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Take It to the Limit: The Outer Bounds of Limitation of Liability and Damage Limit Provisions in Construction Related Contracts



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Damage Limit Provisions in Construction Related Contracts**

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**Take It to the Limit:
The Outer Bounds of Limitation of Liability
and Damage Limit Provisions in Construction Contracting**

Jonathan J. Dunn

I. Introduction

From negotiated, “bet the company” EPC contracts, to routine purchase orders for equipment and materials, limitation of liability, damage limitation, indemnity and “exculpatory” provisions are part of many construction related contracts. These provisions mostly serve a valid purpose of facilitating transactions that might not otherwise occur where risk is high and price is low. Some of these provisions are hard-fought during negotiations, and others are routine and not considered controversial. There are clearly distinctions between these types of provisions. For instance, indemnity in its purest form allocates risk against third party claims, while an “exculpatory” clause would relieve one party from all liability without allocating responsibility. *See, e.g.,* Cathleen M. Devlin, *Indemnity & Exculpation: Circle of Confusion in the Courts*, 33 Emory L.J. 135, 170-71 (1984). Similarly, a limitation on *liability* – such as a consequential damages waiver that excludes a category of damages – is different from a *damage* limit – which affords for payment of a maximum amount regardless of the type of damages incurred. Yet, still, sometimes those drafting such provisions blur the lines and often courts have not always treated the various types of provisions distinctly. Collectively, this paper refers to the myriad of such similar provisions as limitation of liability provisions (“LOL provisions”).

This paper provides examples of the many types of LOL provisions found in construction related contracts, but its focus is on enforcement, and more specifically, how courts interpret LOL provisions when enforceable, and under what circumstances statutes or courts have prohibited or restricted their enforcement in whole or part. Although authorities vary vastly among jurisdictions, generally, statutes or decisional authority make enforcement of such provisions illegal when the provision effectively shields a party from egregious wrongful conduct. What is “wrongful” and the degree of conduct deemed egregious varies – sometimes drastically – depending on the sophistication of the parties to the contract and on jurisdictional case law. In some jurisdictions, even where otherwise enforceable, an “economic breach” may not be available to a party hoping to rely on such a provision because it is intentional and may be contrary to laws regulating the industry.

II. Limitation of Liability (LOL) Provisions: Types, Uses and Purposes in Construction Contracting

LOL provisions are found in owner-contractor agreements, designer agreements, subcontracts, hauling, equipment leasing, and purchase orders normally used for construction projects. This section explores the typical LOL provisions found in

construction related contracts, gives specific examples of heavily negotiated LOL provisions, and explores their purpose and justification.

A. LOL Provisions Are Standard Fare In Many Construction Related Contracts, and Address and Allocate Numerous Risks

LOL provisions take numerous forms and are quite common in construction related contracts. For example, the American Institute of Architects® (“AIA®”) and Consensus DOCS® forms both include LOL provisions in the form of mutual waivers of consequential damages (CONSENSUS DOCS® 200, Section 6.6; AIA® A201, Section 15.1.6). Also, like most construction contract, liquidated damages are suggested for owner damages for delay.

The industry standard forms are not atypical, as manuscript forms also exclude or limit liability on numerous categories of otherwise recoverable damages. Even without contractual provisions, there are limits to recoverable damages, but these limits are subject to complex and inconsistently applied legal doctrines such as, for example, “proximate cause” concerning tort damages (See generally 6 Philip L. Bruner & Patrick J. O’Connor, Jr., Bruner & O’Connor on Construction Law §§19:5 (West Publ. 2012 Ed., incl. 2020 Suppl.) (hereafter, “Bruner & O’Connor OCL §_”)) and “foreseeability” concerning breach of contract damages (See, 6 Bruner & O’Connor OCL §19:15), as well as related doctrines developed through case law. See, e.g., 6 Bruner & O’Connor OCL §§19:6-13 (tort damage limitations) and §§19:17-34 (contract law damage limitations).

Sometimes LOL provisions are obvious and labeled as such. In many instances, however, LOL provisions have developed distinct names of their own. For instance, the following are all LOL provisions to the extent they limit damages, liability, or exculpate a party in whole or part:

<u>Provision</u>	<u>Description of LOL Result</u>
Indemnity	Where not prohibited, may limit liability of a negligent party to “active negligence,” “sole negligence,” “gross-negligence,” or intentional wrongful acts (i.e., allowing a party to escape damages for lessor culpable conduct, like e.g., “passive negligence”).
Waiver of Consequential Damages	Limits liability for a category of damages, namely, consequential or “special” damages.
No Damage for Delay	Limits liability for a category of damages, namely delay damages

