



Dealing with Limitation of Liability Clauses in Contracts

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Contracts are everywhere. A contract is simply an enforceable agreement, or the legal obligations stemming from that agreement.¹ With some exceptions, a contract need not be written, so even the purchase of a morning coffee is a contract.²

As the expectations associated with a contract get more complicated, a written contract can help ensure all parties have a clear understanding of what will occur during the performance of that contract. This written contract can have many names, including a Purchase Order.

Often, the process of creating a written contract is focused on items like the scope of work or the specifications of the item to be purchased and the price to be paid for that work or item. As such, sometimes the “legal terms” – things like the termination clause and the location for a lawsuit – are something of an afterthought. However, when negotiating a contract, it is important to consider what will happen in the event things do not go according to plan.

An indemnification clause – which “assigns the risk for a potential loss as part of the bargain of the parties”³ – is frequently one piece of that puzzle. Vendors are increasingly attempting to add another piece to the puzzle: a “Limitation of Liability” clause.

What is a Limitation of Liability Clause?

A Limitation of Liability clause seeks to limit a party’s financial exposure under a contract. These clauses are not new. They date at least to the 1830s, when stage coach operators – who would otherwise be liable for nearly any loss of a passenger’s baggage – attempted to limit their liability regarding baggage.⁴

Today, Limitation of Liability clauses often present themselves in two different ways. The first is a clause that limits the amount a vendor will pay to a municipality under any circumstances. This clause would provide something like: “IN NO EVENT WILL VENDOR BE LIABLE TO MUNICIPALITY FOR MORE THAN X.” Sometimes “X” will be a fixed number. Other times it will reference the contract amount or the amount actually paid to that point under the contract. It could also reference the amount of insurance the contract requires the vendor to carry. Even as vendors are increasingly looking to add this clause to contracts – and may even represent the clause as an “industry standard” – that does not mean that the amount of the vendor’s financial exposure is an industry standard.

The second is a clause that limits what the vendor will compensate the municipality for. This clause

would provide something like: “IN NO EVENT WILL VENDOR BE LIABLE FOR ANY INDIRECT, SPECIAL, OR CONSEQUENTIAL DAMAGES ARISING UNDER OR RELATING TO THIS AGREEMENT.” In general, the idea of this clause is that the vendor will only be responsible for damages that are direct and predictable.

Unlike an exculpatory clause – which seeks to relieve a party from all liability for harm caused by his or her own negligence⁵ – a Limitation of Liability clause seeks to cap a party’s liability. Accordingly, while Wisconsin courts have frequently found exculpatory clauses unenforceable,⁶ a court is likely to find a Limitation of Liability clause enforceable. For example, in 2005 the Wisconsin Supreme Court found a clause that limited a publishing company’s liability to the amount paid to the publishing company to be enforceable.⁷

Therefore, municipalities will want to be on the lookout for Limitation of Liability clauses when reviewing contracts and be aware of the ramifications from agreeing to a Limitation of Liability clause. The courts are unlikely to bail out a municipality that does not read the contract in question carefully, or that does not understand the terms of the approved contract.

1. See, e.g., Bouvier Law Dictionary.

2. Sometimes, a written contract is required. In order to enforce a contract for the sale of goods over \$500, Wisconsin does generally require “some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by the party’s authorized agent or broker.” Wis. Stat. § 402.20(1)

3. *Estate of Kriefall v Sizzler United States Franchise, Inc.*, 2012 WI 70 ¶ 34, 342 Wis. 2d 29, 816 N.W.2d 853.

4. See, e.g., *Hollister v Nowlen*, 19 Wend. 234 (N.Y. Sup. Ct. 1938); *Cole v. Goodwin & Story*, 19 Wend. 251 (N.Y. Sup. Ct. 1938); *Walker v. Skipwith*, 19 Tenn. (Meigs) 502 (Tenn. 1938).

5. *Merten v. Nathan*, 108 Wis. 2d 205, 210, 321 N.W. 2d 173 (1982).

6. The Wisconsin Supreme Court has not held that an exculpatory clause is “invalid per se.” *Atkins v. Swimwest Family Fitness Ctr.*, 2005 WI 4. However, in 2005, the Wisconsin Supreme Court did note that “each exculpatory contract that this court has looked at in the past 25 years has been held unenforceable.” *Rainbow Country Rentals & Retail, Inc. v. Ameritech Publ’g, Inc.*, 286 Wis. 2d 170, 706 N.W.2d 95 (2005).

7. *Rainbow Country Rentals & Retail, Inc. v. Ameritech Publ’g, Inc.*, 286 Wis. 2d 170, 706 N.W.2d 95 (2005).

Avoiding Limitation of Liability Clauses in the First Place

Before starting the procurement process, it is possible to take steps to make it clear that a contract containing a Limitation of Liability clause is not of interest to the municipality. This can help properly calibrate a vendor or prospective vendor's expectations. This could mean including language in a Request for Proposals, Solicitation for Services, or Invitation to Bidders expressing the municipality's lack of interest in a Limitation of Liability clause. It could also mean having a standard contract or set of Terms and Conditions that can be shared with potential vendors, rather than starting from a vendor's standard contract or Terms and Conditions. There can be value in establishing the contractual starting point.

