A/E RISK REVIEW

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Limitation of Liability Continues to Gain Acceptance

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.

For decades, professional liability specialists have urged design professionals to include Limitation of Liability clauses in their client contracts as an effective method to reduce risks and, in turn, lower the size of their insurance premiums. Such contractual clauses establish an upper dollar limit to the amount that a design firm is liable to a client for its negligent acts, errors and omissions.

Many design firms have been successful in using these clauses and have realized significant savings on their PL insurance premiums as a result. Others, however, have steadfastly refused to insert an LoL clause in their contracts. Their reluctance is twofold:

1. They don't believe their clients would accept such clauses. In fact, they fear that some clients might even decline to hire a design firm that asks for such a limitation.
2. They believe that even if they get such a clause in their contract, it would likely be unenforceable. They point to a history of courts throwing out such clauses for being unreasonable and unfair.

It is true that some clients won't accept limitation of liability clauses in their contracts with design consultants. However, many do. When LoL clauses are properly written and presented, clients will likely recognize that the contract language is not intended to relieve the design firm of its obligations for any errors or omissions that occur, but simply to allocate liabilities on an equitable basis. It's simply unfair to expect a design firm to accept unlimited liability in exchange for a comparatively modest design fee.

It is also true that, in the past, limitation of liability clauses were often thrown out in court. But this was a time before such contractual clauses became standardized and common place, not only within the A/E/E world, but among service providers and their clients in many, many industries. What's more, clauses were often rejected by courts not because the judge or jury felt the concept of limited liability was unacceptable, but because the specific clause in question was unfair and relieved the service provider of too much responsibility for their errors or omissions. An LoL clause that limits a design firms liability to a few hundred dollars, for example, is likely unfair to the client. Today, there are reasonable standards for liability limits in place that have resulted from years of experience in contract negotiations and the court cases that have tested these clauses.

The Historic Court Cases In Support of LoL

Anyone who has devoted time researching the history of limitation of liability clauses in the architect and engineering field are likely aware of some of the many court cases that have upheld the viability of LoL. Among them:

- The landmark 1991 *Markborough v. Superior Court* case in California. Here a developer sued a consulting engineer for $5 million when a liner on a manmade lake failed. The developer challenged an LoL clause that limited the engineer's liability to its total fee, which was $67,640. A trial court agreed with the engineer, upholding the LoL clause, and an appellate court upheld the trial court's decision.

- *R-1 Associates, Inc. v. Goldberg-Zoino & Associates, Inc.* (1996). A developer claimed that an LoL clause it had agreed to was invalid because it was against public policy. The state Superior Court of Massachusetts upheld the clause concluding that the 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."
- *Workers Compensation Board of British Columbia v. Neale Staniszkis Doll Adams Architects* (2004).North of the border, a British Columbia court ruled that an LoL clause between the client and lead architect also applied to subconsultants whose services were included in the scope of services specified in the prime's contract.
- *Fort Knox Self Storage Inc. v. Western Technologies* (2006). An appellate court in New Mexico upheld an LoL clause limiting a geotechs liability to the greater of the amount of fees or $50,000, ruling that the clause was distinct from unlawful indemnification and exculpatory clauses.

New Rulings Support LoL Too

The aforementioned four court cases upholding the validity of LoL clauses between designers and their clients are often cited by limitation of liability proponents; but they are all 10-20 years old. What have been the courts' more current rulings on the matter? Here are a couple of LoL cases that were addressed by the courts over the last couple of years you might not be aware of.

Saja v. Keystone Trozze, LLC (2013). In this New York case, an LoL clause in a contract between a homeowner and architect limited the designer's financial liability for any and all claims to the amount of total fees for services rendered on the design of a new residence. Unfortunately, the architect's plans resulted in the first floor of the new home being built nearly two feed below the allowable elevation pertaining to the local flood plain. The homeowner claimed that the limitation of liability clause should be struck down due to the "gross negligence" of the architect.

Both the trial court and an appellate court ruled in favor of the architect, upholding the LoL clause. The appellate court noted that the plaintiff failed to establish the "reckless indifference" standard necessary to reach a level of *gross* negligence. The court further clarified that parties to a contract are free to enter into agreements that limit one party's liability as long as that party's errors or omissions do not meet the level of gross negligence.

