Does a Landlord have a Fiduciary Duty to a Tenant in the Build-out Scenario?

by Collin R. Simonsen

When a landlord leases an office space for the first time, it is not uncommon for the tenant to bear the cost of "building out" the space. In some cases, the landlord also takes upon himself the responsibility of hiring and overseeing the contractor, interior designer, architect, or others who work on the space. If the cost of building out the office space is not a "fixed" cost, or, in other words, if the tenant is responsible for the final cost no matter what it is, then the landlord may have a fiduciary duty to keep costs within reasonable bounds.

Although courts have generally "refrained from definitively listing the instances of fiduciary relationships," some will be "implied in law due to the factual situation surrounding the involved transactions and the relationship of the parties to each other." *First Sec. Bank of Utah N.A. v. Banberry Dev. Corp.*, 786 P.2d 1326, 1332 (Utah 1990).

"Whether or not a…fiduciary relationship exists depends on the facts and circumstances of each individual case." *Id.* (citation and internal quotation marks omitted).

> Whether an agency relationship exists depends upon all the facts and circumstances of the case.… Where evidence as to the alleged agent's authority and/or principal's control is disputed or reasonable inferences drawn from the evidence may differ, the question of whether an agency relationship exists is one of fact for the jury.

United States v. Welch, 327 F.3d 1081, 1102 (10th Cir. 2003) (citation and internal quotation marks omitted).

Furthermore,

> [a] fiduciary is [a person] in a position to… exercise…influence over another. A fiduciary relationship implies a condition of superiority of one of the parties over the other. Generally, in a fiduciary relationship, the property, interest or authority of the other is placed in the charge of the fiduciary.

First Sec. Bank, 782 P.2d at 1333.

When a tenant is bearing the cost of building out the tenant space, but the landlord has full control over how that is accomplished, the "authority of the [tenant] is placed in the charge of the [landlord]" to such an extent that a fiduciary duty could be found. *Id.*

Although no Utah court has ruled on this issue, it is a fact pattern that is closely analogous to another situation where a fiduciary or confidential duty has been found in many jurisdictions. This situation is that of a "cost-plus" construction contract. A cost-plus contract is one where the owner of the property agrees to pay the contractor for the costs of a construction project, plus a certain percentage of the costs as profits to the contractor. In this scenario, there is no defined limit to the amount that the contractor can spend and be reimbursed. And as the cost of the project grows, the profit grows proportionally. In this situation, "the cost-plus contract places the contractor in a role that could be

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termed a 'constructive fiduciary,' i.e., when a contractor holds the owner's pocketbook, it would be inequitable to consider the contractor's duty to be less than that of an agent, a trustee, or a fiduciary." Paul J. Walstad, Sr. & Camille Williams, *Contracting on a Cost-Plus Basis: The Owner's Relationship of Trust with the Contractor*, Construction Briefings No. 2000–12 (2000).

A landlord in the build-out scenario is in the same position as a contractor in the cost-plus scenario. Knowing that he or she will have to lease out the premises to future tenants and that the current tenant will be obligated to pay the costs for building-out the premises, the landlord has an incentive to purchase the best materials and to build the fanciest amenities in the office space. The landlord has no incentive to be vigilant against cost overruns or to dispute spurious charges from the contractor, architect, or suppliers. In essence, the landlord "holds the owner's pocketbook." The landlord should therefore be considered a "constructive fiduciary."

Why does Walsted use the term "constructive fiduciary" rather than just "fiduciary" or "agent"? It is because an actual fiduciary has the power to bind the principal in such a way that the third party could sue the principal for payment *directly*. In the "cost-plus" context and in the "lease build-out" context, this is probably not the case. But when the tenant gets the bill and refuses to pay, the tenant could use the defense of breach of constructive fiduciary duty when the landlord brings suit for breach of contract.

The landlord would be an *actual* agent if he or she had the authority to bind the tenant to costs such that the contractor or supplier had a cause of action against the *tenant*. Where the landlord only binds the tenant to reimburse it for costs that landlord expends, the terms "quasi-agent" or "constructive fiduciary" are appropriate.

If a court determines that the landlord has a fiduciary or "constructive fiduciary" duty, then the landlord may not be able to pass along "unreasonable" costs to the tenant notwithstanding the contractual right to do so. This reasoning comes from the cost-plus scenario, where a contractor has "a duty to make every reasonable effort to minimize costs and thus may recover only for such material and labor which it is necessary to use to complete the job." *Metropolitan Elec. Co. v. Mel-Jac Constr. Co.*, 576 P.2d 323, 325 (Okla. App. 1978).

Further,

> [the contractor] had a duty to be aware of the ongoing or escalating costs of construction and to communicate this information to the [owner] in timely fashion. The gathering of this information was within [the contractor's] ability and expertise, not the [owner]. . . . [The contractor] failed to keep effective track of the costs and likely future costs and failed to communicate the appropriate information.