Talk to Me About A&E: Limits of Liability

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COLLEN PALMER: It's going to provide you with a very valuable potential protection in the event of a claim, so we always, always try to get this into a contract.

SPEAKER 1: Welcome to Talk to Me About A&E, a podcast series focused on risk management for architects and engineers. Host Dan Buelow, managing director of Willis A&E will engage experts across the A&E spectrum on topics ranging from contract details to the broadest trends impacting design professionals in North America.

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DAN BUELOW: Hello and welcome to Talk to Me About A&E. I'm Dan Buelow, managing director of Willis A&E, a special division of WTW that is exclusively dedicated to providing insurance and risk management solutions to architects and engineers. Our topic today is on limitation of liability. Also commonly referred to as LOL, a very important provision that every design firm should strive to get in their contracts with their clients.
In a recent podcast, we talked to Sue Yoakum from Yoakum Law about managing design contingencies. And like negotiating contingencies, establishing a limitation of liability in your agreements makes good business sense, is an appeal to fairness, as well as an important step in establishing and managing client expectations.

While we know some clients and attorneys will push back on having an LOL clause in a professional services agreement, we also know that some of our design professional clients do a better job than others in discussing this important clause with their prospective clients and have in fact had excellent success in getting an LOL provision in their agreements. Those firms that do succeed in limiting their liability in their contracts can benefit greatly.
To help me break down the features and benefits of LOL and what a design firm should consider when negotiating this clause with their prospective clients, I've brought back a very special guest Colleen Palmer. Hello, Colleen.

COLLEEN PALMER: Hi, Dan. How are you?

DAN BUELOW: I'm doing well. It's great to have you back.

COLLEEN PALMER: Thank you. It's great to be here. Thank you for inviting me.

DAN BUELOW: Absolutely. So Colleen was a guest of mine for a podcast we did on negotiating the dreaded indemnity clause in design professional agreements. So if you haven't listened to that podcast, be sure to do that. And Colleen has also been a frequent guest of ours over the years on Willis A&E monthly webinars so it's great to have Colleen back.

Let me tell you a little bit about Colleen. Colleen joined Beazley in December of '07, back a while ago, as an A&E risk manager and is based in their New York office. And before joining Beazley, Colleen was a practicing attorney in Boston where she focused on assisting architects and engineers.

Colleen specializes in providing risk management services to design professionals on a nationwide basis, including conducting risk management seminars and advising on contractual issues. Colleen earned her Bachelor of Science degrees in biology from Cornell University and a Juris Doctor cum laude from the University of Miami School of Law.

And Beazley DP is a long Willis A&E carrier partner of ours and one of the premier tier 1 professional liability insurance carriers insuring design professionals today. So we are lucky to have Colleen with us to help us talk about LOL. So Colleen, a good place to start is what is LOL?

COLLEEN PALMER: Sure. So limitation of liability is a contractual provision that will be negotiated by the design professional and its client. It'll be a provision that's in that design services agreement. And essentially it does exactly what the title says, it limits the design professional's liability. And it is important to have it drafted properly and to have the client understand what it is and what it isn't.

And as you alluded to, it can be difficult to negotiate with the client because, of course, they don't want to limit your liability. They want to be able to come after the design professional or any other party for any kind of damage that they may incur, but it is a valuable provision to have in a contract.

DAN BUELOW: And it really is important to note that if you don't have a limitation liability, you will be assuming essentially unlimited liability. So as a design professional it's something that you really want to be thinking about. And I believe that this is really an appeal to fairness, isn't it? It's an attempt to allocate risk to some reasonable proportion to the profits and other benefits derived by each party.

The design professionals more often than not making a relatively small percentage of the overall profit on any given project in comparison to the contractor and certainly to the owner who will end up with an asset and potential profit and returns for many years. So again, what's fair? It's an important discussion to have. Again, Colleen you mentioned the contract. Talk to us about the contract formation process specific to the limitation liability clause, and what should a design firm consider, and should these clauses be narrowly drafted or broadly drafted?

COLLEEN PALMER: Yeah, those are all good questions. And as you're talking about the provision, I'm shaking my head, yes. This is a podcast so people can't see me, but yes, I totally agree with all of the things that you just said. Great points all.

The provision itself should be broadly worded as opposed to narrowly worded. So you may remember when we had our discussion about indemnity, an indemnity obligation that a design professional will assume towards its client. We talked about the fact that those types of provisions should be narrowly drafted. You want to have as limited indemnity obligation as will be covered by your professional liability insurance, and the magic words to the extent caused by your negligence.

