

Limitation of Liability for the Design Professional: Case in Point

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As more and more issues of liability for the design professional surface, design firms are being forced to take a more defensive approach and become more conscious of the potential risks in their products and services. Increasingly, architects and engineers are looking for ways to reduce their professional design liability, and are negotiating more favorable contractual limitations with the project owner. One such method of negotiation is to include a limitation of liability clause in the design professional's contract. The objective of the limitation of liability clause is to establish the boundaries of liability between the design professional and the owner. The limitation provision also serves to limit the financial exposure of the architect or engineer as a result of their professional negligence, breach of contract, breach of warranty, negligent misrepresentation, and/or causing consequential damages. The limitation of liability clause does not extricate the design professional from liability to the owner; instead, it is a means of clearly defining and allocating the potential risks between the contractual parties by establishing a predetermined recoverable sum.

Courts are generally not in favor of limiting a professional's liability to their client, particularly for their own negligence, no matter how reasonable the limitation provision may be. Nonetheless, courts have been more willing to uphold the limitation provision if it allocates a reasonable and fair distribution of the potential risks to the contractual parties, and the contractual parties mutually agree to the way in which those risks are allocated.

As evident by the rulings of several courts that have either upheld or rejected limitation of liability clauses, the design professional may have more success at contractually limiting its liability to the owner if:

I. Ample opportunity has been given to each party, having reasonably equal bargaining power, to negotiate the limitation of liability clause.

Case in Point: A California appellate court upheld the trial court's decision in the case of an engineering firm that designed a manmade lake with a liner that failed after five years. While the contractual provision limited the engineer's liability to \$50,000 or the fee, which totaled \$67,640, the cost for repairs was reported to be \$5 million. The trial court ruled in favor of the engineer. The client appealed the trial court's decision stating that the limitation provision is valid if the client is made aware of the provision, the specific limitation is negotiated, and it is expressly agreed to by the contractual parties. The appellate court's ruling, which also favored the engineer, was based upon the engineer submitting a letter of transmittal specifically regarding the limitation of liability to the client. The court felt the transmittal letter provided reasonable opportunity for the client to accept, reject, or modify the provisions in the contractual agreement.

It is important to note that since limitation of liability clauses must be negotiated in order to be enforceable, it may be worthwhile for the design professional to retain copies of drafts of the agreements and letters of correspondence pertaining to any contractual negotiations with the project owner.

II. The limitation of liability clause includes a reasonable cap on the financial liability of the design professional. The financial cap should be mutually agreed upon by the contractual parties.

Case in Point: An Oregon State Supreme Court ruled that the limitation fee in a home inspection contract between an engineering firm and the owner was not reasonably apportioned to the damages sustained as a result of the engineer's negligence. Furthermore, the engineering firm did not clearly express the intent to limit the firm's liability for its negligent acts. The limitation of liability provision limited the financial exposure of the engineering firm to the inspection fee of \$200. However, after purchasing the home, the owner's repair costs amounted to \$340,000 as a result of the engineer's failure to detect the problems. The limitation fee does not provide incentive for the engineer to perform with due care. The higher court commented that the unknowing consumer should not shoulder the consequences of the negligent behavior of a licensed professional.

While many design firms establish preset limits, such as \$50,000 or the contractual fee, whichever is higher, the provision should also make it clear that higher limits can be provided (typically for a higher fee), and the opportunity to discuss the higher limits is available. Another method is to leave the limitation fee blank, and make the client aware of the need to negotiate a limit via a transmittal letter that accompanies or is affixed to the contract. Some firms fill in the blank by hand and have both parties initial. The design professional should be persistent in settling the limitation fee before the contract is fully executed.

III. The limitation of liability clause is unambiguous and clearly states the intent of the contractual parties to limit the design professional's liability. The provision should be set apart from the remaining text on the page, preferably with a boldface heading or type, to make the client aware of its presence in the design professional's contract.

Case in Point: Prior to signing the design professional's agreement, the client and the design professional should discuss their mutual risks arising from the project, and the manner in which these financial risks will be allocated. As in the case involving the engineer and the homeowner in Oregon, the court cited that the wording of the limitation of liability clause was ambiguous and did not clearly express the intent to limit the firm's liability for negligence. The clause simply stated that the liability of the engineering firm and the liability of its employees are limited to the contract sum. In addition, the clause did not specify from whom the engineer is seeking to limit its liability, nor did it fully specify the claims or liabilities to which the limitation applied (i.e. "...for any and all claims, losses, expenses, injuries, or damages arising out of or related to this project or the agreement by reason or any act or omission, including breach of contract..."). And finally, the limitation of liability clause did not limit recovery for consequential or special damages such as loss of use, lost profits, and costs of replacement caused by the design professional's negligence.

IV. There is no public policy in existence that could prohibit the enforcement of the limitation of liability provision.

Case in Point: A U.S. District Court in Pennsylvania denied the limitation of liability clause in a contract between an architectural firm and a developer stating that the clause violated Pennsylvania's anti-indemnity statute and was therefore unenforceable. The case involved a feasibility study performed by an architectural firm on a parcel of land being considered for purchase by a developer. The developer purchased the parcel, but later discovered that the property was subject to certain height restrictions; therefore, construction was not feasible on the property. The limitation of liability was established at \$50,000 or the firm's fee, whichever was greater. The district court ruled in favor of the developer as a result of the statute. An appellate court, however, overturned the decision of the lower court stating that the indemnification clause was not the same as the limitation of liability clause. The limitation of liability clause attempts to negotiate the allocation of risks, whereas the indemnification clause attempts to remove all risk. The architect was liable for the \$50,000, which was substantially greater than its fee.

In another matter of dispute between an Alaskan Municipal Corporation and an engineering firm, the limitation of liability clause was not upheld by an Alaskan Superior Court because the limitation provision was against public policy. The issue presented was whether the broad interpretation of the state's statute regarding the indemnification clause, which is known to be unenforceable due to public policy, also applied to the limitation of liability clause, which was arguably implied. In this case, the State of Alaska's legislative history guided the court's ruling.

It is important to keep in mind that the validity of the provisions in the design professional's agreement is subject to court opinions. In many states, the limitation provision has not yet been decided. There is no guarantee that the most carefully worded clause will be upheld under close scrutiny by the courts if a dispute arises.

It should also be noted that the limitation of liability clause does not lessen the liability of the design professional to third parties, such as injured workers, who are not a party to the design professional's agreement.

While this article attempts to provide the design professional with risk management tips, it should not be construed as legal advice. It is strongly recommended that before developing a limitation of liability clause, the design professional seek legal guidance with respect to the appropriate wording and the manner in which the provision is presented to the client.

Case-Proven Successful Tips for Contractually Limiting Liability:

1. Ample opportunity is given for each party, having reasonably equal bargaining power, to negotiate the limitation of liability clause.
2. The limitation of liability clause includes a reasonable cap on the financial liability of the design professional. The financial cap should be mutually agreed to by the contractual parties.
3. The limitation of liability clause is unambiguous and clearly states the intent of the contractual parties to limit

the design professional's liability. The provision should be set apart from the remaining text on the page, preferably with a boldface heading, to make the client aware of its presence.

4. There is no public policy in existence that could prohibit the enforcement of the limitation of liability provision.