Limitation of Liability Enforced in Arizona is Matter for Summary Judgment

The Supreme Court of Arizona held that a limitation of liability clause in a design professional contract is enforceable on a summary judgment motion, without need to have a jury review it, where the clause put a cap on liability in the amount of the fee but did not attempt to relieve the firm of all liability. Since the clause didn't eliminate all liability, it was not an "assumption of the risk" clause subject to a state statute that would otherwise made enforceability of assumption of the risk clauses a matter for jury decision. Such clauses, especially in commercial contracts, are not contrary to public policy and are, therefore, generally enforceable. Unlike the clause in the Georgia case of *Lanier v. Planners*, this clause did not attempt to limit third party claims, but instead addressed only claims by the client against the design firm. As such, the clause was not an indemnity clause and was therefore not subject to any anti-indemnity statute.

This decision is particularly important because the court distinguishes the Georgia decision that had caused so much concern for design professionals and their counsel, and it provides useful insight for drafting clauses to be enforceable.

In *1800 Ocotillo, LLC v. WLB Group, Inc.*, 196 P.3d 222 (Az, 2008), a surveyor entered into a contract with a developer to perform a survey to identify boundary lines and rights-of-way on land to be developer into a townhouse community. The operator of a neighboring canal subsequently claimed an interest in a right-of-way that the surveyor failed to accurately show in its survey. As a result of the discrepancy, the City of Phoenix denied the developer certain building permits.

The developer filed suit against Surveyor for alleged negligence in the preparation of the survey that caused Developer to incur increased costs from construction delays and additional engineering services and designs. In response, Surveyor filed a motion for partial summary judgment arguing that its liability, if any, was capped in the amount of its fee pursuant to a limitation of liability (LoL)clause that read as follows:

"Client agrees that the liability of WLB, its agents and employees, in connection with services hereunder to the Client and to all persona having contractual relationships with them, resulting from any negligent acts, error and/or omissions of WLB, its agents and/or employees is limited to the total fees actually paid by the Client to WLB for services rendered by WLB hereunder."

In an effort to avoid summary judgment, the developer argued to the trial court that the LoL clause was contrary to public policy. The trial court rejected that argument and granted partial summary judgment limiting the potential liability to the amount of fees the surveyor had received. This was appealed to the court of appeals which, although agreeing that the LoL clause didn't violate public policy, nevertheless reversed the trial court summary judgment because it found the clause created a "defense of assumption of risk" and this was required by state statute to be submitted to the jury to decide whether to enforce.

The Supreme Court of Arizona reversed the court of appeals decision and issued a well reasoned decision that cites several other recent LoL decisions from other jurisdictions, and explains and reaffirms several important basic principles of contract law that have great significance for managing risks in contracts.

The court starts its analysis by noting that "Our law generally presumes, especially in commercial contexts, that private parties are best able to determine if particular contractual terms serve their interests."

Next, the court notes that the LoL clause is not subject to the state's anti-indemnity statute that provides:

> "A covenant, clause or understanding in, collateral to or affecting a construction contract or architect-engineer professional service contract that purports to indemnity, to hold harmless or to defend the promissee from or against liability for loss or damage resulting from the sole negligence of the promissee or the promissee's agents, employees or indemnitee is against the public policy of this state and is void."

The concern of this anti-indemnity statute is it to avoid having a party shift ALL liability for its own negligence to another party. The purpose of anti-indemnity statutes, explains the court, is primarily to prevent parties from eliminating their incentive to exercise due care. "Because an indemnity provision eliminates all liability for damages, it also eliminates much of the incentive to exercise due care." In contrast, the LoL provision does not completely insulate the surveyor from liability but merely limits the amount of the liability. As stated by the court: "This provision in the [ ] contract does not completely insulate WLB from liability, as would an indemnity or hold harmless provision, nor does it require Ocotillo to defend WLB. The provision merely limits liability."

The court notes that "it is possible that a limitation of liability provision could cap the potential recovery at a dollar amount so low as to effectively eliminate the incentive to take precautions…." But the court did not find that to be the case here.

The plaintiff also argued that, pursuant to a state statute, shareholders of "professional corporations" are "personally and fully liable and accountable for any negligent or wrongful act or misconduct" that the shareholder commits while rendering services on behalf of the professional corporation. Another statute cited by the plaintiff provides that each member or employee of the firm that performs the services on behalf of the firm "shall remain personally liable for any results of the negligent or wrongful acts, omissions or misconduct committed by him." The court rejected plaintiff's argument that these statutes were intended to prevent professionals from limiting their liability where the engineering firm was not a "professional" corporation. It was a traditional corporation and the statutes did not apply to it.

It is important to note that the court here reviewed and considered the decision in the recent Georgia limitation of liability case of *Lanier v. Planners & Engineers*, 663 S.E.2d 240 (2008) which had in turn referred to the lower appellate court decision in *1800 Ocotillo*. The key, according to the court, was that unlike the Georgia case, the LoL clause at issue here did not contain any reference to limiting liability for third-party claims brought by the general public. Important for understanding how future cases might be reviewed in Georgia , the Arizona Supreme Court notes: "Lanier also distinguished , and apparently approved, the liability-limiting clause is *Valhal*, which is virtually identical to the provision at issue here."

The court rejected the plaintiff's argument that the LoL constituted an assumption of the risk clause that was governed by a state statute that limited the applicability of such assumption of the risk clauses. The court stated that the statute must be correctly interpreted to apply only

to clauses that relieve a defendant of "any" duty, and that where such a harsh result in possible because all such duty has been eliminated, a jury must be permitted to decide whether the clause is enforceable.

The key decision by the Supreme Court in this LoL case is that the LoL does not create such a harsh result as to constitute an assumption of the risk clause that must go to the jury for determination. In fact, the court noted: "Moreover, the benefits of such agreements in allowing parties to prospectively allocate potential losses in excess of the cap would be largely lost if their enforceability turned in every case on after-the-fact jury determinations."

Risk Management Notes: Several important lessons are learned from this decision including:

(1) Keep the limitation of liability clause and any indemnity clause totally separate and apart;

(2) Don't attempt by the LoL clause to relieve the firm of all liability or to cap the liability so low as to make it unenforceable;

(3) Make the LoL clause apply to actions against any principal, officer, agent and employee of the corporation as well as to the corporation itself.

In addition, it is probably also prudent to introduce the clause with a phrase such as "To the fullest extent permitted by law."

Finally, it is important that the clause clearly state that the LoL applies to all causes of action including breach of contract, breach of warranty, and tort, including negligence.

About the author: J. Kent Holland, a construction lawyer located in Tysons Corner, Virginia, with a national practice (formerly with Wickwire Gavin, P.C. and now with Construction Risk Counsel, PLLC) representing design professionals, contractors and project owners. He is also founder and president of ConstructionRisk, LLC, a consulting firm providing consulting services to owners, design professionals, contractors and attorneys on construction projects.