So with that example of something that should be narrowly drafted, limitation of liability is really the opposite of that. And we want it to be very broad because it's a provision that's going to limit your liability to your client for all damages, for any kind of cause of action that may arise out of your services or the project. So that being said, would you like me to talk about our recommended limitation of liability language and break it down a little bit?

DAN BUELOW: Sure.

COLLEEN PALMER: OK.

DAN BUELOW: That'd be great.

COLLEEN PALMER: So again, with the mindset that we want this to be broadly worded in the design professional's favor, let's talk a little bit-- it's four lines so we'll read it through, and we'll break it down as we go through it.

DAN BUELOW: So this is a suggested clause that you would ask, to consider anyhow, in drafting in a design professional's contract?

COLLEEN PALMER: That's exactly right. And I will say that with all contracts that I review for Beazley policyholders from a risk management and professional liability perspective, we always recommend trying to get this language in the contract. Again, at the end of the day, it's a matter of negotiation. It's not considered a deal breaker from a professional liability perspective, but certainly, from a business standpoint and from a risk management standpoint, it's going to provide you with a very valuable potential protection in the event of a claim, so we always, always try to get this into a contract.

DAN BUELOW: That's a good point. I refer to those as your deal makers, if you will. It's like a mediation clause. It may not be a breaker, but boy, we really would like to have a mediation clause in your agreement. Well, that's another topic, but again, the deal breaker versus the maker I think is the point you were making there.

COLLEEN PALMER: Yeah, you could have me back, and we'll talk about mediation on another one. So for LOL, here's what we generally recommend. And again, there's lots of ways to draft these types of provisions, but you want to keep in mind again, you want it to be broad, you want it to be encompassing all of the damages, all of the claims that could be brought against the professionals.

So here's the language and how we break it down. To the fullest extent permitted by law, the total liability in the aggregate-- so we're talking all liability, the complete liability-- of the professional and the professional's officers, directors, employees, agents, and consultants. So again, we want to have this broad definition of who is falling under the umbrella of the LOL protection.

The liability to client and anyone claiming by, through or under client for any and all injuries, claims, losses, expenses, or damages whatsoever arising out of or in any way related to professional services, the project, or this agreement-- so again, we're really being expansive here.

We're talking about all injuries, all claims, arising out of this project or the services from any cause or causes whatsoever including but not limited to negligence, strict liability, breach of contract, breach of warranty. Here we go again, nice and broad, any kind of cause of action that can be brought against the professional. And then here's our money language, shall not exceed the total compensation received by professional under this agreement or the total amount of X, whichever is greater.

And this last part is something that is really the $50 million question, no pun intended, about well, what should we limit our liability, to what number should we plug in there? And it's not an easy answer. I'm going to give the lawyerly answer of it depends, and it is ultimately a matter of negotiation.

But this standard recommended language that we have, you'll note that I said, the liability will not exceed the total compensation received, and we expressly include the word received because in the event a claim is made, if you haven't been paid all of your fees, then arguably your limitation of liability would be more favorable by having that word received in there, or some amount certain that the parties negotiate. So that's our standard language, that's the provision that we generally recommend.

DAN BUELOW: Great example of the wording so that's very helpful. And then you get into that dollar amount, as you say, and I think that is an important thing to talk about here. We have some clients that have been very good at having a dollar amount that is a multiple of their fees. And one question I would have is, could it be too low of an amount?

Could it be egregiously low that somebody throws this out? Have you ever seen that? I think that's one thing I would ask you at this point is understanding that where this is enforceable? I mean states will vary. And then how it's worded. So I will say right upfront something that as a broker we always will say, check with an attorney. Get legal advice for the state that you're working in so you understand the nuances of that law and have this worded and properly drafted because these could be required to be in a certain font or size or specifically isolated or negotiated separately, right?

COLLEEN PALMER: That's exactly right. And Florida is a state that immediately jumps to my mind where Florida has a particular statute that does have very specific requirements as to the font, having your typeface be in bold lettering, a certain size and that sort of thing. So you absolutely do want to check with local counsel and the law governing the agreement because pretty much all states do enforce what they deem a properly worded limitation of liability.

But you want to make sure that you're not running afoul of what that state generally will enforce. Cases in various states have found that certain wording is enforceable or is not enforceable, so definitely very important to check with counsel. As far as the dollar amount, courts have generally found that you do have to have some, and here's an expression, some skin in the game.

They're not going to just let you say, we have no liability on this project. They don't want it to be an exculpatory clause where you just say, oh, we're not liable for anything we've done. Courts do want you to stand behind your work and have some, like I said, skin in the game.

