

Bank isn't liable for architect fees

by Eric T. Berkman

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Architects hired by a real estate developer could not hold the bank that financed the construction project liable for fees the developer failed to pay, a Superior Court judge has found.

The plaintiff architects argued that the defendant bank — which took over the project after the developer defaulted on its loan payments — was liable for the unpaid fees under an “instrumentality” theory.

But Judge Douglas J. Wilkins disagreed, finding that the plaintiffs failed to show the bank assumed sufficient control over the developer for the theory to apply.

“[The instrumentality theory requires a showing] that the subservient corporation was being used to further the purposes of the dominant corporation and that the subservient corporation in reality had no separate, independent existence of its own,” wrote Wilkins, quoting the 1st U.S. Circuit Court of Appeals’ 2009 decision in *FAMM Steel, Inc. v. Sovereign Bank*.

“The undisputed facts fall far short of meeting this burden.”

The 10-page decision is *Creative West Architects, LLC, et al. v. Downtown Natick Development Co., LLC, et al.*, Lawyers Weekly No. 12-070-11. [The full text of the ruling can be ordered by clicking here.](#)

Careful scrutiny

Lender’s counsel Richard E. Gentilli of Bartlett, Hackett, Feinberg in Boston said the ruling is consistent with the law in most jurisdictions.

“In this case, you had an unsecured creditor trying to fashion some matter of imposing liability on the bank, but the bank was doing nothing more than what banks ordinarily do when they have a failed real estate project and an out-of-business developer, which is to maximize what they can get out of their collateral,” he said. “There’s usually a shortfall [in such instances], and there was a huge one in this case, but had the bank done nothing and foreclosed, it would have been even bigger.”

Christopher R. Vaccaro of Stoneham was counsel for the developer, which was not party to the instrumentality claim. Vaccaro said that while the ruling does not eliminate the instrumentality theory as a potential tool for creditors seeking to impose lender liability, it does show that the courts will scrutinize such claims very carefully.

“They will probably not allow such a claim unless there is a very egregious case where the lender is behaving in an outlandish manner rather than one who is merely exercising its rights and remedies as to a failed real estate project,” he said.

Dennis McKenna of Riemer & Braunstein in Boston, who represents lenders but was not involved in the case, agreed that Wilkins made the correct ruling, given the facts of the case. Nonetheless, he said he was not surprised to see a creditor bring such an action, nor would he be surprised to see more such actions in the future.

“The bank is always the deep pocket in any project,” McKenna said. “Particularly with a bad real estate market and a bad economy, once a project goes south and people start looking at target defendants, the bank is always a target. And plaintiffs’ counsel, when looking for fees, will cast the widest net possible.”

Had the decision gone the other way, it could have had a chilling effect on real estate development, said Jeffrey K. Ganguly of Brennan, Dain, LeRay, Weist, Torpy & Garner in Boston.

"Because of the economy, banks already want more equity out of the borrowers," said Ganguly, who represents both developers and lenders. "If [liability based on the facts in *Creative West*] became an issue, they'd be expecting borrowers to pay out of pocket for soft costs [like architect fees], which would make it more difficult for them to engage in development projects."

Ganguly added that while nobody can blame the architects in the case, since they had done nothing wrong, vendors likely will now think twice before entering into an agreement to accept deferred compensation, which the architects had done here.

Plaintiffs' counsel Rory Z. Fazendeiro of Adler, Pollock & Sheehan in Boston could not be reached for comment prior to deadline.

Payment dispute

Defendant Robert F. Rinaldi established defendant Downtown Natick Development Co. to develop a condominium project. In order to finance the project, DNDC borrowed \$8.6 million from defendant Needham Bank.

DNDC hired plaintiffs Creative West Architects and CWA Architects for design, consulting and management services in connection with the project.

According to language in a contract executed in December 2006, the plaintiffs would defer a portion of their payment — \$12,000 for each of eight units — until the closing for the relevant unit.

The contract also indicated that should DNDC have insufficient funds to pay the plaintiffs, their claim would be subordinate to that of Needham Bank and the prior owner of the property.

Ultimately, the project ran into financial difficulties, DNDC stopped making interest payments on its bank loan, and, in April 2009, Needham Bank declared DNDC in default. DNDC also failed to pay the plaintiffs approximately \$100,000 in fees.

At about the same time, Rinaldi returned to work for his previous employer, EMC Corp., and DNDC had no further involvement in the project.

Needham Bank began to take control of the project, paying Rinaldi's project manager directly in an individual capacity to oversee the project's completion.

In the summer of 2009, the bank took steps toward auctioning the project's unsold units and, in August of that year, assumed final decisionmaking authority on construction decisions.

A month later, the bank replaced Rinaldi's general contractor with its own contractor and hired a replacement architectural firm. The bank refused to pay the plaintiffs for their services.

The bank then worked with and paid its own contractors and subcontractors — and controlled unit sales — through December 2009, when the bank, through a subsidiary, acquired the property at a foreclosure sale for \$6.7 million.

On Nov. 17, 2009, the plaintiffs sued the bank, alleging that it was liable for DNDC's nonpayment under the instrumentality theory. The plaintiffs also brought a mechanic's lien claim, as well as a claim alleging intentional interference with a contractual relationship.

The bank moved for summary judgment.

Insufficient control

Wilkins rejected the plaintiffs' instrumentality theory of lender liability, noting that liability under the theory would require a showing that the bank exerted such a degree of control over the borrower — in this case DNDC — as to render the borrower "a mere business conduit for the

lender.”

In practical terms, that would mean showing that DNDC had no separate, independent existence of its own, the judge said. But in *Creative West*, the bank merely took control of the project as a result of DNDC's default.

“The bank did nothing more than act to protect and realize its own security,” Wilkins said.

Meanwhile, the plaintiffs' own contract with DNDC recognized the bank's status as a senior creditor that would be paid first in the event of a default, he said.

“There is nothing ‘unjust’ about a creditor's exercise of rights set forth in a mortgage, particularly as against plaintiffs who knew of those rights and agreed to take a junior position,” he concluded, granting summary judgment for the defendant. “To impose liability on facts like those presented here would impair the value of collateral and chill the extension of credit for housing projects.”

Wilkins went on to reject the plaintiffs' intentional interference and mechanic's lien claims as well.

For more information about the judge mentioned in this story, visit the Judge Center at www.judgecenter.com.

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CASE: *Creative West Architects, LLC, et al. v. Downtown Natick Development Co., LLC, et al.*, Lawyers Weekly No. 12-070-11

COURT: Superior Court

ISSUE: Could architects hired by a real estate developer hold the bank that financed the construction project liable under the “instrumentality” theory for fees that the developer failed to pay?

DECISION: No, because the architects failed to show that the bank assumed control over the developer to the point that it had no separate, independent existence of its own

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