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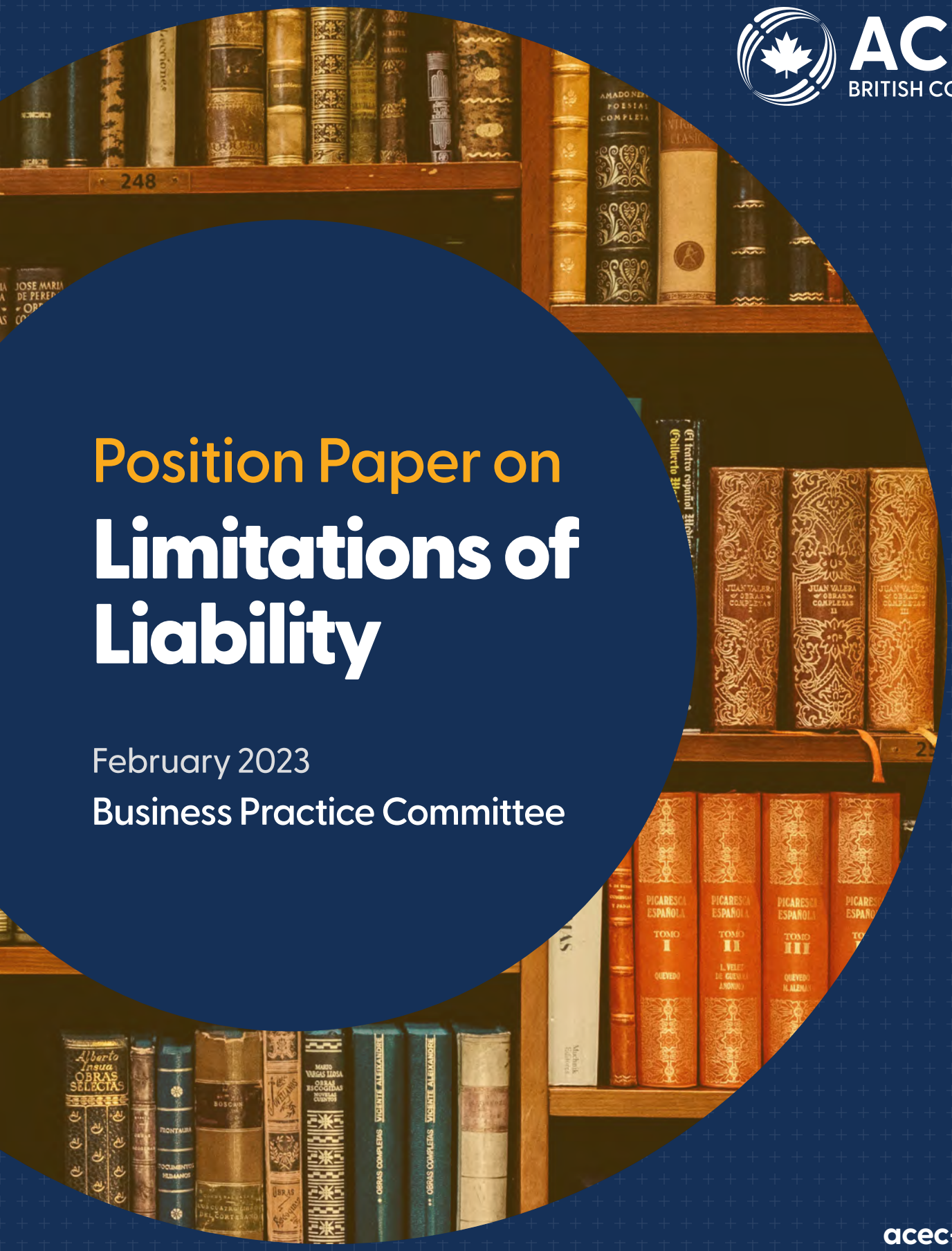

Position Paper on
Limitations of Liability

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Business Practice Committee

acec-bc.ca

ABOUT THIS PAPER – LIMITATIONS OF LIABILITY:

Note: This is an update to the original released in June 2010.

Limitation of liability clauses are included in agreements between a client and their consultant. The clauses limit a consulting engineer's risk or financial exposure to liability for claims that may be brought by the client in the event they suffer a loss related to the consultant's services.

Consulting engineers must be aware of limitation of liability clauses and seek to include them as a standard part of every client-consultant agreement. Limitation of liability clauses can generally limit a consultant's liability:

1) To a monetary amount;
2) To certain types of damages; and/or,
3) In time (i.e., prevent claims from being brought after expiry of a certain period).

It is in the consultant's best interests to limit liability exposure to clients to the extent possible. The purpose of this limitation is to allocate a project's risk in reasonable proportion to the profits and other benefits derived by each party. The risk a consultant bears should be commensurate with the financial return and the consultant's ability to manage the risk.