I like the multiple of the fee. I think that's definitely one way to go. Sometimes the number or the liability amount will be tied to insurance. That's not my favored way to draft the limitation of liability. Certainly if there's any tie to the insurance, you want it to be tied to the available proceeds of insurance at the time of resolution of the claim because professional liability insurance is a depleting limits policy. So if the policy is not at its full limits, you don't want your limitation liability to be more than what is available to you.

DAN BUELOW: Great point. So we want this clause. We want it properly worded. We want the clause in the case that you gave as an example, our advice would be to have a heading on that. It's clearly defined. It's a specific and separate clause so it's been negotiated. It's not buried anywhere in that agreement. I think it's an important point on that. And then where you're also going with this is, you're thinking about, well, what do I limit the liability again? It's an appeal of fairness.

So if I'm a surveyor or an engineer or an architect for that matter, and I'm going to make $300,000 for doing whatever scope I agreed to on a project that is $50, $100 plus million project, is it fair to have my entire business hanging over based on that fee? Again, what is a fair proportionate amount of risk versus reward, I think is that conversation.

And to your point too is that well, what if I have a couple of million dollars or so of insurance limits there, do I want that fully exposed? And ideally, not on these smaller projects. But I think that if you are getting pushback, and if you can't get that fee amount in there or a multiple of that fee, you do want to have a fallback of your insurance limits. Better than nothing, right?

COLLEEN PALMER: Correct.

DAN BUELOW: And I think that's something into your point, if you do that, you need to put in that word, available proceeds at the time of settlement to your point that those limits could be eroded. So if you say to my limits, and you have $2 million limits, but you only have $1 million available, you could be holding the proverbial bag on that, and I think that that's a good pushback.

And I also I think it's a good to talk about some of the negotiation here because I hear this from some of our other clients is that their clients or their owners or often their attorneys will be saying, no, we want to strike this. Get it out entirely. And I think that it might be a good idea to have a conversation then about, well, what's the problem? What's the issue here? Let's talk about the insurance requirements. You're asking us to have, in this scenario, $2 million of insurance or whatever that is.

A professional liability insurance will limit it to that $2 million. And if they keep pushing back, well, do you want more insurance limit? I mean, this is one option to consider is that you may be better off going and getting additional limit, maybe a specific job access, and you can often not more than double what that is.

But if it makes sense in that particular scenario to say, well, maybe we'll get $1 million of additional limit because will that make you happy? Will that satisfy you? And then we're going to want a limitation liability. Oh, by the way, for that $1 million I would argue that the owner should pay for that additional coverage because it would be dedicated for their project. But I think that's a good conversation to have and not just walk away when they reject it out of hand, right?

COLLEEN PALMER: For sure. Absolutely. One other point that we're kind of hinting around here that I think is worthwhile to mention is that you can learn so much about your client during the contract negotiation phase. And if your client is showing their cards where they want you to take on significant liability which is exponentially more than what your fee is for a project, where they just outright reject any kind of attempt to limit your liability, or they want a heightened standard of care, or they want an overly broad indemnity.

This is the time where design professionals can really hone in on what the client's expectations are for them and their performance and the project, and to the extent that they're seeing these client expectations are unrealistic and unreasonable, it's an opportunity for the design professional to provide some education to the client.

Maybe a client doesn't know what professional liability insurance covers, and that it is a depleting limits policy, which is a unique type of policy as compared to other available coverages. And depending on how the negotiations go, maybe at the end of the day, this is a project that the design professional doesn't want to take.

But I think that we don't want to gloss over how much a professional can learn about its client as they're negotiating a contract, which is really the project is never going to get any better. This is the honeymoon phase. Nothing bad has happened yet. So if it's bad at this point, you have to keep in your mind, OK, what's going to happen when there is an issue on the project? So I just want to make that point here as we're talking about this.

DAN BUELOW: It's a great point. And I've always said that if your prospective client is an unreasonable, unpleasant, individual to deal with this stage of your relationship, as you say the honeymoon stage, how reasonable or pleasant are they going to be when things get a little difficult?

And back to this point too is that your contract is by far the very best opportunity vehicle to establish and then manage those expectations. So that's an excellent point. And also just as we are talking about the contingency discussion that we had, you can't have a conversation about contingencies without the standard of care. So back to the importance of that. So those are great points.

And I was also thinking about this wording here is that with firms to have it ideally in your standard terms and conditions, in your letter agreement, you have this as one of those things. And if you're dealing with an owner drafted agreement, you know that the owner is rarely, if ever, going to volunteer this clause.

