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Professionals involved in design-build projects should be aware of the risks they face when they contract with the owner to be solely responsible for both construction and design. In this respect, the design-builder should strive to include limitation of liability clauses in their contractual agreements. In what follows, the enforceability of limitation of liability clauses will be discussed along with important measures to follow when utilizing this contractual tool.

The Risk Management Committee of the Canadian Design-Build Institute will continue to circulate articles of this nature to members as they become available. We trust this will be found to be of interest and beneficial to the members.

The Fine Art of Limiting Liability
By Steve Vorbrodt, Singleton Urquhart, LLP

Introduction
Almost all professionals these days provide their clients with a written engagement letter – if they don't, they should. This includes all sorts of professionals including architects and engineers as well as design-builders. Many design firms try to limit their exposure in the event of errors or omissions by including limitation of liability clauses in their engagement letters and / or contract terms. However, the professionals who rely on them may not always be as protected as they think they are.

An issue that routinely arises in professional liability cases is the scope of and enforceability of these limitation clauses. There are several issues that may or may not make all or portions of engagement letters problematic to enforce. These include whether the engagement letter was signed; the scope of the limitation clause; whether the limitation clause was understood by the client; and whether the clause is unenforceable of the basis of unconscionability or on public policy grounds.

Most professionals are usually more focused on providing good services than on the terms of their engagement letters. In addition, when trying to win over a client, it is natural to want to spend less time (or even avoid) discussing contract wording and payment terms. This is especially so when the contract wording relates to what will happen in the event the professional is negligent. However, professionals who avoid clearly setting out the scope of services to be provided and the limits of liability in the event of errors or omissions are missing an opportunity to limit their exposure. This can cause problems down the road. Similarly, professionals who rely more heavily on limitation clauses in their contracts may face exposure if the clauses aren't well drafted or the execution of the agreement is not handled properly.

This article will explore some of the common pitfalls with limitation clauses in engagement letters and contracts which prevent them from limiting exposure as intended. These pitfalls include:

- failing to get the contract signed (something that never ceases to amaze lawyers!);
- failing to ensure the client has ample opportunity to read understand the contract; and
- including unduly harsh or otherwise unfair clauses.

Being aware of the issues that can arise relating to the application and enforceability of limitation clauses may assist your firm in assessing your exposure to professional liability claims.

Limitation of Liability Clauses Generally

Why do these clauses only limit liability instead of excluding it completely? In an ideal world – depending on who you are - professionals could simply have their clients sign engagement letters that absolved them from all liability in the event of an error or omission. This would be consistent with the courts' recognition that there is a public interest in allowing parties the freedom to structure their contractual relationships as they like. However, the courts try to balance the general principle of freedom of contract against public policy concerns that a party (such as a professional) who agrees to a binding contractual obligation should not be free to absolve itself entirely from its duty to perform that obligation. For this reason, the courts will look closely at contracts that attempt to limit liability for non-performance of a contractual obligation.

In addition, lawmakers recognize that there is a public interest in preventing some professionals from having their clients sign engagement letters that absolve them from liability. This includes lawyers whose governing legislation prohibits provisions in contracts that the lawyer is not liable for negligence. Other professions, such as architects and engineers, are permitted to limit (but not exclude) liability in an engagement letter.

The most common way limitation clauses seek to cap the amount of recoverable damages are by limiting them as follows: 1) to a specified dollar amount; 2) to the amount of omissions insurance coverage in effect at the time; or 3) to the amount of fees charged.

Generally speaking, the courts will be cautious about enforcing limitation clauses that limit liability to a relatively small dollar amount. The courts will be less inclined to find a clause objectionable the more proportionate the amount is in relation to the project. Some clauses limit recovery to the amount of fees charged. Fortunately, (or not, depending on who you are), in many professional negligence actions (especially in construction projects), the fees charged in relation to potential damages are often high enough to satisfy the courts. In fact, the court recently upheld a clause in an engagement letter provided by the defendant accounting firm where the damages were limited to the amount of fees (*Felty v. Ernst & Young*, 2015 BCCA 445).