Dealing with Limitation of Liability Clauses when They Arise

If Limitation of Liability clauses have not begun to appear in your municipality, they almost certainly will soon. There are several steps that can be taken to deal with a Limitation of Liability clause when it appears.

First, talk to the vendor. It can be helpful to understand where the vendor is coming from with respect to the Limitation of Liability clause. There may well be more than meets the eye regarding their inclusion of this clause. If that root cause can be identified, there may be a way to address the root cause that makes sense for both the vendor and municipality. This also would allow a municipality to respond to the vendor's actual issue rather than a municipality's

imagined version of the vendor's issue. Open dialogue can also help create goodwill with the vendor during the contract negotiation process.

Second, try to remove the Limitation of Liability clause. Cities across the state have had success in pushing back against these clauses. Even if a Limitation of Liability clause is an "industry standard," that does not mean it needs to be in your municipality's contract.

Third, if the vendor refuses to budge on the removal of the Limitation of Liability clause, consider whether contracting with that vendor is in the best interest of your municipality. There is almost certainly another vendor that provides a similar service or product. Even when not legally required, it can be worthwhile to use a Request for Proposal or similar public

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facing process to identify vendors that are interested in providing the service in question to your municipality. If nothing else, this can be helpful at establishing whether a clause truly is an “industry standard” in a given market in a given industry.

When considering whether contracting with a given vendor that insists on a Limitation of Liability clause is in the best interest of your municipality, think about what your municipality knows about the vendor. Is this a vendor that has done significant business with your municipality, leaving a track record of success? Or is it a vendor that has left mess after mess across the country as they go from town to town?

Fourth, is the amount of the liability cap reasonable in light of the potential liability resulting from the contract? In other words, does the amount stated in the clause actually adequately protect the municipality in the event a breach occurs? One relevant consideration is whether the vendor is looking to limit both the type of damage that is compensable and limit the amount that is paid. If so, it is important to think about how those two provisions are likely to interact in the event of an issue: Is the type of compensable damage so limited that it – not the maximum liability amount – is actually the limiting factor to a recovery?

Fifth, if you are unsuccessful at having the Limitation of Liability clause removed, but you still believe that contracting with this vendor is in the best interest of your municipality, think about how the Limitation of Liability clause interacts with the rest of the contract.

For example, how does the payment structure of a contract interact with the Limitation of Liability clause? If liability is limited to the amount actually paid under the contract, a vendor may

have minimal liability exposure early in the contract when not much has been paid to the vendor. At a minimum, limiting liability to the total amount of the contract rather than the amount actually paid under the contract creates a scenario where the municipality could recover damages beyond just getting its money back.

Similarly, how does any insurance provision in the contract interact with the Limitation of Liability clause? A detailed insurance provision requiring Commercial General Liability Insurance, Professional Liability Insurance, and an Umbrella Policy could be rendered almost meaningless – at least to the municipality – by a sufficiently low liability cap. If a municipality is unable to remove a Limitation of Liability clause, tying the liability cap to insurance amounts specified in the contract may – as a practical matter – put the municipality in a similar place as it would be without the Limitation of Liability clause.

Likewise, the Limitation of Liability clause could adversely impact an indemnification clause in the contract. If the vendor is fully indemnifying the municipality, but the contract has a sufficiently low liability cap, the indemnification clause could be much less useful than it appears at first blush.

Sixth, think about whether there should be carve outs to the Limitation of Liability clause. For example, even if the parties decide a Limitation of Liability clause is appropriate generally for a particular contract, it may not be appropriate for that clause to apply across the entire contract. For example, in a design contract if the vendor has guaranteed that the design will not infringe on anyone’s intellectual property rights, a carve out related to intellectual property ownership claims may – at a minimum – be appropriate.

Seventh, if you’ve gotten to this point, think about whether there is a benefit to making the Limitation of Liability clause mutual. In discussing Limitation of Liability clauses, the vendor is likely to suggest it is “unfair” that they bear “unlimited” liability risk for a contract. If that logic holds, and a Limitation of Liability clause is “fair,” then surely a mutual Limitation of Liability clause is also fair.

Conclusion

A Limitation of Liability clause is not lengthy, but it can create a number of wrinkles in an otherwise straightforward contract. Vendors are unlikely to simply stop asking for Limitation of Liability clauses to be included in contracts. Thus, municipalities must be on the lookout for Limitation of Liability clauses, and must think about how a vendor’s proposed Limitation of Liability clause can impact the municipality in the event of an issue. Limitation of Liability clauses should not be an afterthought, or something that gets thrown in at the end to get the contract across the finish line. These are clauses that should be identified early and dealt with thoughtfully keeping in mind the ripple effect they can leave throughout the entire contract.

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