

**ARIZONA SUPREME COURT UPHOLDS ENFORCEABILITY OF
LIMITATION OF LIABILITY CLAUSES IN PROFESSIONAL SERVICES
AGREEMENT BETWEEN OWNER AND ENGINEER**

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On November 3, 2008, the Arizona Supreme Court handed down its opinion in 1800 Ocotillo, LLC v. The WLB Group, Inc., CV-08-0057-PR, vacating the Court of Appeals opinion, which can be found at 217 Ariz. 465, 176 P.3d 33 (App. 2008). The Court of Appeals had held that a contract clause limiting the engineer's liability for negligence to the amount of fees actually paid to the engineer did not contravene Arizona's public policy and was not, therefore, unenforceable. But the Court of Appeals also held that such clauses are tantamount to "assumption of risk" defenses under Article 18, Section 5 of the Arizona Constitution. That constitutional provision requires that "the defenses of contributory negligence and assumption of risk shall, in all cases whatsoever, be a question of fact and shall, at all times, be left to the jury." Accordingly, the Court of Appeals reversed the trial court's entry of summary judgment in favor of WLB Group and ordered the case remanded to the superior court for trial.

WLB Group petitioned the Supreme Court to review the constitutional jury trial issue, and 1800 Ocotillo ("Ocotillo") cross-petitioned the Court to review the enforceability of the liability limitation issue. The Supreme Court granted both petitions and scheduled oral argument.

Meredith Vivona and I represented WLB Group in both the Arizona Court of Appeals and the Arizona Supreme Court. The Supreme Court held in favor of WLB Group on both issues it accepted for review; the decision was unanimous.

The limitation of liability clause in question appeared on a single page of "Standard Conditions" attached to the professional services contract. Ocotillo's agent had signed not only the contract itself, but also this page of Standard Conditions. The clause stated:

Client agrees that the liability of WLB, its agents and employees, in connection with services hereunder to the Client and to all persons having contractual relationships with them,

resulting from any negligent acts, errors 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.

The trial court had granted WLB Group's motion for partial summary judgment, ruling that this clause was enforceable to limit any potential liability WLB Group may have. (The ultimate question of WLB Group's negligence, if any, has never been decided and is, of course, hotly disputed by WLB Group. For purposes of this argument, however, the parties asked the trial court to skip over that question and to rule on the enforceability of the liability limitation provision because that issue could, as a practical matter, be outcome determinative.) Ruling in favor of WLB Group, the trial court capped its potential damages at \$14,242.00, even though Ocotillo had claimed damages in excess of \$1 million.

Both the Court of Appeals and the Supreme Court rejected Ocotillo's arguments that a contractual liability limitation contravenes public policy. The Supreme Court said "courts are hesitant to declare contractual provisions invalid on public policy grounds." Slip op. at 4. Ocotillo had argued that the clause was contrary to Arizona's anti-indemnity statute. A.R.S. § 32-1159. But the Supreme Court said WLB Group's limitation of liability was not an indemnity clause. The provision did not require Ocotillo to hold WLB Group harmless from other claims or to defend WLB Group; it merely limited WLB Group's liability to Ocotillo.

So long as the liability limitation is not so low as to eliminate the professional's incentive to exercise due care, it does not contravene the policy behind the anti-indemnity statute. On this point, the Court said:

Although 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, this is not the case here. Under the Ocotillo contract, WLB remains liable for the fees it earns. The fees undoubtedly were WLB's main reason for undertaking the work. Thus, WLB retains substantial interest in exercising due care because it stands to lose the very thing that induced it to enter into the contract in the first place. Slip op. at 7.

Importantly, to determine whether the damages cap was unacceptably low, the Court compared the damages cap with the total fees paid to WLB Group, not with the total damages claimed, as Ocotillo had urged. Hence, the damages cap here – \$14,242 – was not so low as to render the clause unenforceable.

The Court also rejected Ocotillo's argument that such clauses are against a judicially declared public policy, saying:

Such clauses may desirably allow the parties to allocate as between themselves the risks of damages in excess of the agreed-upon cap, which could preserve incentives for one party to take due care while assigning the risk of greater damages to another party that might be better able to mitigate or insure against them. Slip op. at 9.

The Court next dispatched Ocotillo's assumption of risk argument, reversing the Court of Appeals on this issue. The justices recognized a distinction between that defense, which effectively eliminates a defendant's duty to exercise care, and a cap on liability, which does not. The Court held that construing the Constitutional provision to include limitation of liability clauses "would not comport with either the common meaning of the phrase 'assumption of risk' at the time of the constitutional convention or with the purpose animating the framers." Slip op. at 16. "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." Id.

Finally, Ocotillo argued that there was at least a fact issue as to whether the clause was adequately bargained for, contending that it was contained in a preprinted form attached to the contract, and that it was not specifically negotiated or even discussed. As the Court of Appeals had not decided this issue, the Supreme Court remanded the case to the Court of Appeals to decide it in the first instance. Stay tuned. While we believe this issue will also be decided in WLB Group's favor (after all, Ocotillo signed the very page upon which the clause is found), we will not know for several weeks whether the court will impose elevated bargaining requirements on contracting parties when they purport to limit one party's liability for its own negligence.

Lessons of the Case

1. Contractual limitations of liability in contracts between land developers and design professionals are generally enforceable so long as the cap on damages is not so small, in relation to the professional fee, as to eliminate all incentive for the professional to perform with due care.
2. A defense based on such a clause may be ruled upon by the court on summary judgment if summary judgment would otherwise be appropriate. That is, it does not have to be decided in all cases by a jury.
3. A certain amount of care must be used in the drafting of such clauses, however, and in the contract negotiations. Owners, designers, contractors and subcontractors should consult with knowledgeable legal counsel when embarking upon a contractual relationship where the parties, or some of them, wish to limit their exposure to liability for unforeseen losses of unpredictable magnitude.

Future Events in the Case

We predict this case will yield still more developments of great importance to Arizona's construction industry. For example, the Court of Appeals will likely provide guidance as to the bargaining process required to make such clauses a part of the contract and, therefore, binding on the parties. Moreover, the court could well comment on the confusing state of Arizona's economic loss rule, as the alleged losses were purely economic. If you wish to be advised of these, and other, developments of interest to construction industry participants and practitioners, send an e-mail to my assistant, Jeanne Moran, at jmoran@bffb.com, and request to be placed on our newsletter distribution list.

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