So have that checklist, if you will, so you can catch some of these important clauses that are often not volunteered by the owner, the limitation liability, the mediation clause, the hazardous materials clause. There's a list of those that I think those checklists are very helpful on this. And one other couple of points I want to ask you about, though, is that this is important to note that this is just between the two parties that have agreed to in this agreement. This is not going to limit any liability to a potential third-party exposure liability.

COLLEEN PALMER: That's exactly right. And that was going to be next on my list of points that we discussed. Absolutely correct. This is a provision that limits the professional's liability only to its client. It does not limit a professional's liability to a third party. This is not a get-out-of-jail free card for any and all claims that may be made against the professional.

DAN BUELOW: Yeah, and it's also I think, and we've talked about this Colleen in the past too is that if you're a prime and you have a subconsultant, and they have a subconsultant agreement, consistency of docs is very important. Is you really got to be wary of not allowing your subconsultant to have a limitation liability if you were not successful in getting one in your prime agreement, right?

COLLEEN PALMER: Yeah, absolutely. And this is whereas someone who reviews contracts, I refer to those as reverse contracts in my head because certainly, if you're the prime, you definitely want this limitation of liability in your contract with your client. But if you are the prime and you're retaining a sub, and you don't have that LOL with your client, you absolutely don't want to just accept a substandard terms and conditions which 9 times out of 10 will have an LOL in their favor.

Because if an issue arises and the claim is made that damages are due to your sub's negligence, and they have an LOL to $20,000 and it's $1 million in damages, guess what? Now you as the prime if you didn't get that LOL, you're vicariously liable for your sub and you're on the hook for those damages. So it's very, very important to make sure that there is consistency with the documents. And if you are the prime retaining subs, you review that if the subconsultant is providing their agreement for you to use to retain them, you review that very carefully.

DAN BUELOW: Great point. And I want to talk a little bit about-- this has come up a few times recently for us on the broker side dealing with some of our clients on very large projects. And limitation of liability fits into this conversation here for larger projects that are-- our advice is anything that's $100 million in construction value or more, we would strongly encourage that a project specific insurance policy be considered, which would arguably be a benefit to all parties, versus relying on the dedicated practice policy limits of the various design team members. And for the very large projects, be aware as a design professional, be aware of the fact that the owner may very well be purchasing a product called an Owner's Protective Professional Insurance commonly referred to as OPPI.

Or large design build projects, the contractor will often purchase this same product. And so we don't as a broker that advocates on behalf of design professionals, we don't advocate or sell OPPI or CPPIs. Brokers including those brokers that represent owners or contractors may and it can be a valuable product on those design products, but it's important to note as an advocate for the design professional, that neither an OPPI nor a CPPI will offer you any insurance coverage protection for the design professional.

These products will in fact will look to the design professional's practice policies to essentially be that first layer of this coverage meaning that the owner's OPPI or the contractor's CPPI won't be triggered until the design professional's practice limits are greatly reduced or even exhausted.

So where I'm going with all of this is if you're a design professional, this could be an uncomfortable situation to be in knowing that your client won't be able to tap into this insurance that they paid a lot of money for until they exhaust all or a good portion of your insurance policy or professional policy.

And this can be an adversarial situation because a design firm won't roll over without a fight to protect their PL Practice Policy Limits, nor will their carrier. So a solution that we've worked through on a couple of recent large projects here that I think is worth mentioning here is that we've helped our clients, our design firm clients, and their clients negotiate again, on these larger projects to purchase a project specific policy again, commonly known as a PSPL, and this product does in fact cover the design team.

And the owner arguably should pay for this coverage often given the benefits of having a dedicated insurance for this project, not to mention the benefit of a joint defense provision in this coverage. But what we do then is we then would want to include a limitation of liability clause to the proceeds of that design firm's PSPL policy.

So that the design team's individual members practice policies are not exposed, and there's a huge benefit for all parties including the owner to do this in many cases because they by doing so, the OPPI or the CPPI will be triggered when that project policy is exhausted, rather than going after the practice policy limits of the individual practice policy.

So there's a lot there but there is where this LOL, this limitation of liability, where we've put it in there with the proceeds are that they're not exposing and so the OPPI can be triggered at the exhaustion of the project policy has been a big, big benefit for us using again, an LOL.

And so there's a lot there to unpack obviously, but we have a technical brief on that under insuring single project. So something to keep in mind there. I don't know, Colleen, you got anything to add to all that? But it's something that we have seen work for us, and it's been something again, part of negotiating and really sitting down with your owner to talk through how these coverages work.