<u>Provision</u>	<u>Description of LOL Result</u>
Pay If / When Paid	Limits liability for interest (pay-when-paid) or excuses liability in event of owner non-payment
Exclusive remedy	Limits liability for various damages and limits the remedy available (i.e., repair or replacement, or available insurance)
Force Majeure	Limits contractual liability for performance when certain conditions develop
Termination for Convenience	Often limits recovery of certain damages (e.g., lost profits)
Disclaimers	Limits liability for certain circumstances (i.e., disclaimer of implied warranties or from all liability as a condition of use / service)
Waivers of Subrogation / Controlled Insurance	Limits recovery from responsible parties after insurers cover a loss
(Insufficient) Liquidated Damages	Often limits the liability of a party for delay damages to an amount typically less than actual delay damages
Liquidated Damage Caps	Limits the liability of a party for delay damages to a maximum amount usually less than actual damages
Limitations of Liability and Damage Limits	Limits liability of a party to a maximum dollar amount, regardless of larger damages incurred

It is not the intent of this paper to address each of the many LOL provisions at length, as several scholarly works address the myriad of such provisions in more detail, including many of those that have developed their own distinct body of law. *See generally* 6 Bruner & O'Connor OCL §§19:52 – 19:73. Instead, this paper will focus on a few heavily negotiated LOL provisions and, more particularly, statutes and case law that set restrictions to their enforcement.

B. Common Examples of Heavily Negotiated LOL Provisions

In states where they are not prohibited or restricted (see section III below), heavily negotiated LOL provisions may include indemnity, dollar limits or insurance based limits (including liquidated damages limits), and waivers of consequential damages.

1. Indemnity Provisions

Where free to do so and where bargaining power allows, broad indemnity provisions are often negotiated into contracts. “Indemnity” is defined as follows:

Indemnity is a contract by which one engages to save another from a legal consequence of the conduct of one of the parties or of some other person.

N.D. Cent. Code, § 22-02-01; *See also*, Cal. Civ. Code 2772; Mont. Code Ann., 28-11-301. To the extent indemnity seeks to save the contractee / indemnitee from the legal consequences of the contractee’s / indemnitee’s own conduct, it is an exculpatory provision (or LOL provision). The degree of exculpation has led some courts to describe these provisions as “type I,” “type II,” or “type III” indemnity provisions, explained as follows:

A **type I indemnity** agreement provides " 'expressly and unequivocally' that the indemnitor is to indemnify the indemnitee for, among other things, the negligence of the indemnitee."

A **type II indemnity** agreement provides the indemnitee is indemnified for his own acts of passive negligence, but not his own acts of active negligence. ... Typical language is "'howsoever same may be caused' [citation] or 'regardless of responsibility for negligence' [citation], or 'arising from the use of the premises, facilities, or services of [the indemnitee]' [citation], or 'which might arise in connection with the agreed work' [citation], or "caused by or happening in connection with the equipment or the condition, maintenance, possession, operation or use thereof " ' [citation], or 'from any and all claims for damages to any person or property by reason of the use of said leased property' [citation]." (Ibid.)

A **type III indemnity** agreement provides indemnification for liabilities caused by the indemnitor, but does not provide indemnification for liabilities caused by anyone else.

Heppler v. J.M. Peters Co. (1999, Cal.App.) 73 Cal. App. 4th 1265, 1276-1277 (Fn. 7) (citing *MacDonald & Kruse, Inc. v. San Jose Steel Co.*, . (1972) 29 Cal. App. 3d 413, 419-420) (Emphasis added.).

Judicial interpretation may equate “indemnity” to “exemption” from liability:

[W]e read the word "indemnify" as used in AS 45.45.900 to mean "exempt," and thus construe AS 45.45.900 to prohibit

limitation of liability clauses. Absent legislative action to the contrary, such an interpretation best fulfills the legislature's express intent to prevent a party to a construction contract from bargaining away liability for his or her own negligent acts.

City of Dillingham v. CH2M Hill Northwest, Inc. (1994 S. Ct. Alas.) 873 P.2d 1271, 1277-1278; *See also, Bicknell v. Richard M. Hearn Roofing & Remodeling, Inc.*, 171 Ga. App. 128, 318 S.E.2d 729, 731-32 (Ga. App. 1984).

Indemnity provisions are often heavily negotiated for obvious reasons: they force a party perhaps at lesser fault or without fault, often based on unsubstantiated claims in pleadings, to defend and/or pay for a party who may be at fault.

2. Liability and Dollar Limit Provisions

Especially in engineering and other services contracts where the fee is low compared to the cost of the overall project, liability and dollar limit LOL provisions are often sought to shield design professionals from large losses. Sometimes these provisions are tied not to a specific maximum dollar amount, but instead to insurance products that cover errors and omissions.

