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Drafting an Enforceable Limitation of Liability Clause

The following material is provided for informational purposes only. Before taking any action that could have legal or other important consequences, speak with a qualified professional who can provide guidance that considers your own unique circumstances. We'd like to thank professional liability insurer DPIC Companies for their contributions to this article.

A limitation of liability (LOL) clause in a contract with a client typically limits the liability of the design firm to some proportion of its fee or a defined dollar value. Numerous court cases have upheld the legality of such clauses. A landmark court case was decided in California in 1991 when a developer, Markborough California, Inc., sued the consulting engineers who had designed a manmade lake for a housing project. The lake's liner failed, leading to a \$5 million claim against the engineer. The engineer asserted that, as specified in a clause in its contract with the developer, liability was limited to the amount of its fee -- \$67,640. A trial court agreed with the engineer. The developer appealed, claiming the provision was not specifically negotiated and not expressly agreed to. The appellate court upheld the trial court, citing that the letter of transmittal the engineers sent with the proposed contract gave the client a reasonable opportunity to review the agreement and negotiate any element of it. (*Markborough v. Superior Court*, 227 Cal. App. 3d 705 1991.)

Subsequent cases supporting LOL include *Union Oil Company of California v. John Brown E&C, Valhal Corp. v. Sullivan Associates, Inc.*, and *R1 Associates, Inc. v. Goldberg-Zoino & Associates, Inc.* However,

there are also cases where courts have overturned limitation of liability provisions. For example:

***Ricciardi v. Frank*, 620 N.Y.S. 2d 918 (City Ct. 1994).** In this New York case, a homeowner sued its inspection engineer for failing to detect problems with water intrusion in the basement. The LOL clause limited the engineer's liability to \$375. The court ruled the clause invalid because the homeowner was not given the option to purchase full protection and the clause was presented in the inspection report – *after* the inspection had taken place.

***Estey v. McKenzie Engineering, Inc.*, 324 Ore. 372, 927 P2d 86, 1996.** In this case, an individual contracted an engineering firm to conduct a "limited visual review" of a house he intended to purchase. The contract, a single page, four-paragraph document that specified a fee of \$200, contained a one sentence LOL clause in the third paragraph, which read: "The liability of MEI (McKenzie Engineering, Inc) and the liability of its employees are limited to the Contract Sum." Following a lawsuit and appeal, the Oregon Supreme Court invalidated the LOL clause, ruling it was vague and the specified amount (\$200) was too low in comparison to the actual damages (\$340,000).

So how do you maximize the chances of your LOL clause being enforced if challenged? Generally, if the LOL clause is entered into between parties of relatively equal bargaining strength and is reasonable and clearly drafted, it will be enforceable -- unless there is a state law to the contrary or it is determined that the enforcement of the limitation would be unconscionable. Courts will also examine the language of the LOL clause to determine whether the problem that created the liability is covered by the clause.

Negotiate the LOL Clause

An important factor in enforcing an LOL provision is to be able to show that the provision was negotiated between two parties with relatively equal bargaining power. Your success in negotiating an LOL clause with your client depends on several factors. Your first step should be to initiate a frank discussion of risk allocation concepts. Point out to the client that having something built is a speculative business and that a major portion of reward and risk rightly belongs with the project owner. Concurrently, point out that your fee as a design professional is small in relation to the risk you incur. Don't hesitate to call upon your professional liability broker and/or attorney to assist you in these discussions.

During negotiations, present a preprinted contract that contains a sample LOL provision. Several professional societies include this clause in the body of their standard agreements. Other societies provide sample clauses as addenda. Whether or not you use a professional society contract, you should present your own standard contract language that includes an LOL clause.

Assuming you get your client to agree to the basic concept of equitable risk allocation, discuss and decide on an equitable limit to your liability. Consider offering your services for one fee with the LOL clause, or for a substantially higher fee without the clause. Providing this option to the client is an important point in your favor should the client accept the LOL provision but later challenge it in court.

Attorneys experienced in the design industry often suggest using LOL clauses that provide a blank in which you can fill in an agreed-upon liability dollar cap or percent of fee. If you decide to use a preprinted liability cap, bear in mind that you may weaken the evidence that the clause was negotiated.

Depending on your attorney's advice, and considering your jurisdiction, you may want to highlight the LOL clause in some manner. Some attorneys prefer that the clause be printed in bold, large type, capital letters, or with space provided for both parties to initial. Others include a paragraph just before the signature line of the agreement that states the contract contains a limitation

of liability clause and that the client has read and consents to all terms.

