

# *Drafting Limitation of Liability Clauses*

**Howard W. Ashcraft, Jr.**  
**Hanson, Bridgett, Marcus, Vlahos & Rudy, LLP**

A Practical Guide for Design Professionals

---

## *Introduction*

---

Limitation of liability clauses allow designers to limit their exposure to an agreed upon amount. Generally, the debate over limitation of liability clauses focuses on enforceability. States that reject limitations of liability see them as unenforceable indemnity agreements. States that allow limitations of liability see them as the mere shifting of risk. This paper discusses the drafting of limitation of liability clauses from their earliest formulation to full-featured, modern clauses and provides design professionals with an understanding of the issues critical to enforceability. It also examines post-contract conduct that can undermine the effectiveness of limitation provisions. Recognizing that each state has its own law regarding limitations of liability, this paper only discusses general ideas associated with these clauses. This paper is not intended to address the limitations of liability scheme in your state nor is it a substitute for good legal counsel concerning specific issues and contracts.

## *What Does a Limitation of Liability Clause Accomplish?*

---

### **LIMITATION OF LIABILITY DEFINED**

A limitation of liability clause is a contractual provision that restricts the amount of damages a client can recover from a designer. Properly drafted, and where enforceable, it can provide protection against contractual breaches and negligence and is a valuable tool for allocating project risk. But it does not protect the designer against liability for intentional misconduct, nor does it limit the designer's liability to persons other than the client. Third-parties who have not signed the designer's contract are not bound by the limitation provision.

---

## *Are Limitation of Liability Clauses Enforceable?*

---

Whether or not a limitation of liability clause is enforceable depends upon the law of the state in which it is trying to be enforced. Some states have found limitation of liability clauses void as unenforceable indemnity provisions. For example, in *City of Dillingham v. CH2M Hill Northwest, Inc.*,<sup>1</sup> the Supreme Court of Alaska refused to uphold a standard limitation of liability clause between a civil engineer and its client. The Alaska court noted the Alaska legislature had enacted a statute barring indemnity for sole negligence in construction contracts. The court commented that by enacting the bar, the Alaska legislature intended to prevent parties from bargaining away liability. The court then concluded that limitation of liability clauses were merely attempts to bargain away liability and as such were barred by the statute.

Other states, however, have upheld the enforceability of limitation of liability clauses. In *Markborough v. Superior Court*,<sup>2</sup> the California Appeals court upheld a limitation of liability clause contained in the fine print of a civil engineer's standard terms and conditions. Although the developer objected that it had not read the clause – and that the clause was never specifically agreed to – the court held that the clause was enforceable as long as there was an *opportunity* to negotiate.

Although the California court upheld the limitation of liability, it did so with four important caveats.

- The client was a major residential developer. The court assumed it was a sophisticated client capable of negotiating commercial agreements. Consumer transactions may be subject to stricter scrutiny;<sup>3</sup>
- The suit did not involve personal injuries. The damages were “only money.” An attempt to limit liability for non-economic injuries may also be subject to stricter scrutiny;<sup>4</sup>
- The limitation amount was reasonable. The engineer used the common “\$50,000 or the amount of the fee, whichever is greater” formula. If the limitation amount had been extremely low, it might have been unenforceable; and
- The court found there was an actual opportunity for negotiation. If the designer had strong bargaining power and refused to negotiate, then the clause might not have been enforceable.

Despite these caveats, limitation of liability clauses have significant practical utility.

---

<sup>1</sup> *City of Dillingham v. CH2M Hill Northwest, Inc.* (1994) 873 P.2d 1271.

<sup>2</sup> *Markborough v. Superior Court* (1991) 227 Cal.App.3d 705, 277.

<sup>3</sup> For example, in the depublished opinion of *Viner v. Brockaway*, a court held that a limitation of liability was not enforceable against homeowners even though they were represented by counsel. Because it is depublished, *Viner* is not part of California law. But it shows the extent courts will go to protect consumers.

<sup>4</sup> The *Markborough* court closely examined, and distinguished, a California Supreme Court decision, *Tunkl v. Regents of University of California* (1963) 60 Cal.2d 92. *Tunkl* involved an unsuccessful waiver of liability by a University of California hospital. The important and personal nature of the services - emergency medical care - was a factor in determining that the waiver was unenforceable.