Consider the case of *Florida Power & Light Co. v. Mid-Valley, Inc.*, (11th Cir., 1985) 763 F.2d 1316. In *Florida Power*, Florida Power as owner contracted with Mid-Valley to design, engineer, survey and oversee construction of a cooling water reservoir. After project completion, there was a sudden collapse and failure of an embankment of the reservoir. Florida Power sued Mid-Valley and others performing design services (sub-consultants) for negligence. The design services contract contained the following LOL provision:

Paragraph VIII

(8) Engineer shall provide the following insurance: [omitted for brevity]. Upon written request of Owner received within five days of the acceptance hereof, Engineer will provide additional insurance, if available including increased coverage and/or limits, and the Owner will pay Engineer an agreed amount for the increased coverage. ***Engineer's liability to Owner for any indemnity commitments or for any damages arising in any way out of the performance of this contract is limited to such insurance coverages and amounts. In no event shall Engineer be liable for any indirect, special or consequential loss or damage arising out of the performance of services hereunder including, but not limited to, loss of use, loss of profit, or business interruption whether caused by negligence of Engineer, or otherwise, and Owner shall indemnify and hold***

Engineer harmless from any such damages or liability.
(emphasis supplied).

Florida Power & Light Co. v. Mid-Valley, Inc., 763 F.2d at 1318. The court strictly construed the provision, but noted that negligence was expressly mentioned, and dismissed the negligence claim.

Similarly, it is common for service providers with relatively small fees to include LOL provisions similar the following dollar based on specific dollar amounts:

Engineer's liability to Owner for any indemnity or any damages arising or relating in any way to this contract or services contemplated herein, whether due to breach, negligence or otherwise, is limited to the amount of the fees payable to Engineer hereunder or \$50,000.00, whichever is greater, regardless of the type of damages incurred by Owner, whether direct, consequential, incidental or otherwise.

See, e.g., Markborough Cal. v. Superior Court (1991 Cal. App.) 227 Cal. App. 3d 705.

Assuming the wrongdoer has no significant deductible and will not be adversely affected in future premiums, arguably, LOL provisions tied to available insurance are particularly problematic for the aggrieved party in pursuing designers. Arguably, such provisions completely remove any responsibility from the wrongdoer (other than reputation, there is no financial repercussion) and give no incentive of the wrongdoer to mitigate damages. Additionally, such provisions are especially problematic when tied to “available proceeds” in professional liability insurance cases, as these policies are often “claims made” with “burning limit” policies. Thus, even if some measure of relief is available at the time of the claim, the insured typically has a right to refuse to settle and the injured party will receive less and less of the remaining policy amount as the insured defends the claim.

3. Consequential Damage Waivers (Scope)

It is common for service providers, including contractors and designers, to insist upon consequential damage waiver provisions. While not uncommon, the scope of these provisions varies based on specific language used in the agreement between the parties. As set forth above, such provisions are included in two of the industry’s key forms. CONSENSUS DOCS® 200 provides:

6.6 LIMITED MUTUAL WAIVER OF CONSEQUENTIAL DAMAGES. Except for damages mutually agreed upon by the Parties as liquidated damages in Paragraph 6.5 and excluding losses covered by insurance required by the Contract against

each other for any consequential damages that may arise out of or relate to this Agreement, except for those specific items of damages excluded from this waiver as mutually agreed upon by the Parties and identified below. The Owner agrees to waive damages including but not limited to the Owner's ***loss of use of the Project, any rental expenses incurred, loss of income, profit or financing related to the Project, as well as the loss of business, loss of financing, principal office overhead and expenses, loss of profits not related to this Project, loss of reputation, or insolvency.*** The Contractor agrees to waive damages including but not limited to ***loss of business, loss of financing, principal office overhead and expenses, loss of profits not related to this Project, loss of bonding capacity, loss of reputation, or insolvency.*** The following items of damages are excluded from this mutual waiver: ... (Emphasis added.)

Similarly, AIA® A201 (General Conditions) (2017) also includes a parallel provision:

§ 15.1.6 CLAIMS FOR CONSEQUENTIAL DAMAGES

The Contractor and Owner waive Claims against each other for consequential damages arising out of or relating to this Contract. This mutual waiver includes

- .1 damages incurred by the Owner for ***rental expenses, for losses of use, income, profit, financing, business and reputation, and for loss of management or employee productivity or of the services of such persons;*** and
- .2 damages incurred by the Contractor for ***principal office expenses including the compensation of personnel stationed there, for losses of financing, business and reputation, and for loss of profit*** except anticipated profit arising directly from the Work. (Emphasis added.)

These forms set forth examples of damage categories that come within the definition of consequential damages not merely to be helpful to the parties, but likely because state law has been less than consistent with categorizing damages between those that are “direct” and those that are “consequential.” *See, B. Wheatley and R. Canche, Navigating the Labyrinth of Consequential Damages in the Construction Industry: A History of and Legal Approaches to Living with Them, The Construction Lawyer, Vol. 33, No. 3, Summer 2013, at p. 6.* Thus, sage advice to scriveners on this subject is as follows:

When drafting the waiver, carefully consider the type of exposure you want to limit. This understanding must be implemented into the construction contract language to provide clarity to the ever-elusive definition of consequential damages and perhaps avoid years of litigation over what are and what are not consequential damages.

