

## PRO-FORM INSURANCE SERVICES

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### Limitation of Liability Clauses Underused

*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.*

A limitation of liability (LoL) clause remains one of the most effective risk allocation tools available to design firms. Yet it is surprising how many architect and engineering firms don't even attempt to negotiate such clauses in their client contracts.

Naysayers often opine: "They are unprofessional." "Courts won't uphold them." "Clients won't accept them." "If my client rejects an LoL clause, all I've done is damage our relationship and jeopardize future projects."

Actually, a frank discussion regarding risk allocation and reduction can do nothing but improve communication, understanding and professionalism. Even if an LoL clause isn't successfully negotiated, the negotiation process can often gain other advantages such as an expanded scope of services and increased fees in return for unlimited liability.

### What Is an LoL Clause?

A limitation of liability clause is a contract provision that allocates liability between client and design professional – or any two parties to a contract, including primes and subs. It acknowledges that one party (e.g., the project owner) has the most to gain from a project and therefore should accept the greatest degree of risk in the event problems arise. Typically the design professional's potential reward for a project is relatively low – the profit to be retained from the overall fee that is charged. It is only fair that the design firm's liability be in relation to its fee and potential reward.

How are liabilities limited? 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 equate the dollar cap to the amount of professional liability insurance available. 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.

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 or would like another option, here is sample language. *Note: This sample clause is intended as an example 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 last sentence of this clause is recommended to show that the client had the option of foregoing the LoL in exchange for other considerations.

### **The Benefits of Negotiating for LoL**

Discussing limitation of liability with your client provides the momentum to explore all issues of risk management and risk allocation on a project. If you do not use limitation of liability negotiations as a springboard for exploring risk, you won't benefit fully from the concept.

Consider these added benefits:

**Improved client evaluation.** Talking about risk with a client gives you an excellent opportunity to evaluate the client's attitude. If a client rejects an LoL clause outright and appears insensitive to risk management in general, he or she may be quick to look to your firm for recovery at the first sign of any trouble. On the other hand, if a client is set against an LoL clause but acknowledges that risk management is a top concern and seems agreeable to other liability reduction techniques, then you can likely proceed forward with negotiations.

**Enhanced communication.** The LoL discussion can help create a pattern for effective communication at the outset of a project. By discussing LoL with the owner, you will obtain a better understanding of the owner's goals for the project as well as their risk management philosophy and practices. To the extent that a discussion of risk allocation results in a more informed client, a better client relationship and more frequent communications, risk is reduced.

**Claims avoidance.** Limitation of liability clauses not only limit the amount for which a design firm is liable, it helps prevent meritless claims altogether. Clients are less likely to use the traditional court system to press a claim whose value is limited by contract. They will be more likely to pursue alternative dispute resolution (ADR) methods that emphasize prompt, fair settlements without over reliance on attorneys.

**Expansion of scope of services.** Design firms are often successful in negotiating an expanded scope of services and higher fees in lieu of an LoL clause. Broadening the scope of services helps reduce risks when the expansion includes quality control services, prebid conferences, preconstruction conferences, or full-time construction or remediation observation.

**Insurance premium savings.** Professional liability insurance premiums reflect a firm's claims experience. When your use of LoL results in fewer and/or less costly claims, your insurance premiums are kept in check. Some insurers even offer incentives such as premium reductions for

insureds who regularly use LoL clauses. Even when an insurer does not publicize such incentives, the presence of LoL in contracts should be brought to the underwriter's attention as a point to consider when setting your premium.

### **Overcoming Objections**

Despite these benefits, some design professionals continue to greet an LoL clause like Scrooge might greet Santa Claus: Bah humbug! But unless the entire design team is behind the effort to use limitation of liability as a risk allocation tool, a company will not gain full benefit from its usage. Here's how to address the three most common objections to making an effort to negotiate LoL clauses:

***It isn't professional.*** Some design professionals fear that the use of limitation of liability is unprofessional. Yet LoL contract language is used in various industries to allocate risk according to potential reward. Have you ever read the fine print on your ticket from the parking garage? How about your airline ticket? It is a common business practice to limit liabilities to achieve equitable risk allocation that considers who has the most to gain from a business transaction.

***It won't hold up in court.*** The fact of the matter is that LoL clauses for professional negligence exposure have been upheld in federal and state courts. A landmark court case was decided in California in 1991 when a developer sued a consulting engineer for \$5 million when the liner on a manmade lake failed. The engineer asserted that, as specified in an LoL contract clause, liability was limited to the amount of its fee – \$67,640. A trial court agreed with the engineer and an appellate court upheld the trial court. (*Markborough v. Superior Court*, 227 Cal. App. 3d 705 1991.)

In 1995, the Oregon Court of Appeals affirmed a trial court decision that upheld an LoL clause in a four paragraph engineering contract. (*Estey v. McKenzie Engineering, Inc.*) And in Pennsylvania, a U.S. District Court overruled a lower court decision and upheld an LoL clause in an architect's contract (*Valhal Corp. v. Sullivan Associates, Inc.*) In 1996, when a developer in Massachusetts claimed an LoL clause was invalid and against public policy, the state Superior Court upheld the clause, concluding, "...this contract arose out of a private, voluntary transaction in which one party, for consideration, agreed to shoulder a risk which the law would otherwise have placed upon the other party." (*R-I Associates, Inc., v. Goldberg-Zoino & Associates, Inc.*)

In 2004, a British Columbia court ruled that an LoL clause in the contract between a client and prime architect also applied to subconsultants whose services were included in the scope of services specified in the prime's contract (*Workers' Compensation Board of British Columbia v. Neale Staniszki Doll Adams Architects*). Finally, in 2006, an appellate court in New Mexico upheld an LoL clause limiting a geotechnical firm's liability to the greater of the amount of fees or \$50,000, ruling that the clause was distinct from unlawful indemnification and exculpatory clauses (*Fort Knox Self Storage Inc. v. Western Technologies*).

***Owners won't accept it.*** Some folks say owners will never voluntarily accept a provision that limited their ability to recover damages caused by a consultant's mistakes. History has shown these doubters to be wrong: Owners of all types have accepted limitation of liability clauses.

An LoL clause 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 with your client. Remember that no firm ever got limitation of

liability without asking for it. And don't forget to ask for our assistance when planning your negotiation strategy for an LoL clause.

**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.*