The courts will also be more inclined to uphold limitation clauses which specify the type of liability or damages sought to be excluded. For example, limitation clauses that cover claims in "negligence" or claims for "indirect or consequential damages" are more likely to survive than those that seek to limit liability for all "claims arising from services provided pursuant to the agreement."

There are two main hurdles to overcome in trying to rely on a limitation clause: 1) ensuring the clause is incorporated into the contract; and 2) ensuring the clause is enforceable. In what follows, the common pitfalls relating to these issues are discussed.

Does the Limitation Clause Form Part of the Contract?

Before the court looks at whether or not a limitation clause is enforceable, it will first determine whether the clause forms part of the contract between the parties. There are three ways a limitation clause can be incorporated into a contract: 1) by signature; 2) by notice; or 3) by previous course of dealings between the parties.

1. *By Signature*

Having the other party (i.e. the professional's client) sign a written contract containing a well-drafted limitation clause is the simplest and most effective way to confirm the term forms part of the contract. However, this is not foolproof, as will be discussed below.

2. By Notice

In an ordinary commercial transaction where a contract is signed, there is no onus on a party to bring a limitation of liability clause to the attention of the other party. This is because "a person is bound by an agreement to which he has put his signature whether he has read its contents or has chosen to leave them unread" (*Fraser Jewellers (1982) Ltd. v. Dominion Electric Protection Co.* 34 O.R. (3d) 1 (Ont. C.A.). This is especially so in circumstances where the parties had previously entered into similar contracts for similar services. However, this only applies where the parties have equal bargaining power.

In circumstances where the parties have unequal bargaining power, the court may refuse to enforce limitation clauses that were not specifically brought to the other party's attention. The following non-exhaustive list contains some of the factors the court will consider in deciding whether to enforce a limitation clause between two unequal parties: the effect of the exclusion clause in relation to the nature of the contract; the party's normal expectations and whether they intended to be bound by the term; the length and format of the contract and the time available for reading and understanding it. If it can't be established that the limitation clause was read and understood by the party claiming damages, the court may find the clause unenforceable.

Similar (although slightly different) reasoning explains why rental car agencies require customers to initial their standard form contracts. For example, in *Tilden Rent-A-Car Co. v. Clendenning* (1978), 83 D.L.R. (3d) 400 (Ont. C.A.), the Ontario court of Appeal refused to enforce a limitation clause in a signed contract on the basis the customer's attention had not been directed to the clause prohibiting driving while intoxicated.

3. By Course of Dealings

Where the parties have relatively equal bargaining power, the courts may enforce a limitation clause in a contract even though the contract is not signed. This can happen where parties exchange contract documentation but fail to sign the actual contract and then act on the correspondence on the basis of their previous "course of dealings". In fact, this is not an altogether infrequent occurrence.

In such cases, the court will ask what each party was reasonably entitled to conclude about the contract terms that were agreed to from the standpoint of the "officious bystander". The reasoning is that where two parties make a series of similar contracts each containing certain conditions, and then they make another without expressly referring to those conditions, it may be that those conditions ought to be implied. If the officious bystander had asked them whether they intended to leave out the conditions this time, and both parties would be found to have answered "of course not", the conditions will be implied.

While the reasoning is sound, the fact that a court can enforce terms in an unsigned contract document surprises many non-lawyers.

Is the Limitation Clause Otherwise Unenforceable?
Assuming the limitation clause forms part of the contract, it will be enforceable, right? Not always.

The general approach of the courts is that parties are entitled to arrange their commercial affairs as they please. This includes managing risk by limiting the scope of the duties otherwise imposed by the law in their contract terms. However, clearly worded, applicable limitation clauses will not be enforceable if the agreement is found to be unconscionable (unfair, unreasonable) or contrary to public policy.

The court will not consider the nature of the negligence or breach of contract by the professional in question. Parties are entitled to exclude or limit liability for a fundamental breach of contract including an "egregious" breach.

