CURRENT STANDARDS OF RESPONSIBILITY (AND LIABILITY) FOR FINANCIAL PROFESSIONALS - - INCLUDING THE "INFORMAL" FIDUCIARY DUTY

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What is a "Fiduciary Relationship?" - A fiduciary relationship is a special and confidential relationship in which one party occupies a position of confidence, trust and reliance towards another. One is honor-bound to abide by his or her commitments and duties to another and not to betray that trust.

A. Ordinary negligence standard for skilled professionals in an errors and omissions claim

1. A contract for professional services gives rise to a duty by the professional to exercise the degree of care, skill, and competence that reasonably competent members of the same skilled profession would exercise under similar circumstances. *See Southwestern Bell Tel. Co. v. DeLanney*, 809 S.W.2d 493, 494 n. 1 (Tex. 1991). The ordinary duty for skilled professionals is less stringent than the duty created by a fiduciary relationship.

2. Texas Pattern Jury Charge 60.1 discusses the ordinary standard of care for accountants.

3. Two (2) year statute of limitations for filing ordinary negligence claim.

B. Characteristics of a fiduciary relationship

1. Special confidence
   A fiduciary relationship exists where a special confidence is reposed in another who in equity and good conscience is bound to act in good faith and with due regard to the interests of the one reposing confidence; and

2. Gives advice for benefit of another
   A fiduciary relationship exists when the parties are under a duty to act for or give advice for the benefit of another upon matters within the scope of the relation.

C. Types of fiduciary relationships

1. "Formal" fiduciary relationship

Relationships that give rise to fiduciary duties as a matter of law are called "formal" fiduciary relationships. Formal fiduciary relationships include:

- Attorney-Client
- Partner-Partner
- Trustee-Beneficiary
- Principal-Agent (including employer/employee)
- Financial Advisor-Client
- Borrower-Lender
- Parties to a Joint Venture
- Broker-Client
- Escrow Agent-Client

a. The normal accountant-client relationship **does not** involve a formal fiduciary duty. *Squyres v. Christian*, 253 S.W.2d 470, 471 (Tex. Civ. App.—Fort Worth 1952, writ ref'd n.r.e. *See also Harrison County Finance Corp. v. KPMG Peat Marwick, LLP*, 948 S.W.2d 941, 945 (Tex. App.—Texarkana 1997), rev'd on other grounds, 988 S.W.2d 746 (Tex. 1999)(holding that the relationship between an independent auditor and its own client is not a fiduciary one).

b. An accounting firm retained to audit the financial statement of a company **does not** stand in a fiduciary relationship with that company's shareholders. *See Tal v. Superior Vending, LLC*, 20 A.D.3d 520, 799 N.Y.S.2d 532, 533 (2d Department 2005) (accountant who rendered services to corporation owed no fiduciary duty to a fifty percent shareholder in corporation); *Facchini v. Miller*, No. CV 990587686S, 2000 WL 175580, at *4 (Conn. Super. Ct. Jan. 31, 2000) (accountant owed no fiduciary duty to plaintiff shareholder who merely alleged reliance on financial information generated by accountant).

2. "Informal" fiduciary relationship

If a recognized "formal" fiduciary relationship does not exist, an "informal" fiduciary relationship can arise from the specific actualities of the relationship between the persons involved.

a. Close and confidential personal relationship with a high degree of trust

Informal fiduciary relationships may be created in a situation where trust, influence and reliance have been acquired and abused, or in which confidence has been reposed and betrayed. The origin of the confidence is immaterial, whether the relationship is moral, social, domestic or personal.

b. Long-time business relationship or personal friendship

A person is justified in placing confidence in the belief that another party will act in his best interest, only where he is accustomed to being by the judgment or advice of the other party, and there exists a long association in a business relationship, as well as personal friendship.

c. Business-to-business fiduciary relationships
The existence a fiduciary relationship in non-personal (business) "arms-length business transactions" require a prior relationship of heightened trust and confidence before such a relationship can be imposed on the parties with respect to the transaction that forms the basis of their current dispute. *Meyer v. Cathey*, 167 S.W.3d 327, 331 (Tex. 2005).

3. Texas Pattern Jury Charge 104.1 and 104.2 discuss the considerations for a jury in determining whether a fiduciary relationship exists.

4. Jury Instructions in *Canatxx Energy Ventures v. GE Capital Corporation* illustrate the "real life" application of a fiduciary determination by a jury.

D. When a CPA might be deemed to have a fiduciary relationship with a client

1. CPA holds himself or herself out as general business/financial advisor. CPAs *may* be considered fiduciaries to their clients when they render a variety of services including tax services, asset management and general business consulting. CPA's who call themselves business advisors need to act like business advisors and be prepared to accept the implied responsibilities.

2. The client places a high degree of trust and confidence in the CPA beyond the normal scope of accountant-client relationship.