Id. Further, authors should consider carefully to the extent of consequential damages the other party may incur to ensure true mutuality of consequential damage waiver provisions. See, Ty D. Laurie and Jessica Manning, *AIA A201's "Mutual" Waiver of Consequential Damages*, Construction Law Corner Newsletter, Fall 2015.

C. Purpose and Justification for Use of LOL Provisions

The court in *BB Syndication Servs. v. LM Consultants*, 2011 U.S. Dist. LEXIS 23888, at 18, 2011 WL 856646 (2011 N. D. Ill) stated the reasons for allowing LOL provisions as follows:

The factors favoring enforcement of [LOL provisions] include allowing parties to control their exposure to risk, avoiding the uncertainty, delay and expense of the judicial process, allowing parties to create a “remedy consistent with the economic efficiency in a competitive market,” as well as general policy considerations favoring freedom of contract.

In the words of one author,

Without [exculpatory provisions], providers of goods and services would be forced to litigate more lawsuits, which would increase consumer costs and reduce the availability of goods and services in the marketplace.

See, Holden Branscum, COMMENT: *Enforceability of Exculpatory Clauses: Judicial Declarations of Public Policy as a Means to Promote Freedom of Contract in Tennessee*, 51 U. Mem. L. Rev. 811, 811-812 (2021).

Thus, there can be little doubt that to cover potential liability, certain transactions would either have to be re-priced so high they would be cost-prohibitive. In this sense, enforceable LOL provisions facilitate a great many transactions that may not otherwise occur, preventing the presumed majority of transactions that are successful without any party incurring damages from taking place.

III. Statutory Limits to Enforcement of LOL Provisions

Many states have enacted statutory restrictions, or boundaries, addressing parties' abilities to negotiate LOL provisions in certain circumstances. These restrictions

sometimes apply broadly, or sometimes narrowly based on the type of LOL provision included in the contract. These statutes often fall into three categories: (i) indemnity specific statutes, (ii) other specific statutes, or (iii) broader statutes aimed at preventing provisions exculpating a “wrongdoer” from the consequences of its actions or inactions.

A. Indemnity Statutes

Indemnity provisions have often been viewed as tools of those with superior bargaining power to unfairly shift liability for their actions or inactions in certain circumstances to those with less bargaining power. Because many construction contracts, especially in public contracting, allow the owner to dictate contract terms and involve competitive bidding, unless prohibited by law an owner may dictate broad and favorable language in its favor, shifting or exculpating itself from exposure to losses for its own conduct. Unequal bargaining power and harsh indemnity provisions led many state legislatures to enact legislation in response.

For instance, a number of states have now prohibited the use of exceptionally broad indemnity provisions that limit one party’s liability in various instances. The statutes vary, with some aimed at actions or inactions involving one party’s sole fault, others restrict language in active negligence, gross-negligence, and intentional wrongful conduct, and yet still other statutes prohibit language allocating responsibility for any negligence to the extent it might exculpate a party for its proportionate liability. *See, e.g.*, Alaska Stat. § 45.45.900 (exception for hazardous substances); Ariz. Rev. Stat. §§ 32-1159, 34-226, 41-2586 (with certain exceptions); Ark. Code §§ 4-56-104 and 22-9-214; California Civ. Code §§ 2782 and 2782.05 (effective with Contracts entered after Jan. 1, 2013)(*But, See*, Section III.C. below); Colo. Rev. Stat. §§ 13-50.5-102; 13-21-111.5; Conn. Gen. Stat. § 52-572k; Del. Code, Title 6, § 2704; Ga. Code § 13-8-2; Hawaii Rev. Stat. § 431:10-222; Idaho Rev. Stat. § 29-114; Ill. Compiled Stat., 740 I.L.C.S. § 35/0.01, et seq.; Ind. Code § 26-2-5 (exceptions apply); Iowa Code § 537A.5 (exceptions apply); Kansas Stat. § 16-121 (exceptions apply); Kentucky Rev. Stat. § 371.180; La. Rev. Stat. § 38:2216.G (limited application); Md. Code. Ann., Cts. & Jud. Proc. § 5-401; Mass. Gen. Laws, ch. 149, § 29C (limited application); Minn. Stat. § 337.02 (exceptions); Miss. Code § 31-5-41; Mo. Rev. Stat. § 434.100; Mont. Rev. Code § 28-2-2111 (exceptions); Neb. Rev. Stat. § 25-21,187; Nev. Rev. Stat. § 40.693 (exceptions); N.H. Rev. Stat. §§ 338-A:1 (design professionals) and 338-A:2 (construction contracts); N.J. Stat. § 2A:40A-1; N.M. Stat. § 56-7-1; N.Y. Gen. Oblig. Laws § 5-322.1 (limited application); N.C. Gen. Stat. § 22B-1; N.C. Gen. Stat. § 22B-1; Ohio Rev. Code § 2305.31; Okla. Stat. § 15-221; Or. Rev. Stat. § 30.140; Pa. Stat., Title 68, § 491 (limited application); R.I. Gen. Laws § 6-34-1; S.C. Code § 32-2-10; S.D. Codified Laws § 56-3-18; Tenn. Code § 62-6-123; Tex. Insurance Code Ch. § 151; Utah Code § 13-8-1 (exceptions apply); Va. Code § 11-4.1; Wash. Rev. Code § 4.24.115; W.Va. Code § 55-8-14; and Wis. Stat. § 895.447.