---

Almost all commercial projects match the *Markborough* model. Clients, not designers, have the stronger bargaining position. In most commercial projects, the clients are commercially sophisticated and can understand the contracts they sign. Because personal injury actions are generally brought by third-parties, limitation of liability clauses will not ordinarily block these claims. Thus, none of these caveats significantly undermines the utility of limiting liability in commercial projects.

### *Drafting Limitation of Liability Provisions in California*

---

#### **THE ORIGINAL FORMULA**

Limitation of liability clauses in design contracts were first seriously promoted by ASFE<sup>5</sup> in 1970. Attempting to balance protection and enforceability, the proponents settled on a simple formulation:

#### *Example 1.*

The liability of Consultant to Client for work performed under this Agreement shall not exceed \$50,000 or the amount of Consultant's fee, whichever is greater.

#### **PROBLEMS WITH THE ORIGINAL FORMULA**

Although this formulation was, and is, widely used, it has significant weaknesses. The principal criticisms are:

- The liability limit equals or exceeds the deductible under most design professionals' liability policy. On high risk/low profit projects (such as environmental site assessments), lower liability limits may be advisable;
- The clause does not clearly cover all liability, whether arising from negligence, breach of contract or another theory;
- The clause does not explicitly include the consultant's employees and subconsultants. Claimants can "sue around" the limitation clause by directly naming involved employees and subconsultants;
- Third-party claims, such as claims of end users, subsequent purchasers, homeowner associations, contractors and subcontractors, are not limited by the clause;
- The clause does not address attorneys' fees; and
- The clause does not address insurance coverage differences between professional and general liability policies.

These issues led to significant tinkering with the essential formulation. Some of the modifications enhanced protection. But other modifications undermined enforceability by increasing ambiguity, mixing limitation of liability with indemnity and other concepts, or were so extreme they risked invalidity.

The solutions suggested below can be blended and adapted to particular projects. But, unless you have extensive experience with liability limitations, you should not create new variants without assistance of counsel.

---

<sup>5</sup> Formerly the American Society of Foundation Engineers, now ASFE: The Association of Engineering Firms Practicing in the Geosciences. ASFE remains a strong proponent of liability limitation.

---

## THIRD-PARTY CLAIMS

A limitation of liability clause does not bind third-parties because it is an agreement between the client and the design professional, only. Personal injury actions by workers or delay claims by contractors are examples of actions unaffected by liability limitations. Other risk transfer provisions are better tools for allocating these risks.<sup>6</sup>

Combining indemnity provisions with a liability limitation is attractive because it offers the possibility of solving many problems with a single provision. Although appealing, this approach jeopardizes the limitation clause.

Most states have “anti-indemnity” statutes<sup>7</sup> that apply to construction contracts. Although the exact form varies between jurisdictions, each restricts the scope of allowable indemnification. Combining indemnity with a liability limitation invites a court to use the anti-indemnity statute to invalidate all or part of the clause.

There are three approaches to third-party issues that do not rely upon indemnity.

First, the limitation clause can be drafted such that the limitation amount is *measured* by the aggregate liability to the owner, contractor and subcontractors. Under this type of clause, the amount owed to the owner is reduced by any liability the design professional might have to the contractor or subcontractor. In effect, the limitation amount is a “bank account” which can be drawn down by payments to the client or third-parties. When the “bank account” balance is zero, the designer has no further responsibility to the client, although liability to third-parties may still exist. Since the client does not indemnify the designer from potential claims, the “anti-indemnity” statutes are avoided. Where the design professional has been sued by the client and by third-parties, exposure can be substantially lessened.<sup>8</sup>

### *Example 2.*

OWNER and CONSULTANT have discussed the risks and rewards associated with this project, as well as CONSULTANT’S fee for services. OWNER AND CONSULTANT agree to allocate certain of the risks so that, to the fullest extent permitted by law, CONSULTANT’S total aggregate liability to OWNER and all third-parties is limited to \$\_\_\_\_\_ for any and all injuries, damages, claims, losses, expenses, or claim expenses (including attorneys’ fees) arising out of this AGREEMENT from any cause or causes. Such causes include, but are not limited to, CONSULTANT’S negligence, errors, omissions, strict liability, breach of contract, or breach of warranty.<sup>9</sup>

---

<sup>6</sup> For example, design professionals can be protected from worker injury claims if indemnified by the contractor and named as additional insureds under the contractor’s general liability policy. Part of delay claim risk can be avoided if the general conditions contain a broad consequential damages waiver. Limitation of liability is an important element of a complete risk allocation package.

