

---

---

# PROFESSIONAL LIABILITY UPDATE

A Loss Prevention Newsletter for the Design Profession

---

---

MSP PL 11/99: "Limitation of Liability: A Proven Concept"

November, 1999



## Limitation of Liability A Proven Concept

A limitation of liability (LOL) clause is a contractual agreement between a design professional and client that limits the amount of liability the architect or engineer will be responsible for if there is a problem on the construction project arising out of the negligence of the design professional. The purpose of the clause is simple: to allocate risk in reasonable proportion to the benefits to be derived from the project. In other words, if the providers of a service obtain a small benefit (their fee) while helping their clients achieve a much larger one (their profit), the risk these service providers bear should rightfully be in proportion to their benefit.

Obtaining an LOL clause in all or most of your agreements is not an unrealistic goal. True, in the past, clients and even some design professionals have resisted the idea. But over the last decade the climate has changed considerably.

There are now many firms that routinely ask for and get limitation of liability clauses in most if not all of their contracts. These firms have come to realize – and are convincing their clients – that LOL is a reasonable way to decide the level of responsibility to which an architect or engineer will be held in the event something should go wrong. They recognize, too, that there are many instances in which fault may not originate with the design professional, but the de-

signer will likely be brought into a costly suit, regardless. And they realize that LOL is a proven concept that, if properly negotiated and drafted, has an excellent chance of holding up in court.

### A Landmark Case

A landmark case was decided in California in 1991 when a developer, Markborough California, Inc., sued the consulting engineers who had designed a man-made 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

Published by

**Cavignac & Associates**

INSURANCE BROKERS  
License No. OA99520

1230 Columbia Street, Suite 850  
San Diego, CA 92101-3571

Phone: 619-234-6848 ♦ Facsimile: 619-234-8601

Website: [www.cavignac.com](http://www.cavignac.com)

(Continued from page 1)

and negotiate any element of it (Markborough v. Superior Court, 227 Cal. App. 3d 705 1991).

## Clause Thrown Out Because Amount Too Low

Most reasonable and clearly drafted limitation of liability clauses agreed to by two parties of relatively equal bargaining strength are upheld when tested in court. However, courts generally do not look kindly on LOL clauses that are vague or call for unreasonably low limits that virtually eliminate a design firm's liability.

In one Oregon 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.*"

The plaintiff signed the contract and the services were performed. The defendant delivered a two-page written report, and the plaintiff purchased the house.

Soon afterward, problems with the house were discovered – including a broken water pipe and slanted floors. The plaintiff hired another engineer, had repairs made to the house and sued the defendant for \$340,000 for failure to detect the problems.

The defendant filed a motion for summary judgment, which was granted by the trial court. The court concluded that the contract limited the defendant's liability for negligence. "*The contract is extremely simple containing four short paragraphs,*" the court noted. "*A reader would have to make a real effort for the limited liability clause to escape his or her attention.*"

The plaintiff appealed the decision, but the Oregon Court of Appeals affirmed the trial court decision. However, the Oregon Supreme Court then invalidated the LOL clause, ruling it was too vague and the specified amount (\$200) was too low in comparison to the actual damages (\$340,000) (Estey v. McKenzie Engineering, Inc., 324 Ore. 372, 927 P2d 86, 1996).

## No Guarantees

The enforceability of any limitation of liability provision depends upon a particular state's laws and the individual situations that make up each case. Therefore, there are no guarantees that an LOL clause will be upheld. However, court cases have established some general ground rules that, if followed, maximize the chances that a limitation of liability clause will hold up if challenged.

## Drafting LOL Clauses That Work

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 – and specifically LOL. Try to help the client understand that having something built is a speculative business and that a major portion of the risk and reward rightly belongs with the project owner.

Demonstrate that your liability is limited anyhow: you don't have unlimited resources or unlimited insurance. Nor is insurance the total answer. Point out that professional liability insurance carries an aggregate policy limit that covers all of a design firm's projects, is not always available for a particular risk, and does not assure future coverage.

During contract negotiations, introduce the limitation of liability clause. You may have a greater chance of success in obtaining an LOL clause if you present a preprinted contract that contains an LOL provision. Several professional societies include the clause in the body of their standard agreements. Other societies provide sample clauses as addenda. Whether or not you traditionally use a professional society contract, you should consider developing your own "standard" contract language that includes an LOL clause.

An important factor in enforcing an LOL provision is to be able to show that the provision was negotiated or at least was negotiable. You and your client should discuss and decide on an equitable limit to your liability. You might consider offering your services for one fee with an LOL clause, or for a substantially higher fee without the clause.

We suggest using LOL clauses that provide a blank in which you can insert an agreed-upon liability dollar cap or percent of fee. Some firms believe, however, that they have greater success in obtaining

(Continued from page 2)

LOL provisions if they offer contracts with a dollar figure pre-printed in the body of the contract. If you decide to use a pre-printed liability cap, bear in mind that you may weaken the evidence that the clause was negotiated.