Example language referenced below is from the Canadian Construction Documents Committee Service Contract between Owner and Consultant 2020 (CCDC 31)[1]. While this paper focuses on limiting liability in relation to professional liability claims, the concepts presented below also apply to limiting liability for other types of losses.

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[1] CCDC 31 – 2020 Service Contract Between Owner and Consultant. https://www.ccdc.org/document/ccdc31/

1.0 MONETARY LIMITS

If the consultant obtains a small economic benefit (profit) while helping the client achieve a much larger one, the risk the consultant must bear should be commensurate with the financial return.

CCDC 31 Clause GC 6.2.2 limits the quantum of any claim by the client against the consultant to the insurance proceeds recovered under policies required by the contract[2] and sets a separate limit of $250,000 for losses for which insurance is not required. This can be a reasonable way to allocate the risk of loss on a project between the parties.

The Master Municipal Construction Document Association Client/Consultant Agreement[3] contains another example of an industry accepted clause that limits liability to insurance.

It may sometimes be appropriate for a consultant to contractually limit its liability to a set amount (i.e., a defined monetary limit) or to the value of the engineering fees for the project without reference or recourse to the consultant's insurance program. For example, in small-fee retainer assignments, the relative benefit of the fees may not justify exposing the consultant's insurance at all considering applicable deductible(s) or potential impact to future insurance premiums.

To determine the appropriate limit of liability for each contract, consultants may consider:

- Internal corporate requirements;
- The relationship with the client;
- The value and type of consulting services;
- The economic benefit (profit); and,
- The risks associated with such services if something goes wrong.

If a client requires a consultant to assume greater liability than that for which the consultant is insured, or to accept a contract without any limit of liability, it is important that both parties understand the implications of such an arrangement. The consultant essentially has three choices:

1) Decline the project on the basis that the risk assumed is too great;
2) Take on additional insurance over and above the minimum amount prescribed by the contract and reflect that cost in the bid; or
3) Assume the risk and accept that a significant claim may jeopardize the financial well-being of the firm.

[2] CCDC 31 GC 6.1.2 compels the consultant to carry professional liability insurance (PLI) with a $2,000,000 limit.
[3] Master Municipal Construction Document Association. Client/Consultant Agreement 8.3 *Limits of Liability*. https://www.mmcd.net/resources/clientconsultant-agreement/

Professional Liability Insurance (PLI) is a risk allocation tool that should be discussed with the client at the outset of the project to ensure both the client's and the consultant's interests are reasonably protected, and the financial future of the engineering firm is not put at risk by a particular project. Discussing and resolving risk allocation issues at the front-end of the project (rather than after a dispute has arisen) avoids conflict and damage to the ongoing working relationship between client and consultant that may otherwise occur.

On a larger project, a consultant may not be able to obtain sufficient insurance to completely cover its exposure, or at least not at a reasonable cost, particularly if the client-consultant agreement does not include a limitation of liability clause. In that situation, it may be in the interests of both the client and the consultant to take out a project specific PLI policy. This may increase the initial cost of the project to the client, but the consultants and contractors will be able to offer their services at lower cost because they are not burdened with accepting uninsured risk or obtaining their own insurance.

Consultants should take note that not all limitation of liability clauses are created equal, so each limitation of liability clause should be carefully reviewed to ensure it contains the protections sought.

For example:

- Some agreements contain a limitation of liability but also exclude major protections in other clauses in the agreement like excluding the consultant's indemnity obligations or claims covered by insurance from the limitation of liability.
- Consultants relying on their annual PLI policy for risk management should be particularly careful when limiting liability to insurance coverage in client-consultant agreements. Without a clear upper limit, the entire PLI policy could be exposed under one agreement. If a claim occurs and uses up all coverage, any additional claims related to other agreements would be left with no coverage, posing a financial risk to the firm.

2.0 LIMITS ON TYPES OF DAMAGES

Consultants can greatly reduce their liability exposure by including in the client-consultant agreement a clause limiting their liability to damages to the extent arising directly out of their performance of the agreement. CCDC 31 Clause GC 6.2.4 limits the types of damages that may be advanced against either party using the following language:

> *"Neither party is liable to the other party in relation to the Contract, whether due to breach of contract, tort, negligence, warranty, strict liability or otherwise, for consequential or indirect loss or damages, including without limitation, loss of profits, loss of revenue or loss of anticipated business incurred by other party."*

A client's lost opportunities or reduction or loss of profit are not recoverable when this clause is implemented.

This clause would be particularly useful to a consultant engaged on a large project with potential for business interruption losses, which may be significant and unforeseeable, and for which the consultant should not be responsible even in the event of the consultant's negligence.

Consultants may want to exclude other types of damages based on the specific nature of the project, for example, liquidated damages and other uninsured losses. CCDC 31 Clause GC 6.2 includes additional liability exclusions for consideration.