<sup>7</sup> For example, see, Cal. Civ. Code § 2782, *et seq.*; S.D. Codified Laws § 56-3-18; N.J. Stat. §2A:40A-1.

<sup>8</sup> Consider the case where the clause has a limitation amount of \$250,000 and the designer is liable to the client for \$100,000 and to a contractor for \$200,000. The payment of \$200,000 to the contractor reduces the “bank account” balance to \$50,000, leaving only \$50,000 to pay the owner’s claim. This results in a saving of \$50,000 over not having a limitation clause. Note that the timing of payments is critical to the efficacy of this approach.

<sup>9</sup> Reprinted with permission of ASFE from *Limitation of Liability, A Handbook for Consulting Engineers, Environmental Consultants, Architects, Landscape Architects, and Other Design and Technical Consultants*. Copyright ASFE, 1992.

---

Second, the client can be contractually required to insert a limitation clause favoring the designer in contracts executed by contractor, subcontractors and suppliers. If the client fails to require compliance, the design professional can sue the client for amounts paid to contractors and subcontractors in excess of the limitation amount. This achieves some of the goals of indemnification, albeit without a defense obligation, but does not violate the letter of anti-indemnity statutes.<sup>10</sup>

**Example 3.**

OWNER and CONSULTANT have discussed the risks and rewards associated with this project, as well as CONSULTANT'S fee for services. OWNER and CONSULTANT agree to allocate certain of the risks so that, to the fullest extent permitted by law, CONSULTANT'S total aggregate liability to OWNER and all contractors and subcontractors is limited to \$ \_\_\_\_\_ for any and all injuries, damages, claims, losses, expenses or claim expenses (including attorneys' fees) arising out of this AGREEMENT from any cause or causes. Such causes include, but are not limited to, CONSULTANT'S negligence, errors, omissions, strict liability, breach of contract, or breach of warranty. OWNER further agrees to notify all contractors and sub-contractors of this limitation of CONSULTANT'S liability to them and require them to abide by this limitation of damages suffered by any contractor or subcontractor arising from CONSULTANT'S actions or inactions. Neither the contractor nor any subcontractor assumes any liability for damages to others which may arise on account of CONSULTANT'S actions or inactions.<sup>11</sup>

Third, the general conditions of the owner-contractor agreement can include a limitation of liability clause favoring the design professional. This may cause practical problems since a cautious general contractor may object and since the client may not be able to perceive any advantage to incorporating this requirement, especially if the contractor indicates that the clause will increase the cost of the bid. The inclusion of the clause, without the express agreement of the client, can thus result in a conflict of interest between the engineer and the client.

**SUB-CONSULTANTS AND EMPLOYEES**

In many states a professional is *personally* liable for damages caused by negligent performance of services and can be sued along with his or her firm. Since the firm and the design professional are covered by the same insurance policy, plaintiffs generally have little reason to sue the design professional personally – except where there is a limitation of liability clause. If the clause only benefits the firm, the plaintiff may be able to avoid the clause by suing the design professional directly. Similarly, a plaintiff may be able to avoid a clause by suing the sub-consultant that allegedly erred. To avoid this outcome, the limitation of liability clause should specifically benefit employees and sub-consultants. This can be done in the body of the clause or in a definition, such as the following:

**Example 4.**

As used in this paragraph, "Consultant" includes Consultant, Consultant's sub-consultants, and their respective partners, officers, directors, shareholders and employees.

---

<sup>10</sup> In *Chevron U.S.A., Inc. v. Bragg Crane & Rigging Co.* (1986) 180 Cal.App.3d 639-48, the court upheld an agreement to obtain additional insured coverage although an agreement to indemnify against the same liability would have violated California's anti-indemnity statute.