3. There is a large disparity in the relative levels of expertise and knowledge between the client and CPA (i.e. the client is heavily dependent on the CPA's advice.)

E. Implications of a fiduciary relationship

1. Normal duty under a professional contract for services
If no fiduciary relationship exists, a contract for professional services gives rise to a duty by the professional to exercise the degree of care, skill, and competence that reasonably competent members of the skilled profession would exercise under similar circumstances. *See Southwestern Bell Tel. Co. v. DeLanney*, 809 S.W.2d 493, 494 n. 1 (Tex.1991).

2. Where a fiduciary relationship exists, a CPA has a higher level of duty to the client and hence a greater potential for liability

   a. If the CPA is deemed to be a fiduciary to the client, the CPA is required to exercise the utmost care in the performance of his or her engagement. This means going beyond the normal standard of care a reasonable and prudent accountant would exercise in the performance of his or her engagement.

   b. Having a fiduciary relationship with a client places the burden on the fiduciary to prove that he complied with the heightened fiduciary duty. *Chien v. Chen* 759 S.W.2d 484, 495 (Tex. App.—Austin 1988, no writ).

   c. Transactions between a fiduciary and his principal are presumptively void and the burden lies on the fiduciary to establish the validity of any particular transaction in which he is involved. *Id.*

   d. The statute of limitations for bringing a breach of fiduciary claim is four (4) years (as opposed to two years for a normal negligence claim).

F. Another area of potential liability: Texas Deceptive Trade Practices-Consumer Protection Act ("DTPA")

1. Generally, a person can be liable under the DTPA for engaging in a "laundry list" of false, misleading or deceptive acts or practices in the conduct of any trade or commerce. Tex. Bus. & Com. Code §§ 17.41-63. The DTPA applies generally to providing of either goods or services or both.

2. If violation is deemed to have been "knowing," then defendant can be liable for treble damages.

3. The DTPA allows for attorneys' fees without regard to whether defendant "knowingly" performed the act.

4. The "professional services exemption" generally prohibits DTPA claims based on the rendering of a professional service, the essence of which is the providing of advice, judgment, opinion or similar professional skill. Tex. Bus. & Com. Code § 17.49. However, this exception will **not apply** to:

   a. an express misrepresentation of a material fact that cannot be characterized as advice, judgment or opinion;

b. a failure to disclose information in violation of Section 17.46(b)(24) – non disclosure of information intended to induce consumer into a transaction that consumer would not have entered into had the information been disclosed;

c. an unconscionable action or course of action that cannot be characterized as advice, judgment or opinion;

d. a breach of express warranty that cannot be characterized as advice, judgment or opinion.

G. Recent Texas cases discussing informal fiduciary duty of financial/business advisors

1. *Lee v. Hasson*, 2007 WL 236899 (Tex. App.—Houston [14th Dist], January 30, 2007). Court held that insurance broker/financial advisor had an informal fiduciary relationship with friend whom he advised regarding the division of property in friend's divorce. The Court based its decision on the fact that there was evidence that advisor and friend had a close personal family friendship that predated alleged oral agreement by about six years, that friend relied on advisor for moral, financial and personal guidance or support, that friend's daughter regarded advisor as a father figure, and that friend looked to advisor for guidance when she was seeking to reconcile with husband before friend and husband filed for divorce. Court held that agreement to pay advisor/friend 10% of amount of marital estate received in divorce settlement was void.

2. *Case Western Reserve Life Assurance Company of Ohio v. Graben,* 2007 WL 1879716 (Tex. App.—Ft. Worth, June 28, 2007). Case of a spiritual advisor turned investment advisor. Ex full-time pastor and newly "commissioned broker" with no college degree and no formal education in financial management was deemed to have a fiduciary relationship with unsophisticated client/investors because clients were dependent on pastor/broker for his counsel, experience and advice. Broker's fiduciary duty to clients went well beyond the narrow duty of executing trade orders; broker acted as a financial advisor whom the clients trusted to monitor the performance of their investments and recommend appropriate financial plans, which created a fiduciary relationship. Furthermore, when broker assumed role to act as clients' financial advisor and to monitor and manage their investments, any arms-length business transaction between the parties was elevated into a fiduciary relationship by the very nature of broker's actions, and, thus, a fiduciary relationship did not need to exist prior to, and apart from, the agreement made the basis of clients' lawsuit; clients entrusted their funds for suitable investments and appropriate management.

H. Summary

CPAs may be considered fiduciaries to their clients when they render a variety of services including tax services, asset management and general business consulting, and where the client has consistently relied on the CPA for moral, financial, or personal support and guidance. Where a fiduciary relationship exists, an accountant has a higher level of duty to the client and hence a greater potential for liability. Thus, it is important for CPAs to consider when they might be stepping over the fiduciary line, and what the moral and legal responsibilities are that come with that enhanced status.