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Great American Professional Liability

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LIMITATION OF LIABILITY CLAUSES

By J. Kent Holland, J.D.

The limitation of liability (hereinafter "LoL") clause of a contract is an excellent and powerful way for a design professional to manage or control its risk of liability. By including a LoL clause in the contract, a design professional can better predict the extent of its potential liability and obtain appropriate coverage at a more reasonable cost. The LoL is not a total exculpatory clause since it does not require the designer's client to waive all claims or release the designer of all liability. Consequently, courts generally uphold the LoL clause in contracts between commercial entities, provided that the clause meets certain requirements under the applicable state statutes or common law. This paper includes a discussion of court decisions that have looked favorably upon LoL clauses, and provides examples of effective LoL clauses.

The rationale for capping liability for design professionals is that the small fee paid to the design firm does not justify the firm's assumption of all the risk. The project owner benefits from the sharing of risk because it is able to obtain innovative and cost-effective

continued on page 2 →

Limitation of Liability Clauses, *continued*

designs, and is able to do so at a potentially smaller fee than it would otherwise have to pay to the design professional that would be assuming unlimited liability in the absence of the LoL.

The profit margin for design firms does not support their taking on unlimited risk for project owners. One way to reduce the premiums to everyone's benefit is to include an LoL clause in more contracts. Underwriters generally consider the presence of a limitation of liability clause when underwriting and pricing the risk. Some insurance company applications, for example, include a question concerning how frequently the applicant obtains LoL clauses in their design professional contracts.

Sample Limitation of Liability Clause

Consider the following LoL clause:

> *To the fullest extent permitted by law, the total liability, in the aggregate, of Consultant, Consultant's officers, directors, partners, employees, agents, and subconsultants, to Client, and anyone claiming by, through, or under Client for any claims, losses, costs, or damages whatsoever arising out of, resulting from or in any way related to this Project or Agreement from any cause or causes, including but not limited to negligence, professional errors and omissions, strict liability, breach of contract, or breach of warranty, shall not exceed the total compensation received by Consultant or $50,000 whichever is greater.*

Note several points about this clause, including:

1) The language *"to the fullest extent permitted by law…."* provides a way for a court to save an offending clause by striking out just a portion of an LoL clause that is contrary to public policy in a state, but still enforce the intent of the clause to the maximum extent that the law will permit. So, for example, if the clause suggests that the LoL would apply to claims arising out of gross negligence but a state does not allow a LoL for damages that are caused by gross negligence, instead of throwing the entire clause out, the court could allow the clause to be enforced to limit the liability arising out of damages from everything other than gross negligence. This is important, because without this saving language, the court might otherwise find the entire clause to be void and unenforceable if part of the clause violates public policy or state law.

2) The clause does not merely limit the liability of the corporate entity. It extends the limitation to include claims made against *"Consultant's officers, directors, partners, employees, agents, and subconsultants."* One might think that a court even if the absence of those words, courts would automatically apply the LoL to them. But that is not necessarily so. In one Florida case, where a clause limiting liability to $50,000 referenced only the company, the court held that an individual engineer had an independent duty to the public and could be sued for negligence – and without the protection of the corporate LoL protection.

3) Note that the LoL applies *"to Client, and anyone claiming by, through, or under Client."* The reason to specifically state that the LoL will be applied not only to direct client claims but also to anyone claiming by, through or under the client is that it is possible there could be someone that asserts that they stand

continued on page 3 →

in the shoes of the client by way of a separate agreement with the client, for example, or that they are a beneficiary of the services performed for the client and therefore get to enforce the client's rights against you. This language attempts to make any such claims subject to the same LoL that will be applied to the client itself.

4) The words *"resulting from or in any way related to this Project or Agreement"* are included in the clause so that the LoL applies both to claims and damages arising of the actual performance of the services for the project, and also to claims that the design professional did something at the proposal/agreement phase to negligently misrepresent something to the client upon which the client then relied upon in making its decision to select the design professional or pursue the project. This language is broad enough that it may cover both types of actions against the design professional.

5) The LoL specifies that it applies to claims and damages *"from any cause or causes, including but not limited to negligence, professional errors and omissions, strict liability, breach of contract, or breach of warranty."* It is extremely important that all these types of causes of action are specifically stated in the LoL clause. There have been court decisions where a court enforced an LoL exactly as written so that it only limited the liability to a negligence action but did not limit the liability to a breach of contract complaint since the LoL did not expressly state that it applied to breach of contract actions. Courts will not interpret the LoL clause any more broadly than required to enforce the precise terms of the clause.