<sup>11</sup> Reprinted with permission of ASFE from *Limitation of Liability, A Handbook for Consulting Engineers, Environmental Consultants, Architects, Landscape Architects, and Other Design and Technical Consultants*. Copyright ASFE, 1992.

---

## MASTER CONSULTING AGREEMENTS

Master consulting agreements streamline contract negotiation for multiple assignments and enhance long-term relationships. A master agreement contains the general terms and conditions. Individual task orders contain the work scope and price applicable to a project. Limitation of liability clauses can be effectively embedded in master consulting agreements if the following issues are addressed.

First, is the limitation amount measured on a task-by-task basis, a project basis, or on the value of all services charged under the master contract? Unless this issue is addressed, a court could well “stack” the limitation ceilings of each task order and inflate the liability cap. If the limitation amount is calculated as the greater of a definite sum or the amount of the fee, stacking of many small contracts may result in a very high limitation ceiling as compared to the fee charged.

Second, it may not be clear that the limitation is incorporated into each task order. In some instances, clients will agree to the terms of a master consulting agreement and then confirm individual tasks verbally. It is better practice to create a task order form that will be used with the master agreement and then insist that it be used. The task order form should explicitly confirm the limitation or confirm that all terms, conditions and limitations of the master agreement are not modified by the task order.

Third, some clients confirm task orders with their own “purchase order” forms which contain language superseding any conflicting terms and conditions. Although they have agreed to a limitation in the master agreement, the confirmation may destroy the negotiated liability limitation.<sup>12</sup> If the purchase order form is only a confirmation of scope and price, then a sample form could be attached to the master agreement and language inserted into the master agreement limiting the applicability of the purchase order terms.

The resolution of these problems will vary depending upon your and your client’s needs.

## SCOPE OF RISK

The limitation of liability clause must be carefully drafted to cover the types of risks that could be encountered and the legal theories the claimant could assert. Otherwise, a court may determine that the clause, although valid, does not apply to all, or part of, the action.

In *W. William Graham, Inc. v. City of Cave City*,<sup>13</sup> an engineering firm contracted to prepare plans for a wastewater treatment plant within 135 days. The firm knew that failure to timely complete the plans would reduce the city’s entitlement to public funds. The city sued the engineering firm to recover \$338,935 in lost public funds because the plans were completed late.

The contract between the city and the engineer contained the following limitation of liability clause:

The OWNER agrees to limit the ENGINEER’S liability to the OWNER and to all Construction Contractors and Subcontractors on the Project, due to the ENGINEER’S professional negligent acts, errors or omissions, such that the total aggregate liability of the ENGINEER to those named shall not exceed \$50,000 or the ENGINEER’S total fee for services rendered on this project, whichever is greater.<sup>14</sup>

---

<sup>12</sup> Some firms insert language in the master agreement stating that the master agreement terms supersede any purchase order terms. A reviewing court will not likely enforce these terms as it cannot determine whether the inconsistent purchase order terms are intended to supersede the “don’t supersede” provision.

<sup>13</sup> 289 Ark. 105, 709 S.W.2d 94 (1986).

<sup>14</sup> 709 S.W.2d at 95.

---

The court in *Cave City* noted that “...if [a contract] clause limits liability, it is the duty of this Court to give effect to such clause.”<sup>15</sup> However, the court found that this limitation of liability clause did not apply to *Cave City’s breach of contract* claim. This scope problem can be avoided by explicitly limiting the design professional’s liability for breach of contract, and other causes of action, as well as professional negligence.

**Example 5.**

The liability of Designer, and of Designer’s employees and subconsultants, to Client shall not exceed an aggregate limit of \$50,000 or the amount of the fee, whichever is greater *regardless of the legal theory under which such liability is imposed.*

**ATTORNEYS’ FEE  
CLAUSES**

Professional service agreements should not routinely include attorneys’ fees clauses.<sup>16</sup> But many contracts do contain such clauses, yet do not explicitly indicate whether attorneys’ fees are included in, or are in addition to, damages subject to the limitation amount. This invites challenging the clause.