COLLEEN PALMER: Yeah, I think that it really is with all things with your contract, a matter of sitting down with your client and having the discussion to make sure that you understand what the client is expecting and to make sure that you clarify what you need to clarify as to how your insurance works.

Sometimes you have to start right from the basics what the standard of care is. What's acceptable for you and that you can't provide warranties. You're not a trade contractor. You're a professional. So it's a matter of communication. We always stress the importance of communication and documentation. And that starts right from the precontract discussions and clearly through the contract negotiations.

DAN BUELOW: So Colleen back to the clause that you gave us as a sample there. What would be some possible exceptions to that or carveouts that you might want to address?

COLLEEN PALMER: Sure. And this is where you really have to pay close attention to the words. Because I have seen contracts that will include a beautifully drafted limitation of liability provision. You're just you're so excited, you read it. It's nice and broad. It's encompassing all these causative actions, the big broad umbrella.

And then the next sentence will say, however, the limitation of liability does not apply to the design professional's negligence or any indemnity obligations that the professional has under this agreement. And then you sadly sit down and think, oh, gee, this probably isn't going to provide the professional with significant protection because it's carving out negligence and any indemnity obligations you have. Well, that's the crux of these claims that are made against design professionals.

DAN BUELOW: That's what you want to limit your liability, yeah.

COLLEEN PALMER: That's exactly it. So it really just makes your LOL a moot point. It's worthless essentially at that point when they have these carveouts. So it's really, really important to try to get those exceptions to the LOL protection deleted from the contract in order to allow the provision to have any kind of teeth to protect you.

DAN BUELOW: Great points, Colleen. Before I leave LOL. Anything else? Any parting comments on LOL because I do want to talk a little bit about consequential damages.

COLLEEN PALMER: Yeah, I think we've hit the high points. I guess I would just reiterate that they can be valuable protections to have in your contract, and they will at least give your attorney a starting point to argue that your liability should be limited by having such a provision in your contract. So try to fight for them, try to get them in your contract to the best of your ability.

DAN BUELOW: And again, as I mentioned, we've had some clients that have had some real success getting these in their agreement, and it's been very valuable. So very important. So Colleen, when I was talking to Sue Yoakum on our podcast on design contingencies, we talked a bit about limitation liability, but we also discussed the benefits of having a waiver of consequential damages provision as well. Can you share with us your thoughts on this waiver of consequential damages, and how you think about those versus the LOL?

COLLEEN PALMER: Absolutely. A waiver of consequential damages-- and I say waiver but what I mean really is a mutual waiver. Another great provision to negotiate into your agreement with your client. I think of LOLs and waiver of consequential damages as holding hands provisions. They both can provide protection to the professional, so we recommend trying to get a waiver of consequential damages and pretty much all contracts for all projects.

They I think are potentially more valuable to have in projects that rely heavily on profits or the stream of commerce. And let me elaborate on that a little bit. Consequential damages are those damages that are not direct. And I say that sentence like that immediately clears it up, but courts have traditionally had a little bit of a hard time nailing down what is and is not a consequential damage, and oftentimes that is a big point of problem in a claim.

So an example, if you have a roof that leaks and all of the clothing in this clothing store are damaged and they all have to be replaced, those would be direct damages. But if you have that same leak and it means that store has to shut down and can't operate for three months. The lost profits, the lost revenue that that store may have earned by being open, that would be an example of consequential damages. It's an indirect loss. It's a financial loss. It's a consequence of that direct damage, the leak in the roof.

So these types of provisions I mentioned are particularly important in projects that rely on the stream of commerce on profits like restaurants, hotels, shopping malls. If you're doing a project and it's adding a porch on to a residence, you're probably not going to be too concerned with consequential damages. If you're working on a casino in Vegas that has an opening date of December 1st, consequential damages should be on your mind. So these are provisions that require both parties, your client and yourself, to waive those types of damages against each other.

DAN BUELOW: Excellent. Well, that's a great place to stop. Colleen, I want to thank you. This has been a great discussion on another very important topic, and thanks for joining us and coming back for another podcast.

COLLEEN PALMER: Well, thank you for having me and inviting me on behalf of Beazley to chat with you, Dan. I enjoy these so much.

DAN BUELOW: It's always great to have you, Colleen. And thank you for joining another episode here of Talk to Me About A&E. For a full listing of our podcasts and other Willis A&E education offerings, be sure to check out our website at www.wtwae.com. Talk to you soon.

SPEAKER 1: Thank you for joining us for this WTW podcast featuring the latest thinking on the intersection of people, capital, and risk. For more information on Willis A&E and our educational programs, visit willisae.com. WTW hopes you found the general information provided in this podcast informative and helpful.

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