6) Be realistic in the amount that is set for the LoL. In the clause we state that the liability *"shall not exceed the total compensation received by Consultant or $50,000 whichever is greater."* Courts often look at whether the amount set for the LoL is sufficient to be meaningful. If the fee is only $2,000, a court might deem that too small of an amount to establish for a meaningful liability limitation. It might be deemed a mere slap on the hand. On the other hand, if the fee is $2,000, but the design firm agrees to pay an LoL of $50,000 because that is higher than the fee, a court may be impressed by the fact that the LoL is many times greater than the fee – and courts have looked favorably upon that when enforcing the LoL. Beware that stating that the LoL will be the "fee or $50,000 whichever is less" is generally not a good idea, and may cause the LoL not to be enforced because the amount is deemed too nominal by the court.

There are many good ways to craft an enforceable LoL clause. The ideas and language expressed above are just my reasoning and wording. I've had good luck enforcing similarly worded clauses, but other wording can certainly be used, keeping in mind what courts look at when reviewing and enforcing clauses.

Discussion of Case Law

Case 1: LoL Successfully Limited Liability to Total Fees

Where a LoL clause in a design professional contract would limit a homeowner's claim against its designer to the total fee for services, the appellate court in *Saja v. Keystone Trozze, LLC,* 106 A.D.3d 1168 (NY 2013), found in favor of the designer. It affirmed the summary judgment in favor of the designer that was granted by the trial court. The LoL clause in the contract provided that the plaintiff "agree[d], to the fullest

continued on page 4 →

extent permitted by law, to limit the liability of [designer] … to [plaintiffs] … for any and all claims, losses, costs, damages or any nature whatsoever or claims expenses from any cause or causes, so that the total aggregate liability of [designer] … shall not exceed [its] total fee for services rendered on this project."

The court explained "As a general rule, parties are free to enter into contracts that absolve a party from its own negligence or that limit liability to a nominal sum." The court further stated that "As a matter of public policy, however, exculpatory or limitation of liability clauses are not enforceable in the face of grossly negligent conduct." The plaintiff attempted to circumvent the LoL clause by alleging gross negligence. If the allegations had been sufficiently detailed to demonstrate that there were facts that could permit a jury to find gross negligence, the court would have declined to apply the LoL clause to dismiss the case at the summary judgment stage, but the court found the allegations lacking in that regard and enforced the LoL.

It is interesting to note that the court interpreted the LoL clause to apply to both negligence and breach of contract claims, even though the clause was somewhat generic in stating that the limitation would apply to "any and all claims, losses, costs, damages of any nature whatsoever for claims expenses from any cause of causes…." Courts in other jurisdictions might require that the LoL clause be written to specifically name the types of causes of action to which it applies, such as torts, negligence, breach of contract, breach of warranty, and strict liability. Also of note is the fact that the court did not address the dollar amount of the LoL and whether it evaluated its sufficiency under the circumstances. Courts in some jurisdictions may have considered whether the fees caused the LoL to be so nominal as to be unenforceable. What we learn from this decision is that the rules of contract drafting that are set forth at the beginning of this paper are not hard and fast rules that are applied by all courts. The decision on whether an LoL clause will be enforced is somewhat subjective and varies state to state and even judge to judge.

Case 2: LoL Clause for Architect's Own Negligence Was Reasonable

An architect's contract containing a LoL was enforced to grant a partial summary judgment limiting the architect's liability to $70,000 in the face of a $4.2 million claim for damages due to structural problems that required a nearly completed hotel that had to be demolished. In the case of Sams Hotel Group, LLC v. Environs, Inc., 716 F.3d 432 (7th Cir. 2013), the US Court of Appeals for the Seventh Circuit held the LoL clause in question applied to claims arising out of the indemnitor's own negligence and it was not relevant that the clause did not specifically reference the indemnitor's "own" negligence in contrast to negligence in general. The court explained the distinction between an exculpatory clause that removes all liability from a party, in contrast to an LoL clause that allows damage, even if only nominal in comparison to the total amount claimed. Applying Indiana law, the court stated that parties have freedom of contract and that "includes the freedom to make a bad bargain." To allow the plaintiff to get out from under the bargained for LoL clause "would permit an end-run around Indiana's economic loss rule and [plaintiff's] own contract with [the design professional]."