Consider the following scenario. If the designer commits an error causing \$250,000 in damage, but has a \$50,000 limitation of liability provision, it might offer to pay the limitation amount. But the client will not settle for this amount, because if it sues it will recover at least \$50,000 plus its attorneys’ fees. And if it convinces the court that the limitation does not apply, then it will recover the full \$250,000 and its attorneys’ fees. Since it can never recover less than the offer, the client should reject it and sue.

The incentive to challenge the clause can be avoided by including attorneys’ fees within the damages limit.

**Example 6.**

The liability of Consultant, and of Consultant’s employees and sub-consultants, to Client, *including attorneys’ fees awarded under this Agreement*, shall not exceed an aggregate limit of \$50,000 or the amount of the fee, whichever is greater regardless of the legal theory under which such liability is imposed.

An alternative approach ties recovery of attorneys’ fees to the validity of the limitation clause. By redefining “prevailing party” in the attorneys’ fees clause, the engineer is granted its attorneys’ fees if the clause is upheld. Thus the challenging client may prevail in the lawsuit, but if the limitation is upheld, the client, and not the consultant, pays the attorneys’ fees.

**Example 7.**

In any action to enforce or interpret the terms of this Agreement, the prevailing party shall be awarded, in addition to any other remedy or compensation, its attorneys’ fees and costs, including fees of expert witnesses. *In any action against Consultant (including any cross-action, cross-complaint or third-party complaint), Consultant shall be deemed the prevailing party unless Client receives a judgment exceeding the limitation amount stated in paragraph \_\_\_\_\_.*

---

<sup>15</sup> *id.*

<sup>16</sup> As a general rule, attorneys’ fees clauses favor the party most likely to institute suit. Designers are the party least likely to initiate litigation.

---

**CONSEQUENTIAL DAMAGES**

Consequential<sup>17</sup> damages are a major component of many malpractice claims. Since a broad liability limitation may be difficult to negotiate and enforce, you can sometimes accomplish similar goals by negotiating a simple waiver of consequential damages.

*Example 8.*

In no event shall Engineer or its subconsultants of any tier be liable in contract, tort, strict liability, warranty or otherwise, for any special, incidental or consequential damages, such as, but not limited to, delay, disruption, loss of product, loss of anticipated profits or revenue, loss of use of the equipment or system, non-operation or increased expense of operation of other equipment or systems, cost of capital, or cost of purchase or replacement equipment systems or power.

**ENVIRONMENTAL RISKS**

A client may not be willing to accept a blanket liability limitation, but may be willing to limit the liability associated with a particular risk. Environmental risks are good candidates for this approach. Clients should recognize that the consultant should not be liable for remediating existing contamination – the contamination is, and should remain, the responsibility of the owner/generator.

*Example 9.*

Consultant's liability to Client, including attorneys' fees awarded pursuant to this Agreement, for claims, damages, or losses arising out of the treatment, transport, storage, discharge, dispersal, or release of hazardous materials, shall be limited to \$50,000 or the amount of the fee, whichever is greater and regardless of the legal theory under which liability is imposed.

**MULTI-JURISDICTIONAL CLAUSES**

Many consulting firms practice in a variety of jurisdictions. Although most jurisdictions permit limitation of liability, some do not. To avoid invalidation of an entire agreement or an entire limitation of liability clause, a savings clause, such as "To the fullest extent permitted by law," should be used where multi-jurisdictional use is anticipated. Better yet, review the limitation of liability clause with a good construction lawyer in the jurisdiction where you will use the clause.

---

### *Managing Limitation of Liability Clauses*

---

A well-drafted clause can be destroyed by sloppy contract administration. This section discusses several post-contracting problems that can undermine the liability provision.

**MULTI-PHASE PROJECTS**

Phased, multi-year projects present a substantial risk of inconsistent agreements. Some clients may agree to execute the design professional's standard agreement for preliminary or consulting work, but then require their own forms for later phases, which may extinguish the liability limitation. And even if the parties continue to use design professional's form, inconsistencies may occur. The limitation provision's terms or amount may have changed over the years. In such cases, can the client choose among between them? Can the client "stack" the clauses? If there is an ambiguity, the court will generally favor the most unlimited interpretation. Where attached "general conditions" are used, they are sometimes not attached or included with agreements or authorizations for later phases. The client may successfully argue that omitting the general conditions removed the limitation clause.

