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Professional Liability of Business Consultants

I. Introduction

Corporations and other business entities (the “Client”) engage the services of management consultant firms (the “Consultant”) for many reasons, including assistance with day-to-day business transactions and advice on large transactions. As part of this relationship, the Client and the Consultant usually enter in to an agreement whereby the rights and duties of both parties are defined. This agreement is controlling over any subsequent disputes that arise out of the parties’ relationship. If purely economic damages (as opposed to personal or property damage) are sustained by the Client as a result of the services performed by the Consultant pursuant to the contract, the Client is limited to seeking damages for breach of contract pursuant to the “economic loss doctrine.”

However, many courts have permitted recovery of economic loss arising from negligence in the area of professional malpractice. Professionals such as accountants, attorneys, and in some jurisdictions business consultants, owe their clients extra contractual duties which are impossible to memorialize in contracts, and that therefore the economic loss doctrine does not bar tort recovery against them. Not all jurisdictions have extended professional malpractice to “management consultants.” For those jurisdictions that do, the duty owed by the Consultant to the Client usually requires that Consultant to possess and apply the knowledge, skill and ability that a reasonable careful professional in the field would exercise under the circumstances. A failure to satisfy this professional standard of care can

lead to claims of professional malpractice and negligent misrepresentation against the Consultant resulting in liability and damages.

Moreover, the Client/Consultant relationship may also create a fiduciary relationship. Even though a Consultant may be engaged by the Client as an independent contractor, the Consultant may still owe the Client a fiduciary duty based upon the role the Consultant is playing in the Client's business. To determine the scope and extent of this fiduciary relationship the Courts will often refer to the parties consulting agreement.

II. Economic Loss Doctrine

Courts have defined economic losses as financial losses such as indebtedness incurred and return of monies paid, as distinguished from damages for injury to person or property.¹ The economic loss doctrine seeks to limit contract liability to economic damages that are the foreseeable result of any breach of contract.² This doctrine presupposes that since these damages are obviously foreseeable, the potential victim has the best opportunity and the lowest cost to negotiate alternative protective arrangements for such losses.³

As such, many jurisdictions hold that purely economic losses are unrecoverable in tort and strict liability actions in the absence of personal injury or property damage.⁴ Where there is contractual privity between the parties the economic loss rule is "founded on the theory that parties to a contract may allocate their risks by agreement and do not need the special protections of tort law to recover for damages caused by a breach of the contract."⁵ However, despite the fact that the law restricts liability for negligently-caused economic harm, it does permit recovery for such harm in special circumstances such as intentional tort, where

¹ A.T. Kearney, Inc. v. International Business Machs. Corp., 73 F.3d 238 (9th Cir. 1995)

² *Analysts Int'l Corp. v. Recycled Paper Prod.*, 1987 U.S. Dist. LEXIS 5611, *13 (N.D. Ill. 1987)

³ *Rardin v. T&D Mach. Handling, Inc.*, 890 F.2d 24, 29 (7th Cir. 1989)

⁴ *Lyons v. State Farm Fire & Cas. Co.*, 349 Ill. App. 3d 404, 412 (Ill. App. Ct. 5th Dist. 2004); *Bristol-Myers Squibb, Indus. Div. v. Delta Star*, 206 A.D.2d 177, 181 (N.Y. App. Div. 4th Dep't 1994); *Fieldstone Co. v. Briggs Plumbing Products, Inc.*, 54 Cal. App. 4th 357, 363-364 (Cal. App. 4th Dist. 1997); *Rissler & McMurry Co. v. Sheridan Area Water Supply*, 929 P.2d 1228, 1234 (Wyo. 1996)

⁵ *Arthur D. Little Int'l v. Dooyang Corp.*, 928 F. Supp. 1189 (D. Mass 1996).

physical harm accompanies economic loss, or where the defendant publishes false and disparaging statements.⁶

III. Professional Malpractice and Negligent Misrepresentation

1. Professional Malpractice Generally

Although the economic loss doctrine relegates a part seeking economic losses to a breach of contract action, many jurisdictions also permit the recovery of economic loss arising from negligence in the area of professional malpractice. Those states that permit recovery for economic loss under a theory of professional malpractice include Illinois, South Carolina, Texas, California, Florida, Alabama, Connecticut, Massachusetts, New York, West Virginia, Indiana, Iowa, Minnesota, Tennessee, Wyoming, Oregon, Rhode Island and Georgia. Conversely, many states do not permit such recovery: Michigan, Maryland, Virginia, Arizona, Pennsylvania, Delaware, Idaho, Alaska and Hawaii. To bring a cause of action for professional malpractice, some jurisdictions require the plaintiff and defendant be in privity of contract.⁷