The client's only argument against enforcing the LoL clauses was that the client should be excused because the LoL language didn't refer explicitly to the architect's own negligence. This argument by the developer relied primarily on cases that would completely indemnify or exculpate a defendant for its own negligence. For those types of clauses to be enforceable, the court explained that under Indiana law they must clearly

continued on page 5 →

Limitation of Liability Clauses, *continued*

and unequivocally manifest a commitment by the one party to pay for damages caused by the other party's own negligence. But an indemnification clause is not the same as a limitation of liability clause, and the court stated that because they serve different purposes they must not be analyzed alike.

As explained by the court, "Limitation of liability clauses … do not operate as insurance the way that indemnification clauses do. They also do not entirely prevent one party to the contract from bringing a claim against the other, as exculpatory clauses do. Limitation of liability clauses serve to establish a contractual ceiling on the amount of damages to be awarded if a plaintiff prevails in later litigation between the contracting parties."

Case 3: Court Rejected Public Policy Argument

Where the developer of an apartment complex brought suit against a professional engineering firm seeking damages resulting from the alleged negligent design of the storm water drainage system, the court granted a partial summary judgment based on a LoL clause in the engineer's contract that limited liability to the amount of fees paid. On appeal, the summary judgment was sustained, with the court rejecting numerous arguments by the plaintiff that the LoL violated public policy and was unenforceable. This decision succinctly addresses the public policy issues and the right of parties to contract as they wish.

The plaintiff argued that the LoL clause violated public "because it attempts to insulate a licensed professional engineer, whose work inherently and necessarily impacts upon public safety and welfare, from the full consequences of its failure to exercise reasonable care and skill in the performance of its practice." The court disagreed. In explaining its reasoning, the court began by reiterating the axiom that "unless prohibited by statute or public policy [,] the parties to a contract are free to contract on any terms and about any subject matter in which they have an interest." In this case, the court found no specific statute prohibiting a contractual agreement to limit damages, and therefore found no conflict between the damages limitation clause and the public policy of the state.

One argument by the plaintiff was that "allowing professional engineers to limit their liability to the amount of their fee is contrary to sound public policy because it would remove an incentive to exercise care in practicing their profession." The court found this argument without merit because "The damages limitation clause at issue merely limits the amount of damages the engineer might owe to Lanier. It does not, however, preclude recovery against PEC by a third party for personal injuries resulting from PEC's design or construction."

The court held that the damages limitation clause in the instant case does not exculpate PEC from any wrongful conduct or release them from liability, but "merely limits the amount of damages Lanier may recover from PEC." For this reason, the court held that the clause did not violate the statute. *Lanier at McEver, L.P. v. Planners & Engineers Collaborative, Inc.,* 646 S.E. 2d 505 (2007).

continued on page 6 →

Limitation of Liability Clauses, *continued*

Conclusion

What we learn from the cases discussed above, and many other LoL decisions around the country, is that LoL clauses are often enforced even in the face of difficult facts. The clauses can limit recovery that would otherwise be permitted under state law, but they must clearly express their intent and specify every legal theory or cause of action to which the LoL will be applied. As a general matter, it may be prudent to keep the LoL clause separate from an Indemnification clause. Whereas state anti-indemnity statutes may restrict the use of an indemnification clause, the same statute might not restrict the use of an LoL clause. A court that might find an indemnification or exculpatory clause violates public policy might not find the same fault with an LoL clause where clause only affects the rights between parties to the contract who had the ability to negotiate its terms.

Don't be shy about including a Limitation of Liability clause in your standard form contracts and don't hesitate to ask your client to insert a Limitation of Liability clause into their form contracts if you are asked to sign a client-generated agreement.

About the author:
J. Kent Holland, Jr., is an attorney at Construction Risk Counsel, PLLC located in Tysons Corner, Virginia. Kent represents design professionals, contractors, and owners in his national practice. He was formerly a member of the law firm Wickwire Gavin, P.C. and employed by the Office of General Counsel of the U.S. Environmental Protection Agency. Kent is also the founder and president of ConstructionRisk, LLC, which provides consulting services, risk management analysis, and insurance advice.