SAMS Hotel Group, LLC, v. Environs, Inc. (2013). In this Indiana case, the client, SAMS, hired the architect, Environs, to design a hotel. The fee for the project was $70,000 and the contract included an LoL clause that limited the architects liability to "not exceed the amount of the total lump sum fee."

Unfortunately, after construction had commenced it was discovered that the design contained serious flaws regarding the foundation and wall supports -- so serious that the county building department condemned the nearly completed structure, which eventually had to be demolished. SAMS filed a suit against Environs alleging $4.2 million in damages and sued for both negligence (a tort claim) and breach of contract.

A federal district court dismissed the negligence claim, filed as a tort claim with the intent to circumvent the LoL clause. The court noted that the economic loss rule applies to construction contracts under Indiana law and thus the architect could not be held liable under a tort theory for purely economic losses. The court did find that Environs was liable under the breach of contract charge, but also found that the LoL clause was enforceable. Thus, the court awarded the plaintiff only $70,000.

Crafting an LoL Clause that Sticks

We've now seen that LoL clauses continue to be upheld in court despite attempts by plaintiffs to overturn or circumvent them. Still, these clauses need to be carefully drafted to maximize the chances of being acceptable to a client and then surviving a challenge in the event of a claim. Here are a few tips:

First off, don't reinvent the wheel. The AIA and EJCDC have developed standard form contracts that include limitation of liability clauses coordinated with the rest of their contracts. Many professional liability insurers also offer recommended language. All of these clauses are based on years of experience in developing language that will stand up to client and court challenges.

The core of a good LoL clause will have language that reads something like: *In recognition of the relative risks and benefits of the project to both the client and the consultant, risks are 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 and damages from any cause or causes.* Of course, you will want to get the advice of your legal counsel to come up with language that best fits your particular situation.

A good LoL clause will clearly spell out in unmistaken clarity the aggregate and total limit of your liability. This limit can be set out as a dollar amount, such as $50,000 or $100,000, or it can be tied to your total fee for the project. One other option is to tie the limit of liability to the available insurance limits of your professional liability policy at the time of settlement or judgment. Regardless of how you and your legal counsel establish the amount, it is generally recommend that you state that this liability limit applies to any and all liability or cause of action however alleged or arising unless otherwise prohibited by law.

Once you and your attorney have developed your LoL language and present it to a client, make efforts to show that this contract clause was fairly negotiated. For example, demonstrate that the client had the option of raising or foregoing this limit in exchange for an equitable adjustment in the designer's fee to compensate for the increased liability risk. Some attorneys suggest that the LoL clause be set apart from surrounding text in the contract by using boldface or highlighted text. Some also suggest that the dollar amount of the liability limit be written by hand and initialed by both parties. This further demonstrates that the client is fully aware of and accepts the negotiated limits.

Many Benefits, Win or Lose

Obviously, design firms who successfully negotiate LoL clauses in their client contracts stand to benefit financially in the event of a future claim. Not only is their financial liability capped at a reasonable level commensurate with their fee, but clients may be less likely to file a questionable claim in the first place. Knowing their potential recovery is capped, they may be more likely to seek a nonmonetary solution to a perceived design error or reach a mediated settlement instead of heading to the courts.

Plus there's another potential cost savings for design firms who regularly negotiate LoL clauses in their contract. Some insurers offer incentives such as premium reductions for design firms that include LoL clauses in the bulk of their client contracts.

Even if a client eventually says no to an LoL clause the negotiation process can still present sizeable benefits for A/E/E firms. The conversation regarding LoL allows you to judge a potential client's risk management philosophy and introduce the risk-versus-reward inequities that design firms face. It may lead you to agree upon other risk management options such as agreements to use alternative dispute resolution in the event of a project upset, or the scheduling of regular communications to address risk management throughout the life of the project. You might even be able to negotiate a wider scope of services and higher fee, in lieu of an LoL clause, to help address loss prevention practices during the design phase and on the jobsite.

Finally, a potential client's curt, hostile reaction to a discussion of LoL or additional risk management services might just cause you to think twice about accepting a project. And turning down a risky project from a questionable owner just may lead you to cap your liability at $0 by just saying "no."

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.