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The essentials of negotiating a limitation of liability clause

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A limitation of liability (LoL) clause can be one of the most effective risk allocation tools available to design and environmental firms. However, these clauses can also be among the most difficult to negotiate with your client and, depending on your jurisdiction, one of the most contested once applied. Therefore it is crucial that any LoL clause be carefully drafted in a fair and equitable manner that is likely to hold up to a challenge in court.

While courts generally do not favor limiting someone's liability for their own negligence, they will uphold limitation of liability clauses when they are fair, reasonable and mutually agreed to by parties with equal bargaining power and ample opportunity to negotiate. California courts have been receptive to enforcing such provisions. Note that these agreements will not apply to any third parties to a dispute.

The key elements of an LoL clause

A limitation of liability clause is a contract provision that allocates liability between parties—e.g., a consultant and its client, or a prime consultant and a subconsultant. It acknowledges that one party (e.g., the client) has the most to gain from a business agreement and therefore should accept the greatest degree of risk in the event problems arise. Typically, the environmental or design professional's potential reward for a project is relatively low—the one-time net profit retained from the overall fee charged. The project owner can generate substantial long-term profits from a completed project. It is only fair that each party's liability be in relation to its potential reward.

There are numerous contractual methods of limiting the design or environmental firm's liability. Many attorneys suggest choosing a reasonable fixed amount, such as $50,000 or $100,000, as the liability limit. Others set the limit at the greater of a fixed amount or the full amount of the consulting firm's fee.

Some LoL agreements equate the dollar cap to the amount of professional liability insurance available. If you use this type of limit, make certain the wording reflects "actual insurance coverage proceeds available at the time of settlement or judgment" in the event your policy limit has been eroded by other claims.

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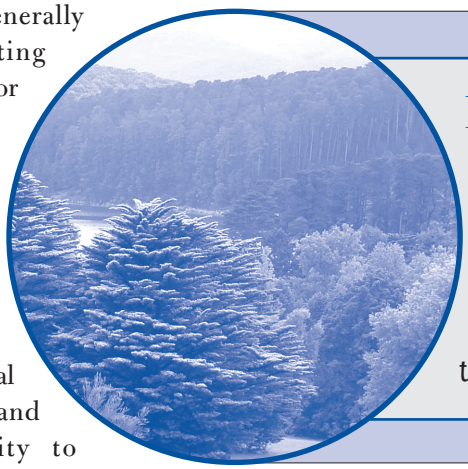

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Standard form contracts—such as those published by the AIA or EJCDC—have developed limitation of liability clauses that are coordinated with the rest of their contracts. Some firms prefer to draft their own version of the LoL agreement. Regardless, a limitation of liability clause typically includes the following provisions:

- 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. The text should be unambiguous as to its intent.
- A total aggregate liability of the consultant to the client is established. This limit can be set as a specific dollar amount or tied to the consultant's fees on the project or the available professional liability insurance limits.
- It is stated that the liability limit applies to any and all liability or cause of action however alleged or arising, unless otherwise prohibited by law.
- It is stated that the limit of liability was fairly negotiated and that the client had the option of altering or foregoing this limit in exchange for an equitable adjustment to the consultant's fee. This addition shows that the LoL clause was expressly negotiated and the client had the option of foregoing, increasing or decreasing the LoL in exchange for financial considerations.

Some attorneys suggest that the LoL clause be set apart from surrounding text in the contract by using a boldface heading or highlighted text. Some even suggest that the dollar amount of the limit be written in by hand and that both parties initial the clause to demonstrate that the project owner was fully aware of its presence and negotiated the limit.

The benefits of negotiating for LoL

You will not always be successful in negotiating a limitation of liability clause. However, simply discussing limitation of liability with your client provides momentum to explore various issues of risk management and risk allocation on a project. If you don't even attempt to negotiate an LoL clause, you miss out on the following benefits:

Improved client evaluation. Talking about limitations of liability with a client gives you an excellent opportunity to evaluate the client's attitude toward risk management. 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 acknowledges that risk management is a viable goal, you can work toward loss prevention practices even if the LoL clause doesn't make it into your contract.

Enhanced communication. The LoL discussion can help create a pattern for straightforward communication with your client at the outset of a project. By discussing LoL, you obtain a better understanding of clients' goals for the project as well as their overall project 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 can be addressed and reduced.

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

Claims avoidance. Successfully negotiating a limitation of liability clause not only limits the amount for which a firm is liable, it helps prevent meritless claims altogether. Clients are less likely to use the traditional court system to press a weak claim when the ultimate reward 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.

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 internal objections

Some environmental or design firms have refused to even attempt to negotiate a limitation of liability clause with their clients. They say it's unprofessional, owners won't accept it and —even if they do accept it—it won't hold up in court. Here's how to address these three common objections to making an effort to negotiate LoL clauses:

It isn't professional. LoL contract language is used in various industries to allocate risk according to potential reward. Have you ever read the fine print on a ticket from a parking garage? How about an airline ticket or computer software? 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.

Project owners won't accept it. Some folks say owners will never voluntarily accept a provision that limits 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 once they hear the risk-reward argument and understand that accepting the clause can result in a lower fee. This is particularly true when the project owner has had a history of relatively error-free projects with the firm.

It won't hold up in court. The fact of the matter is LoL clauses for professional negligence claims have been upheld in both 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 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-1 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 Staniszkis Doll Adams Architects*). (Note: we recommend that the provision specifically include your "employees and subconsultants.") 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

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$50,000, ruling that the clause was distinct from unlawful indemnification and exculpatory clauses *(Fort Knox Self Storage Inc. v. Western Technologies)*.

A worthy goal

An LoL clause will not be attainable in every one of your client contracts. However, attempting to negotiate such clauses for all of your projects is a worthy goal. LoL clauses should be considered almost mandatory for high-risk projects or those projects performed for very low fees or with donated services.

Even if the LoL clause is refused, you have started the "risk versus reward" education process with your client and opened the door to expanded services and higher fees. Remember: 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.

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