As set forth above, in Alaska, the restrictions stemming from an indemnity statute were interpreted to apply more broadly than to indemnity provisions, but rather were applied to LOL provisions generally. See, *City of Dillingham v. CH2M Hill Northwest, Inc.* (1994 S. Ct. Alas.) 873 P.2d 1271. Other courts have distinguished indemnity from other types of LOL provisions, including damage limits and waivers of consequential damages. For instance, consider *US Nitrogen, LLC v. Weatherly, Inc.*, 343 F. Supp. 3d 1354 (2018 N. D. Ga.). In *US Nitrogen*, an engineering design firm negligently designed an ammunition nitrate solution plant, resulting in significant tear out and replacement of concrete, mechanical piping, and other work costing the owner more than \$30 million. The design agreement contained a limitation of damages cap at fifteen percent (15%) of its price for the services, as well as a waiver of consequential damages. The court distinguished indemnity against third party claims from LOL provisions addressing direct and consequential damages due to breach and negligence between sophisticated commercial parties, and enforced the LOL provisions, restricting the Owner's claim for damages to the \$3 million fee.

One outcome of the numerous and varying state statutes is extra work for lawyers who draft agreements for multi-state contracting parties, often requiring assistance from local lawyers or substantial legal research to ensure compliance with the applicable jurisdiction's law. In some states, it may not be clear if an illegal indemnity provision violating the applicable indemnity statutes means a court will treat the offending contract as if no indemnity provision exists at all, or if instead it will simply restrict the illegal indemnity provision to the scope allowed in the statute. Still, where allowed, indemnity provisions are often the most fiercely negotiated of LOL provisions.

B. Miscellaneous Specific Statutes

Some states have specific statutes preventing certain parties from using certain LOL provisions in certain construction contracting scenarios.

For instance, in Florida as in a number of states, statutes exist addressing advance waiver of lien rights and pay-if-paid provisions. Fla. Stat. §713.20(2) (2001); *See also*, Cal. Civ. Code §8122; Del. Code. Ann. tit. 6 § 3507 (e); A. L. Mass. GL ch. 149, § 29E; Mont. Code Ann. § 28-2-723; Nev. Rev. Stat. Ann. §§ 624.624-624.626 (as interpreted by *Lehrer McGovern Bovis, Inc. v. Bullock Insulation, Inc.*, 124 Nev. 1102 (Nev. 2008)); NY General Obligations Law §5-322.1; NY Lien Law § 34; N.C. Gen. Stat. § 22C-2; Ohio Rev. Code § 4113.62(E); S.C. Code Ann. § 29-6-230; Vir. Isl. Code Ann. tit. 28, §§ 251 – 270 (as interpreted in *Shearman & Assocs. v. Continental Cas. Co.*, 901 F. Supp. 199 (1995, D. Vir. Isl.)).

Numerous other statutes address other specific issues in construction. Arizona has a constitutional article (Ariz. Const. art. XVIII, § 5) that defers enforcement of LOL provisions to a jury as a question of fact: “the validity of an express

contractual assumption of risk is a question of fact for a jury, not a judge.” *Phelps v. Firebird Raceway, Inc.*, 210 Ariz. 403, 111 P.3d 1003, 1010 (2005).

California is perhaps most prolific in enacting statutes regulating the construction industry, having statutory schemes for licensing of contractors, their discipline, and restrictions on certain terms for persons contracting with licensed contractors (Cal. Bus. & Prof. Code §7000, et seq.), both public and private contracting (Cal. Civil Code §8000 et. seq.), and specifically related to public contracting under the California Public Contracting Code. For example, California has the following statutory restrictions:

Cal. Pub. Cont. Code §1104 (forbidding local public agencies from transferring risk of design errors or omissions to the contractor, except in clearly marked design-build projects);

Cal. Pub. Cont. Code §7102 (no damage for delay clauses in prime and subcontracts deemed illegal as a matter of public policy on public improvement contracts for areas below four (4) feet);

Cal. Pub. Cont. Code §7104 (mandating type I and type II differing site conditions, and environmentally hazardous site conditions provisions into public contracts);

Cal. Civ. Code §2782 (making void and unenforceable indemnity provisions in construction contracts that shift risk for sole negligence or willful misconduct, and void the same with respect to active negligence risk shifting after 2013; provided, however, there are certain exceptions as allowed in certain other Civil Code sections).

