



Alerts

Bank Not Liable to Architects Under "Instrumentality" Theory for Defaulted Developer's Nonpayment of Fees

May 9, 2011

Professional Lines Alert

The Middlesex Superior Court (Massachusetts) recently considered whether architects hired by a real estate developer could hold the bank that financed the construction project liable for the professional fees that the developer failed to pay. *Creative West Architects, LLC, et al. v. Downtown Natick Development Co., LLC et al.*, Case No. 2009-4513-A (Apr. 12, 2011).

Plaintiff architects entered into contracts with a developer to provide architectural services related to the development of a condominium project. Pursuant to their contracts, the architects agreed to defer a portion of their fees—\$12,000 for each of eight units—until the closing for each unit. Ultimately, the project ran into financial difficulties and the developer stopped making interest payments on its loan from defendant bank. The bank consequently declared the developer in default. The developer also failed to pay the architects approximately \$100,000 in fees.

After the default, the bank took control of the project. The bank paid the developer's former project manager directly in an individual capacity to oversee the project's completion, assumed decision-making authority on construction decisions, replaced the original general contractor with its own contractor, and hired a replacement architectural firm. It refused to pay the architects for the services provided to the developer prior to the default.

The architects sued, alleging that the bank was liable for the developer's nonpayment of fees under an "instrumentality" theory. They also argued that the bank had assumed sufficient control over the developer such that the developer was being used to further the bank's purposes and that the developer in reality had no separate, independent existence of its own.

The superior court rejected the architect's 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 the developer—as to render the borrower "a mere business conduit for the lender." The court noted that the instrumentality theory addresses control over the borrower itself, not the project, and that the bank merely took control of the project as a result of the developer's default. The court also rejected the architects' mechanics' lien claim on the ground that the architects had failed to strictly comply with the statute's procedural requirements.

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Practice Note

Professional service providers should carefully consider the possible risks of entering into an agreement to accept deferred compensation, which the architects had done here, particularly given the current economic climate. Also, it is critical that architects and other design professionals take the necessary steps to preserve all avenues of potential recovery of fees including, where available, mechanics' liens.