The general duty of care required of professionals under a theory of professional malpractice is to possess and apply the knowledge, skill and ability that a reasonable careful professional in the field would exercise under the circumstances.⁸ In Illinois, for example, the established standard of care for all professionals is to the use of the same degree of knowledge, skill and ability as an ordinarily careful professional would exercise under similar circumstances.⁹

⁶ Canal Electric Co. v. Westinghouse Electric Co., 973 F.2d 988 (1st Cir 1992).

⁷ Ervin v. Mann Frankfort Stein & Lipp CPAS, LLP, 234 S.W.3d 172 (Tex. App. 2007)

⁸ Hirschberg v. State, 91 Misc. 2d 590, 593 (N.Y. Ct. Cl. 1977); Miller v. Silver, 181 Cal. App. 3d 652, 659 (Cal. App. 2d Dist. 1986)

⁹ *Advincula v. United Blood Servs.*, 176 Ill. 2d 1, 23 (Ill. 1996); *Matarese v. Buka*, 386 Ill. App. 3d 176, 181 (Ill. App. Ct. 1st Dist. 2008)

The duty of care expected of a professional is also provided for in §299A of the Restatement (Second) of Torts which states as follows:¹⁰

Undertaking in Profession or Trade:

Unless he represents that he has greater or less skill or knowledge, one who undertakes to render services in the practice of a profession or trade is required to exercise the skill and knowledge normally possessed by members of that profession or trade in good standing in similar communities.

2. Negligent Misrepresentation

Another common cause of action brought against professionals in those states the permit recovery for economic loss is for negligent misrepresentation. The Restatement (Second) of Torts¹¹ defines “negligent misrepresentation” as follows:

Information Negligently Supplied for the Guidance of Others

(1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

3. Management Consulting Firms

Not all jurisdictions hold that “management consulting firms” are professionals for the purposes of a professional malpractice claim based upon negligence. Usually, professional malpractice extends to professions such as doctors, accountants, attorneys and engineers.¹² Research indicates that Illinois has extended professional malpractice to “business consultants,” while Massachusetts has not.

4. Case studies

*Arthur D. Little Int'l v. Dooyang Corporation*¹³

Defendants Dooyang Corporation hired Plaintiff Arthur D. Little International Inc., (“ADL”) to provide business consulting services in relation to an investment in an

¹⁰ Restat 2d of Torts, § 299A

¹¹ Restat 2d of Torts, § 552

¹² Restat 2d of Torts, § 299A, comment b.

¹³ 928 F. Supp. 1189 (D. Mass. 1996)

aluminum smelter¹⁴. ADL brought this action to collect on three unpaid bills totaling approximately \$460,000, and to recover for damages incurred by reliance on Dooyang's promise to pay the bills¹⁵. Dooyang counter claimed for fraud, negligent misrepresentation, negligence, breach of contract and unfair and deceptive trade practices¹⁶. Although Massachusetts courts have permitted recovery of economic loss arising from negligence in the area of professional malpractice, the Court in the instant case declined to hold that the doctrine of professional malpractice covers business consultants¹⁷.

*Gallagher Corp. v. Massachusetts Mut. Life Ins. Co.*¹⁸

Plaintiff Gallagher Corporation brought action against defendant Massachusetts Mutual Life Insurance Co., alleging that defendant breached its fiduciary duty under the Employee Retirement Income Security Act of 1974 (ERISA) and based on other counts including negligent misrepresentation¹⁹. The Court relied on *Congregation of the Passion v. Touche Ross & Co.*²⁰, in which the State Supreme Court found that accountants, like attorneys, owe their clients extra contractual duties which are impossible to memorialize in contracts, and that therefore the economic loss doctrine would not bar tort recovery against them²¹. The Court further added that the evolution of the economic loss doctrine shows that the doctrine is applicable to the service industry only where the duty of the party performing the service is defined by the contract that he executes with his client²². Where a duty arises outside of the contract, the economic loss doctrine does not prohibit recovery in tort for the negligent breach of that duty²³. In the instant case the Court considered the services of the

¹⁴ *Id.* at 1192.