Interestingly, within the indemnity section of the California Civil Code, there is also a specific provision **allowing** LOL provisions. Cal. Civ. Code §2782.5. California Civil Code Section 2782.5 provides:

§2782.5 Allocation or limitation of liability

Nothing contained in Section 2782 shall prevent a party to a construction contract and the owner or other party for whose account the construction contract is being performed from negotiating and expressly agreeing with respect to the allocation, release, liquidation, exclusion, or limitation as between the parties of any liability (a) for design defects, or (b) of the promisee to the promisor arising out of or relating to the construction contract.

Although Cal. Civ. Code §2782.5 is broadly written, the *Markborough* court also reconciled this statute with the indemnity statute, concluding:

First, the anti-indemnity statute, section 2782, was intended to change the law to prohibit one party to a construction contract from avoiding liability to third parties because of its sole negligence by forcing the other party to the contract to provide indemnification. Secondly, we believe section 2782.5 was not intended to change existing law but rather was intended merely to reaffirm and clarify that limitation of liability provisions remain valid notwithstanding section 2782.

Id., at 712.

Accordingly, outside of specific restrictions for indemnity provisions with respect to third-party liability, *Markborough* left to the courts on a case-by-case basis a determination of whether the LOL provisions (other than indemnity provisions in construction contracts) were permissible under case law and other statutes setting forth California public policy. Further, *Markborough Cal. v. Superior Court*, (1991 Cal. App.) 227 Cal. App. 3d 705, a widely cited court of appeal decision, determined that the statutory words “negotiating and expressly agreeing” in the commercial context simply means the party complaining of the LOL provision had an opportunity to accept or reject the provision. This has been harmonized to include signed work-orders in the field that included LOL provisions if a history of signing them exists between the parties (*Marin Storage & Trucking, Inc. v. Benco Contr. & Eng’g, Inc.*, (2001 Cal. App.) 89 Cal. App. 4th 1042), but not to include unilaterally scripted, unsigned invoices and bills of lading (*C9 Ventures v. SVC-West, L.P.*, (2012 Cal. App.) 202 Cal. App. 4th 1483).

C. Broader Policy Statutes

Some states have broad “public policy” statutes restricting contracting parties ability to use LOL provisions to shield themselves liability for certain actions and inactions. For instance, Cal. Civ. Code 1668 provides as follows:

§ 1668. Certain contracts unlawful

All contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or **violation of law, whether willful or negligent**, are against the policy of the law. (Emphasis added.)

Similarly, Montana also has a statutory prohibition for any contracts to have as their object, directly or indirectly, the exemption of anyone from responsibility for their own fraud, their willful injury to the person or property of another, or for their willful or negligent violation of the law. Montana Code Ann. § 28-2-702.

IV. Judicial Limits to Enforcement of LOL Provisions

Outcomes for disputes in the contracting industry – consistent with its name – are mostly controlled through the law of contracts. In a broad legal sense, most of the time, contract law remedies and contract damage theories are applicable. It is quite common, however, for a plaintiff to assert tort claims in addition to or alternatively to contract claims against a construction industry defendant. LOL provisions are often an issue at this intersection of tort and contract law.

Courts have struggled with this intersection. One author noted:

Where state law is silent, generally it is left to the state's courts to determine the enforceability of an exculpatory clause. Therefore, each state's highest court must define the appropriate balance between the freedom to contract and the public policy concerns involved in exculpating tort liability. As with many common law rules, state courts create complicated distinctions and caveats over time, which lower courts must then attempt to reconcile.

Tennessee is no exception, and this area of the law is vague and troubled with confusion. For nearly fifty years, contracting parties and legal practitioners in Tennessee have grappled with exculpatory clauses, as the Tennessee Supreme Court has struggled to clearly define their enforceability.

H. Branscum, COMMENT: *Enforceability of Exculpatory Clauses: Judicial Declarations of Public Policy as a Means to Promote Freedom of Contract in Tennessee*, 51 U. Mem. L. Rev. 811, 812-813.

The California Supreme Court summarized the struggle as follows:

'the law has looked carefully and with some skepticism at those who attempt to contract away their legal liability for the commission of torts.' Courts and commentators have observed that such releases pose a conflict between contract and tort law. On the one hand is the freedom of individuals to agree to limit their future liability; balanced against that are public policies underlying our tort system: as a general matter, we seek to maintain or reinforce a reasonable standard of care in community life and require wrongdoers – not the community at large – to provide appropriate recompense to injured parties. [Citation omitted.]

