiff alleged that contract, which empowered architect to bid and negotiate with suppliers on plaintiff's behalf, created agency—and thus fiduciary—relationship); *Vikell*, 946 P.2d at 597 (finding no fiduciary relationship existed between plaintiff and one of its engineers because the defendant-engineer was one of a broader team who exercised little practical control over the project); *Will & Cosby and Assocs. v. Salomonsky*, 48 Va. Cir. 500, at *2 (Va. Cir. Ct. 1999) (denying demurrer regarding fiduciary duty claim against architect on ground that questions of fact existed as to whether the architect acted as the plaintiff's agent).

13. See *Jones*, 484 A.2d at 305-06 (finding fiduciary relationship between homeowner and contractor and noting as relevant that unlike the contractor the homeowners "were not experts in house construction"); *Garrison v. CC Builders*, 179 P.3d 867, 878 (Wyo. 2008) (finding no fiduciary relationship between homeowners and builder and noting that plaintiff was a "successful and sophisticated businessman").

14. See *Garrison*, 179 P.3d at 878 (noting as relevant in denying fiduciary claim that the parties' did not have pre-existing substantial relationship of trust).

15. *Meinhard*, 164 N.E. at 546.

16. See *Jones*, 484 A.2d at 305 (concluding that contractor's fiduciary obligations required him to "be aware of the ongoing or escalating costs of construction and to communicate this information to the [client] in timely fashion").

17. For example, Oklahoma law imposes a statutory duty upon a general contractor to hold funds in trust for the payment of subcontractors, a duty which in turn creates a fiduciary relationship between the owner and contractor as to lienable claims that come due. See *Murphy Oil USA v. Wood*, 438 F.3d 1008, 1017 (10th Cir. 2006) (citing Okla. Stat. tit. 42, §§152-53).

18. Although the rule varies by jurisdiction, as a general matter the economic loss doctrine "prohibits plaintiffs from recovering in tort economic losses to which their entitlement flows only from a contract." *Werwinski v. Ford Motor*, 286 F.3d 661, 671 (3d Cir. 2002) (internal quotation marks and citation omitted). Defendants have utilized the doctrine successfully to dismiss fiduciary duty claims. See, e.g., *BGW Design v. Serv. Am.*, 2010 WL 5014289, at *6 (S.D. Fla. Dec. 3, 2010) (dismissing fiduciary duty claim under Florida's economic loss rule); *Ginley v. E.B. Mahoney Builders*, 2005 WL 27534, at *2-*3 (E.D. Pa. Jan. 5, 2005) (dismissing fiduciary duty claim under Pennsylvania's "gist of the action doctrine," which bars conversion of contract claims into tort claims unless the "gravamen of the action sounds in tort").

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