Depending upon your attorney's advice, and considering your jurisdiction, you may want to highlight the LOL clause in some manner. Some design professionals (or their attorneys) prefer that the clause be printed in bold, large type, capital letters, or with space provided for both parties to initial. Still 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. You could also place the LOL clause at the very end of the contract, immediately above the client's signature line.

## How Much?

Many design firms choose \$50,000 or \$100,000 as the fixed dollar liability limit. Others set the liability limit at 80% or even 100% of the design firm's fee. Even if your client demands a higher cap, any limitation is better than none.

Some clients insist on equating the dollar cap to the amount of professional liability insurance you carry. If you agree to this limit, try to 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.

## Sample Language

Some 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. (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 Design Profes-***

# Limited Scope Calls for Limited Liability

A client who refuses to pay for risk management services such as construction observation limits a design firm's ability to control liabilities. Therefore, one negotiating tactic is to match the scope of services (and fee) to your limits of liability.

For example, if a client seeks a limited range of design services for a limited fee, offer the client a choice of two or more options. At one end is a contract that calls for a full scope of services, including adequate observation, at an appropriate fee. Here, the design firm would accept a substantial amount of the liability for design errors or omissions. At the other end would be a limited scope of services with a limitation of liability clause that provides an acceptable risk-to-reward ratio.

If the client balks at this negotiation approach, explain: *"If you are going to limit my ability to function properly as a professional, then I am going to match that with a limitation of my professional exposure."* ❀

***sional, the risks have been allocated such that the Client agrees, to the fullest extent permitted by law, to limit the liability of the Design Professional and his or her subconsultants to the Client and to all construction contractors and subcontractors on the project for any and all claims, losses, costs, damages of any nature whatsoever and claim expenses from any cause or causes, so that the total aggregate liability of the Design Professional and his or her subconsultants to all those named shall not exceed \$\_\_\_\_\_, or the Design Professional's total fee for services rendered on this project, whichever is greater. Such claims and clauses include, but are not limited to, negligence, professional errors or omissions, strict liability and breach of contractor warranty.***

The above clause is a reasonable provision that incorporates most of the features necessary to give you sufficient protection but should be relatively acceptable to your clients.

Some design firms believe that a simplified version of LOL is easier to obtain. These firms ar-

(Continued on page 4)

(Continued from page 3)

gue 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 clause might read:

***“To the fullest extent permitted by law, the Client agrees to limit the Design Professional’s liability for the Client’s damages to the sum of \$\_\_\_\_\_ or the Design Professional’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, you may prefer a clause that gives you added protection:

***“To the fullest extent permitted by law, and notwithstanding any other provision of this Agreement, the total liability, in the aggregate, of the Design Professional and the Design Professional’s officers, employees, agents and subconsultants, and any of them, to the Client and anyone claiming by, through or under the Client, for any and all claims, losses, costs or damages of any nature whatsoever arising out of, resulting from or in any way related to the Project or the Agreement from any cause or causes, including but not limited to the negligence, professional errors or omissions, strict liability, breach of contract or warranty, express or implied, of the Design Professional or the Design Professional’s officers, directors employees, agents or subconsultants, or any of them, shall not exceed the total compensation received by the Design Professional under this Agreement, or the total amount of \$\_\_\_\_\_, whichever is greater.”***

Note that the above clause limits your liability and that of your subconsultants to the owner to a certain sum for not only your negligence but also any joint negligence with others. By including your subconsultants, you preclude the possibility of paying for joint liability claims – and may even prevent the subconsultant from later seeking damages against you.

## 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. 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.

As a matter of practice:

- Discuss the concept of risk allocation in relation to financial reward with your clients.
- With legal counsel, draft a limitation of liability clause that fits your unique situation.
- Make the LOL clause clear and obvious in the contract.
- Establish a means to show that the contracting parties knew of the clause’s presence, understood it and had an opportunity to negotiate it. This is most important when the client is small or may otherwise appear to be unsophisticated or of unequal bargaining strength.
- Set a reasonable dollar amount, e.g. “\$50,000 or the fee, whichever is greater.” Do not attempt to limit the liability to a nominal amount that a court would likely dismiss as unreasonable.
- Clearly state in the LOL clause that it applies to every legal theory or cause of action, including negligence, breach of contract and warranty. Also state that it is enforceable “to the fullest extent permitted by law.”
- Keep the LOL clause separate from any indemnification clause in the contract.

If you would like additional information on the topic of limitation of liability, or any other insurance or risk management issue pertaining to the design profession, contact us or visit us on-line at [www.cavignac.com](http://www.cavignac.com). ✿

---

---

***Disclaimer:*** This article is written from an insurance perspective and is meant to be used for informational purposes only. It is not the intent of this article to provide legal advice, or advice for any specific fact, situation or circumstance. Contact legal counsel for specific advice.

---

---