City of Santa Barbara v. Superior Court (2007) 41 Cal.4th 747, at p. 754.

Outside of disputes between sophisticated commercial parties, generally, many states apply an “unconscionability” type analysis based on various factors. As lamented by one author:

The problem with determining the enforceability of an exculpatory clause is not a lack of rules or case law - the problem is that there are too many rules. Because exculpatory clauses are a matter of contract law, each state's supreme court is the authoritative interpreter of these provisions. Therefore, the Supreme Court of the United States is only able to promulgate rules dealing with exculpatory clauses where federal statutes are concerned. Since there is not a single bright-line rule to apply, every state has had to come up with their own set of standards, factors, or elements. Some states have chosen to follow California in the usage of the *Tunkl* factors, [] other states have considered the Restatement (Second) of Contracts, [] and even more have cherry-picked elements and factors from both to create a new standard. [] While having so many rules to choose from may not seem like a bad idea, having too many standards can make the process of analyzing exculpatory provisions ineffective.

Several states have created methods for examining exculpatory clauses - resulting in several different tests and numerous unique factors. Unfortunately, having too many tests to choose from only causes confusion when attempting to analyze an exculpatory clause.

Maggie Lu, [COMMENT: Against Public Policy: Enforceability of Exculpatory Clauses](#), 60 *S. Tex. L. Rev.* 497, 498 (Summer, 2019) (citing in footnotes, *Tunkl v. Regents of Univ. of Cal.*, (1963 Cal. Supr. Ct.) 60 Cal. 2d 92; Restatement (Second) of Contracts § 195 (Am. Law Inst. 1981); *Morgan v. South*, 466 So. 2d 107, 117 (Ala. 1985); *Anchorage v. Locker*, 723 P.2d 1261, 1265 (Alaska 1986); *Tunkl*, 383 P.2d at 444-47; *Hanks v. Powder Ridge Rest. Corp.*, 885 A.2d 734, 744 (Conn. 2005); *Baker v. Stewarts' Inc.*, 433 N.W.2d 706, 708 (Iowa 1988); *Berlangieri v. Running Elk Corp.*, 76 P.3d 1098, 1109 (N.M. 2003).

A. Many Courts Enforce LOL Provisions for Breach of Contract Disputes Where Language is Clear and Unequivocal

LOL provisions have traditionally found disdain in the courts even where they are enforced. Consider the comments of one court construing an indemnity provision:

Our "judicial policy of disfavor" towards such clauses, *Auto Owners Mutual Ins. Co. v. Northern Ind. Public Service Co.*

(7th Cir. 1969), 414 F. 2d 192, 195, is grounded in the recognition that the obligation to insure another party against the cost of the other's own negligence is "so extraordinary and harsh . . .," *Buford v. Sewerage and Water Bd.* (1937), Orl. La. App., 175 So. 110, 113, with "the potential liabilities assumed . . . awesome", *Auto Owners Mutual Ins. Co. v. Northern Ind. Public Service Co.*, *supra*, that a promisor would not lightly accept such a burden knowingly and willingly. Our decision today simply implements that judicial policy.

.... The contractor who knowingly and willingly promises to indemnify the contractee for the latter's negligence may not successfully complain if such a requirement was made explicit by the terms of the contract.

Even casual research reveals a vast number of reported opinions filled with vehement controversy over the meaning of phrases, words, and punctuation in contractual provisions purporting to require one party to bear the burden of the other's negligence. *See 27 ALR 3d 663; 68 ALR 3d 7.* We are not so foolish to think that by requiring explicit language the amount of litigation upon this subject in Indiana will be appreciably reduced. But we concur with the views expressed by the dissent in *Jordan v. City of New York* (1957), 3 App. Div. 2d 507, 514, 162 N.Y.S. 2d 145, 152, *aff'd.*, 5 N.Y. 2d 723, 177 N.Y.S. 2d 709, 152 N.E.2d 667:

"The lawyers who specialize in this field are well aware that clauses such as those under consideration in this case demand laborious judicial parsing, in an effort to distill the intent of the parties. Surely, at this stage, it is not too much to require them to stop waging verbal duels and to state unmistakably whether or not a contract purports to burden the indemnitor with another's negligence."

Indiana State Highway Com. v. Thomas, (1976 Ind. Ct. App.) 169 Ind. App. 13, 31-32, 346 N.E.2d 252, 263-264. *Accord, Orkin Exterminating Co. v. Montagano* (Fla. 4th D.C.A. 1978), 359 So. 2d 512, 514 ("We must require draftsmen of all contracts which contain them [exculpatory clauses] to use clear and unequivocal language totally without a hint of deceptive come-on, or inconsistent clauses.").