¹⁵ *Id.* at 1200.

¹⁶ *Id.* at 1201-1202.

¹⁷ *Id.* at 1202- 1203.

¹⁸ 940 F. Supp. 176, 179 (N.D. Ill. 1996)

¹⁹ *Id.* at 178.

²⁰ 159 Ill. 2d 137 (Ill. 1994)

²¹ *Id.* at 179.

²² *Id.*

²³ *Id.*

Defendant as “business consulting²⁴.” Business consultants generally hold themselves out as professionals who owe duties of care and loyalty to their clients which exist independent of any contract²⁵. Moreover, their products are often advisory in character and thus intangible, the way an attorney's brief is valuable for the ideas that it provides²⁶. The Court held that considering the services provided by the Defendants, the economic loss doctrine would not apply and that the Plaintiff's claim for relief was proper²⁷.

Bridgestone/Firestone, Inc. v. Cap Gemini Am.,²⁸

The Plaintiff, Bridgestone/Firestone, Inc. (“BFS”) brought this civil action against Defendant Cap Gemini America, Inc. on grounds of negligent misrepresentation, professional negligence and breach of contract²⁹. The Defendant argued that the professional negligence claim should be dismissed because such a cause does not exist in Tennessee against business consultants or because it seeks duplicative damages³⁰. The Court relied on the Restatement (Second) of Torts, § 299A to determine whether computer consultant comes under the ‘profession or trade’ under the section³¹. Defendant argued that in Tennessee economic damages alone lie solely in contract recovery and not in tort³². The Court held that Professional negligence claims of the Plaintiff will not be dismissed because the complaint is not for purely economic loss but also for damage to property³³. Regarding the negligent misrepresentation claim, Defendant argued that misrepresentation must consist of a statement of a material fact and that their statements of opinion or intention are not actionable³⁴. The Court did not dismiss the negligent misrepresentation claim stating that under Tennessee law

²⁴ *Id.* at 180.

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.*

²⁸ 2002 Del. Super. LEXIS 291 (Del. Super. Ct. May 23, 2002)

²⁹ *Id.* at 2.

³⁰ *Id.* at 9.

³¹ *Id.*

³² *Id.* at 11.

³³ *Id.* at 12.

³⁴ *Id.* at 13.

a negligent misrepresentation claim is a violation of a duty separate and distinct from any contract³⁵. Several Tennessee cases hold that a negligent misrepresentation claim can be brought regardless of whether the plaintiff is in privity of contract with the defendant³⁶. The obligation to use reasonable care in supplying information for the guidance of others in the course of their business transactions arises at law and is "independent of contract"³⁷. Even so, if the same facts support a recovery in contract and tort, a plaintiff may not have but one recovery³⁸.

IV. Fiduciary Relationship between a Client and Consultant

A fiduciary relationship exists when one party places trust and confidence in another who is in a dominant or superior position³⁹. In addition, a fiduciary relationship arises between two persons when one person is under a duty to act for or give advice for the benefit of another on matters within the scope of their relationship⁴⁰. The fiduciary's obligations to the dependent party include a duty of loyalty and a duty to exercise reasonable skill and care⁴¹. Accordingly, the fiduciary is liable for harm resulting from a breach of the duties imposed by the existence of such a relationship⁴².

Conclusion

Liability for negligence may result only from the breach of a duty running between a tortfeasor and the injured party. The existence of a duty between the parties is an issue of law for the courts to decide. Once the nature of the duty has been determined, whether a particular defendant owes a duty to a particular plaintiff becomes a question of fact. Law provides that brokers, and investment consultants and advisors, must always exercise

³⁵ *Id.* at 16-17.

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

³⁹ *McKelvey v. Pierce*, 173 N.J. 26, 57 (N.J. 2002)

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.*

diligence in the advice and recommendations they make to their clients. Loss or injury may occur even if the consultant has exercised reasonable care and provided the advice in good faith. However, the element of liability is always dependant on the corresponding provision in the agreement engaging the specialist. Although the Restatement (Second) of Torts demands a particular duty of care in the practice of a profession or trade, Courts are reluctant to attribute such responsibility to newer professions and trades. Courts still apply this rule only on the traditional professions limited to legal, medical, accountants, and architects. While some Courts decline/deter to recognize computer consultants as a profession or trade, certain other Courts have recognized 'business consulting' to have extra-contractual duties; though not expressly declaring them as profession or trade.