In determining whether the limitation clause is enforceable, the courts will look to see whether there is an imbalance of bargaining power between the parties and if so, whether one of the parties used this imbalance unconscionably. In *Tercon Contractors Ltd. v. B.C. (Transportation and Highways)*, 2010 SCC 4, the Supreme Court of Canada confirmed that the requirements for setting aside a bargain on the basis of unconscionability are as follows: 1) inequality in the position of the parties arising from the ignorance, need or distress of the weaker, which left them in the power of the stronger; and 2) proof of substantial unfairness in the bargain. Generally speaking, there has to be an abuse of the bargaining power.

There does not appear to be a clear test of what will amount to abuse in order to make a limitation clause unconscionable. The courts have considered the innocent party's mental capacity, their degree of business literacy and whether they obtained or had access to independent legal advice. The conduct of the offending party while the contract was being made does not need rise to the level of criminality or fraud to justify a finding of abuse.

As indicated above, the amount of the compensation to be paid in the event the limitation clause is invoked should not be unfair or unreasonable. In *Solway v. Davis Moving & Storage Inc*. (2002), 62 O.R. (3rd) 522 (Ont. C.A.), the Ontario Court of Appeal considered a limitation clause that attempted to limit liability for household goods stolen during the course of a move carried out by the defendant moving company to "60 cents a pound." In defence of a subrogated claim by the plaintiff's insurer, the defendant movers attempted to rely on the limitation clause to limit damages to $7,100. However, the court appears to have found this amount was insufficient compensation where the loss claimed was comprised of "highly valuable" rare artifacts and antiques collected by the plaintiffs through their travels around the world. Accordingly, the clause was found to be unenforceable on the basis of unconscionability.

The cases relating to waivers of liability (although somewhat different) are also instructive. In determining the applicable terms of the contract, the courts look at the circumstances of the parties when the contract was made, whether the effect of the clause is contrary to the nature of the contract and the party's normal expectations, the length and format of the contract document and the amount of time made available to read the contract. In *Arndt v. The Ruskin Slo Pitch Association*, 2011 BCSC 1530, the court considered a waiver and release of liability clause printed on the back of a sign-up roster for a non-profit softball league. The words, "I agree to waiver" appeared under the signature line on the front of the form in very faint, small red type while the terms of the waiver were printed on the reverse. The court dismissed the

defendant's application to enforce the limitation clause on the basis that the plaintiff, who claimed for injuries sustained during a softball game, had not intended to sign a liability release when she signed the roster and the defendant had failed to take reasonable steps to bring the waiver to the attention to her attention in circumstances where she would not expect it.

Assuming the clause is not unconscionable, the final step in the court's analysis is to determine whether the clause is otherwise objectionable on public policy grounds. In circumstances where a limitation clause in a contract is freely negotiated by parties of equal bargaining power, a plaintiff who seeks to avoid the effect of a limitation clause must identify the overriding public policy that it says outweighs the public interest in the enforcement of the contract. What these public policy grounds are exactly is not well defined in the case law. Some examples of accepted considerations that may override the freedom of contract principle include conduct approaching criminality or fraud.

Conclusion

As should be clear, the courts will allow parties to limit the scope and extent of their liability through limitation of liability clauses in certain circumstances. However, a professional's chances of successfully limiting their exposure are increased if they have clearly worded and comprehensive written engagement letters which set out the scope of services to be provided and the applicable limits of liability. Legal advice should be sought in respect of any engagement letter on which a professional seeks to rely.

Before the engagement is confirmed and before providing services, the professional should ensure:

- an engagement letter is provided to the client which includes, among other things, a clause clearly limiting liability in the event of errors or omissions;
- the limitation clause is not overly harsh, unreasonable or otherwise unconscionable;
- the other party has had ample time to review the engagement letter; and
- the engagement letter is signed by the parties.

Those seeking to rely on limitation clauses should consider these issues to ensure their engagement letters are protecting them as well as they think they are. They may not be.

Design-build professionals and firms should be acquainted with these issues to ensure they have sufficient insurance coverage in place to cover any potential claims that may arise relating to the provision of their services. Among other things, professional liability and/or other applicable insurance coverage should be in place in the event that a limitation clause proves to be unenforceable and alternately, to protect against the claims that will survive these clauses (including the cost of defending such claims).

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