---

<sup>17</sup> Examples of consequential damages include lost profits, increased costs and similar economic losses.

---

Multi-phase projects can also lead to “gaps” in limitation. For instance, the parties may enter into a written agreement for the first phase but proceed in later phases under verbal authorization. Even if the final phase is covered by a written agreement, the ambiguity surrounding the intervening phase or phases will seriously undermine the liability limitation.

Before initiating a new phase of work, the design professional should review prior agreements to assure consistency, absence of gaps, and proper integration of the limitation provisions.

## **OUT OF SCOPE WORK**

As a project draws to a close, the design professional may determine that he or she has incurred significant fees and costs providing work that exceeded basic services. Often, a substantial amount of this work has not been authorized in writing, although it was clearly necessary. If the design professional cannot negotiate an adjustment under the contract, he or she must attempt to recover for this out-of-scope work on a non-contractual basis. But if the recovery is not based on the written agreement, then the limitation clause contained in the agreement may not apply.

This is particularly true if the limitation of liability clause applies to liability arising under “this Agreement.” Drafting the clause on a “project” basis reduces this risk. However, if the definition of the project is subject to change, then the better practice is to assure that extra work is authorized under the changes clause of the contract prior to the work being performed. Not only does this preserve the limitation clause, it increases the prospect of being paid for the out-of-scope work.

## **ASSIGNED CONTRACTS**

Many developers require design professionals to assign their agreement to lenders or successor entities. In a pure assignment, the assignee receives the benefits of the contract, but none of the obligations. Thus, the assignee may be able to sue the design professional without the burden of the limitation of liability clause.

There are two solutions to this problem. First, the agreement between owner and design professional should have a non-assignment clause. This forces the client to seek the design professional’s approval, which may be conditioned upon extending the liability limitation to the assignee. Second, when an assignment is requested, the design professional can modify the assignment form to require that all, or some, of the client’s obligations be transferred by assignment. Besides preserving the limitation of liability clause, the redrafting of the assignment agreement can also clarify the assignee’s responsibility to continue, or bring current, all payment due the design professional.

### *Example 10.*

In consideration of Consultant’s consent to Client’s assignment to Bank of the Agreement of \_\_\_\_\_, 2001, Client and Bank agree that they are bound by the terms, conditions and limitations of that Agreement as if Bank had executed the Agreement as “Client.” Client and Bank also agree that the limitation of liability contained in paragraph \_\_ of the Agreement is the aggregate limit of Engineer’s liability to Client and Bank. If Engineer is liable to both Client and Bank, Consultant shall not have any duty to allocate payment between them.

## *Conclusion*

---

Limitation of liability clauses can be effective tools to redress the economic imbalances present in modern construction projects. To achieve this end, the clauses must be carefully and clearly drafted. Further, the design professional’s contracting and management practices must be sensitive to the limitation clause. Careless practices may undermine the clause and waste the effort incurred in negotiating the limitation clause.

*Bibliography*

---

*Limitation of Liability, A Handbook for Consulting Engineers, Environmental Consultants, Architects, Landscape Architects, and Other Design and Technical Consultants.* ASFE, 1992.

*Limitation of Liability in Design Professional Contracts,* EJCDC No. 1910-9E (1988 Edition).

*Guide Sheet for Including Limitation of Liability in the Standard Form of Agreement Between Owner and Engineer for Professional Services,* EJCDC No. 1910-9-F (1988 Edition).

*Standard Form of Agreement Between Owner and Engineer for Professional Services,* EJCDC No. 1910-1, Ex. H (1992 Edition).

*Standard Form of Agreement Between Owner and Geotechnical Engineer for Professional Services,* EJCDC No. 1910-27-A (1989 Edition).

*Guide for Amendments to AIA Documents B141,* AIA Document B511 (1996).

*Standard Terms and Conditions for Hazardous Waste Contracts,* Hazardous Waste Action Coalition (1986).

*The Contract Guide,* DPIC Companies (1993).