3.0 TIME-BASED LIMITS

The importance of incorporating a contractual time limit on claims is highlighted by the liberal interpretation the courts in this jurisdiction have given to the Limitation Act[4]. Unless a contractual time limit exists, construction-related claims for defects in engineering work can typically be brought, in some circumstances, as late as 15 years after substantial completion of a project. As our courts have stated, engineers are particularly vulnerable to stale claims:

> *"A professional advisor drafts a document or designs a structure and finds himself attacked when, generations later, damage flows from his act. The attack may come at a time when mind and memory have faded or even failed altogether. He may not be able to recall or may have an imperfect memory of instructions or discussions which excluded liability, or which redefined in some limiting fashion the duty he undertook."* [5]

Potential prejudice to engineers due to the passage of time highlights the importance of including a clause in every client-consultant agreement that provides a date-certain within which claims against the consultant must be brought.

A limitation clause such as the one found in CCDC 31 Clause GC 6.2.2.1 accomplishes this objective. It states that no claims may be brought by the client six years after either:

> *"completion of the Professional Services or within such shorter period as may be prescribed by any limitation or statute in the jurisdiction in which the Project is located."*

A client may not want to limit the time within which a claim must be brought. Instead, clients sometimes request consultants to contract out of or extend a limitation period. Consultants should avoid this long-tail exposure unless they have specifically considered the risk, obtained the appropriate insurance, and charged an appropriate premium. The client should explain the reasons why the consultant is being asked to assume greater liability than would otherwise be imposed by law, and the consultant should educate the client about the increased cost associated with increased assumption of risk, including the potential impact this may have on PLI coverage.

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4 BC Limitation Act (SBC 2012). https://www.bclaws.gov.bc.ca/civix/document/id/complete/statreg/12013_01
5 Costigan v. Ruzicka (1984), 13 D.L.R. (4th) 368 (Alta. C.A.) at 377

Enforceability

A common question in the construction industry – including consulting engineers – is whether limitation of liability clauses have been found by the courts to be enforceable.

The Supreme Court of Canada has held that these clauses are enforceable provided they are not unconscionable, unfair, unreasonable, or otherwise contrary to public policy[6]. This determination is highly fact driven and as such, a comprehensive review of the law is beyond the scope of this discussion. Generally, where parties are of equal bargaining power, and they are aware of what they are agreeing to, the courts will permit them to make their own bargain and hold them to the terms of that bargain. In the past, Court decisions have upheld limitation of liability clauses in client-consultant agreements[7].

There are steps a consultant can take to increase the likelihood that a limitation of liability clause will be upheld:

1) Bring the limitation to the client's attention. This is typically done through properly executing a client-consultant agreement, ideally obtaining the client's initials on each page of the agreement.
2) If the client is unsophisticated, explain the limitation of liability clause in writing
3) Ensure both parties execute the contract prior to commencing the services.

Other Considerations

Consultants may have other limitation of liability concerns depending on the nature of the project. For example:

<u>Who controls or is best positioned to manage certain types of risk?</u>

Consultants should be cautious about accepting types or levels of risk over which they have little or no control.

<u>Are there differences between the risk to the prime and sub consultants or differences resulting from complexity or size of the consultant's organization?</u>

A prime consultant may have a different perspective on limitation of liability than subconsultants hired for a small portion of the overall project. In addition, larger firms may act as self-insured, while smaller firms may rely on their PLI and be unable to accept the same limitation of liability. Prime consultants should consider their subconsultants when negotiating the client-consultant agreement, and risk should be allocated equitably through consultant-subconsultant agreements.

6 Guarantee Co. of North America v. Gordon Capital Corp., [1999] 3 S.C.R. 423 at 64
7 Summitville Consolidated Mining Co. v. Klohn Leonoff Ltd. (1989) 21 C.L.R. (2d) 128 (B.C.S.C.) and Howe Sound School District No. 48 v. Killick Metz Bowen Rose Architects and Planners Inc. 2007 BCSC 28

How should consultants consider their insurance policy deductible?

It is important for consultants to understand how PLI deductibles apply to their firm on both project-specific and annual insurance policies. Firms with higher deductibles should consider their deductible when evaluating small projects.

For example, what is a reasonable limitation of liability for a small project generating fees an order of magnitude smaller than the firm's deductible? It is not uncommon for small-fee projects to result in large claims. In addition to the financial burden, there is stress and unbillable time spent managing a claim, which results in lost opportunities and unpaid effort.

How might this apply to third-party claims?

Since the limitation of liability is in the client-consultant agreement, it does not apply to third-party claims. Insurance may be available for third-party claims and the entire policy limits may be exposed.

Are there other clauses that can impact the risk associated with assuming liability?

Indemnification clauses are often important to review in conjunction with limitation of liability clauses, including in relation to claims against individuals. Refer to the ACEC-BC Position Paper, "Indemnities and Claims Against Individual Engineers" (August 2010) for further details.