Establish an Equitable Limit

As the two overturned cases demonstrate, courts do not look favorably on LOL clauses that limit liability to a minimal dollar amount. Many attorneys suggest choosing a reasonable fixed amount such as \$50,000 or \$100,000 as the liability limit. Others set the liability limit at the greater of a fixed amount (\$50,000, for example), or the full amount of the design firm's fee.

Some clients insist on equating the dollar cap to the amount of professional liability insurance you carry. If you agree to this limit, make certain the wording reflects "insurance coverage available at the time of settlement or judgment" in the event your policy limit has been eroded by another claim. Even if your client demands a higher cap, any limitation is better than none.

Sample Language

Standard form contracts — such as those published by the AIA or EJCDC — have developed limitation of liability clauses that are coordinated with the rest of their contracts. If you don't use these forms, are using your client's contract, or would like another option, here are some alternatives provided by professional liability insurer DPIC Companies. (All clauses herein are intended as examples only and should be reviewed and modified by competent legal counsel to reflect variations in applicable local law and the specific circumstances of your contract.)

LIMITATION OF LIABILITY

In recognition of the relative risks and benefits of the project to both the Client and the Consultant, the risks have been allocated such that the Client agrees, to the fullest extent permitted by law, to limit the liability of the Consultant to the Client for any and all claims, losses, costs, damages of any nature whatsoever or claims expenses from any cause or causes, including attorneys' fees and costs and expert witness fees and costs, so that the total aggregate liability of the Consultant to the Client shall not exceed \$_____, or the Consultant's total fee for services rendered on this project, whichever is greater. It is intended that this limitation apply to any and all liability or cause of

action however alleged or arising, unless otherwise prohibited by law. Additional limits of liability of \$_____ may be made a part of this Agreement for a fee of ___% of the total fees included herein.

The above clause is a reasonable provision that incorporates most of the features necessary to give you sufficient protection while being relatively acceptable to most clients. However, some design firms believe that a simplified version of LOL is easier to obtain. These firms argue that although such a clause may not provide the protection of a more detailed one, the client has agreed to the principal of reasonable risk allocation and will likely be willing to work out problems as they occur on the project. Such a basic clause might read:

LIMITATION OF LIABILITY

To the maximum extent permitted by law, the Client agrees to limit the Consultant's liability for the Client's damages to the sum of \$_____ or the Consultant's fee, whichever is greater. This limitation shall apply regardless of the cause of action or legal theory pled or asserted.

For high-risk projects, such as condominiums, PSAs or projects that involve hazardous materials, a stringent LOL clause should be considered a must-have. Note that the clause below limits your liability not only to your client, but also to the contractor and his or her subs. Because some courts may interpret this as an indemnity, DPIC recommends presenting the clause in two paragraphs. If the second paragraph is challenged, your LOL clause may survive intact:

LIMITATION OF LIABILITY

To the fullest extent permitted by law, and not withstanding any other provision of this Agreement, the total liability, in the aggregate, of the Consultant and the Consultant's officers, directors, partners, employees and subconsultants, and any of them, to the Client and anyone claiming by or through the Client, for any and all claims, losses, costs or damages, including attorneys' fees and costs and expert-witness fees and costs of any nature whatsoever or claims expenses resulting from or in any way related to the Project or the Agreement from any cause or causes shall not exceed the total compensation received by the Consultant under this Agreement, or the total

amount of \$_____, whichever is greater. It is intended that this limitation apply to any and all liability or cause of action however alleged or arising, unless otherwise prohibited by law.

Contractor and Subcontractor Claims

The Client further agrees, to the fullest extent permitted by law, to limit the liability of the Consultant and the Consultant's officers, directors, partners, employees and subconsultants to all construction contractors and subcontractors on the Project for any and all claims, losses, costs, damages of any nature whatsoever or claims expenses from any cause or causes, including attorneys' fees and costs and expert witness fees and costs, so that the total aggregate liability of the Consultant and the Consultant's subconsultants to all those named shall not exceed \$_____, or the Consultant's total fee for services rendered on this Project, whichever is greater. It is intended that this limitation apply to any and all liability or cause of action however alleged or arising unless otherwise prohibited by law.

In Summary

Limitation of liability may not be attainable in every one of your contracts, but attempting to negotiate such clauses for all of your projects is a worthy goal. And even if the clause is refused, you have started the "risk versus reward" education process for you and your client. Remember that no firm ever got limitation of liability without asking for it.

Can We Be of Assistance?

We may be able to help you by providing referrals to consultants, and by providing guidance relative to insurance issues, and even to certain preventives, from construction observation through the development and application of sound human resources management policies and procedures. Please call on us for assistance. We're a member of the Professional Liability Agents Network (PLAN). We're here to help.