Limitation of Liability in a Professional Services Contract

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In addition to a well-structured professional liability insurance program, negotiating a limitation of liability ("LOL") clause is another vital way of managing risk on a given project and is a ‘must have’ in any professional contract.

This important risk management tool establishes the maximum liability an architect, engineer, surveyor, or contractor will face if the client makes a claim. Negotiating an LOL clause protects professional firms from unlimited liability and mitigates large legal exposures that can put your firm’s financial health at risk.

Here are some key things you need to know about using a limitation of liability clause and determining the appropriate level of liability.

Be Clear:
Be sure the LOL clause is clearly worded and specific. It should state the amount to which liability is limited, and that all claims, losses, costs, expenses, or damages of any kind are included in the LOL to the full extent permitted by law.

Determine the appropriate limit:
The amount of the limitation of liability must be meaningful, and must take into account the potential damages that could arise from the project. That said, any limitation is better than none. A low LOL encourages dialogue even if it is ultimately unenforceable. A higher limit is better than none at all, since, as a standard practice, you don’t want to leave the liability unlimited.

In some cases, courts have found that limits that are unreasonably low may not be enforced, resulting in defendants having to pay more than the limit stated in the contract. The dollar amount of a Limitation of Liability is a key factor because courts in many jurisdictions have found that an LOL clause will not be enforced if the limit is too low or otherwise doesn’t bear a reasonable relationship to the amount at stake in the event of a dispute resulting from the contract.

Three common ways to determine the appropriate liability limit are:
1. Limiting liability to the amount of the firm’s professional fees for the project,
2. Selecting a round number like $50,000 or $100,000 that is appropriate to the size of the project, or
3. Limiting liability to the amount of the firm’s per claim limit on their professional liability policy. Be sure to specify that it is the amount “available at the time of settlement or judgment,” as this accounts for any prior claims that have eroded the policy. This reduces the possibility the design professional will have to make up the difference if there has been a prior claim that reduced the original policy limit.

If the design professional’s fee is small, another approach is to use a hybrid of the first two amounts by specifying that the limit is the greater of the fee or $100,000, for example. When in doubt, seek legal counsel to determine the appropriate limit.
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LOL Clauses are not enforceable against everyone and in all states

- LOL clauses apply only to the party who agreed to the limitation. They do not apply to claims by other third parties.

- Maintain a paper trail of your discussions with your client regarding the limitation of liability. You may be called upon to show that the provision was negotiated fairly and without undue pressure on the party agreeing to the limitation.

- While a useful risk management tool, not all state courts enforce limitation of liability provisions. Hiscox provides policyholders with a no-cost consultation from an attorney to assist in determining an appropriate limit of liability and its applicability in your state.

Limitation of Liability clause example:
The Owner agrees, to the fullest extent permitted by law, to limit the liability of [firm name] to the Owner for any and all claims, losses, costs, expenses, or damages of any nature whatsoever, including attorney and expert-witness fees and costs, from any cause or causes, so that the total aggregate liability of the [professional] to the Owner shall not exceed [negotiated dollar amount]. It is intended that this limitation apply to any and all liability or causes of action however alleged or arising, unless otherwise specifically prohibited by law.

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