Still, in the context of disputes between commercial entities, to the extent not prohibited or restricted by statute (e.g., indemnity statutes), many courts will enforce a clear and unequivocally worded LOL provisions as long as intentional misconduct is not at issue. *See, Ivey Plants, Inc. v. FMC Corp.*, (1973 Fla. App.)

282 So. 2d 205; *Florida Power & Light Co. v. Mid-Valley, Inc.* (11th Cir. 1985), 763 F.2d 1316; *Markborough Cal. v. Superior Court* (1991 Cal.App.) 227 Cal. App. 3d 705;

The opinion in *Rutter v. Arlington Park Jockey Club*, summed up how a number of courts view the issue when part a dispute between sophisticated commercial entities:

[I]n Illinois, at least when contracts between parties of relatively equal bargaining strength are be construed, the risk that a party will be guilty of negligence is treated like any other commercial risk that may cause harm to the other party to a commercial transaction. In the evaluation of foreseeable commercial risks, Illinois seems to attach greater importance to the commercial interest in certainty than to the policy of deterring negligence.

510 F.2d 1065, 1067 (7th Cir. 1975).

However, the case of *BB Syndication Servs. v L.M. Consultants, Inc.*, (2011 N.D. Ill.) 2011 U.S. Dist. LEXIS 23888, 2011 WL 856646, is instructive on how enforcement may vary from state to state. In *BB Syndication*, BB Syndication was a construction lender who contracted with L.M. Consultants for pre-construction cost estimating services, and post loan schedule, quality, change order, payment and construction observation incident its construction loan to a developer. L.M. Consultants – as part of pre-construction services – estimated the project could be built for \$34M. However, after BB Syndication disbursed \$26M (75% of the loan/cost estimate) during construction, and after the developer defaulted on the loan, L.M. Consultants reported that another \$34.5M would be required to complete construction of the project. The consultant defended breach of contract, negligence, and negligent misrepresentation claims based on an LOL provision limiting recovery to fees paid the consultant.

The *BB Syndication* LOL provision applied to “all claims arising out of, in connection with, or resulting from the performance of th[e] [a]greement” between the parties. Analyzing both Illinois and Wisconsin law, applying the economic loss rule and factors akin to unconscionability, the court enforced the LOL provision and limited the lender’s claims, concluding that both Illinois and Wisconsin law support enforcement. However, if the court would have applied California law where “negligent misrepresentation” is a species of fraud, not negligence, query whether the result would have been different. *See, Continental Airlines, Inc. v. McDonnell Douglas Corp.* (1989) 216 Cal.App.3d 388, 404 (“[A] cause of action for negligent misrepresentation is included within the meaning of the word ‘fraud’ in [California Civil Code] section 1668”); *Frittelli v. 350 North Canon Drive, LP*, 202 Cal.App.4th 35, 43 [citing *City of Santa Barbara v. Superior Court* (2007) 41 Cal.4th 747, 777 (addressing “gross-negligence”); *see*

also *Jung Jae Lee v. Fed. St. L.A., LLC* (C.D. Cal. May 3, 2016) 2016 U.S. Dist. LEXIS 59423, at 28-29.).

Not every jurisdiction allows LOL provisions for personal injury, however. The Supreme Court of Virginia has unequivocally held that public policy forbids the enforcement of a release or waiver for personal injury caused by future acts of negligence. (See *Johnson's Adm'x v. Richmond and Danville R.R. Co.*, 86 Va. 975, 978, 11 S.E. 829, 830 (1890); *Hiett v. Lake Barcroft Community Assoc.*, 244 Va. 191, 194-195 (1992).

B. Many Courts “Strictly Construe” LOL Provisions to Limit Their Scope and Application

Even in commercial disputes cases, LOL provisions are generally strictly construed in most states against the party seeking to enforce them. *Nunes Turfgrass, Inc. v. Vaughan-Jacklin Seed Co.* (1988) 200 Cal.App.3d 1518, 1538; *Peregrine Pharms, Inc. v. Clinical Supplies Mgmt.*, *supra*, 2014 U.S. Dist. LEXIS 1057756 at 18-19. Some states construe such clauses according to their nature, which are, in effect, forfeiture provisions that are to be construed so as to avoid a forfeiture of rights. A long established rule in California, if an agreement can be reasonably interpreted so as to avoid a forfeiture, it is the duty of the court to avoid it. *Universal Sales Corp. v. Cal. etc. Mfg. Co.* (1942) 20 Cal.2d 751, 771. Because forfeitures are disfavored, any inconsistent acts or dealings by the party claiming a forfeiture will be regarded as a waiver thereof. *Bank of America Nat'l Trust & Sav. Asso. v. Cranston* (1967) 252 Cal.App.2d 208, 214. Further, these courts may shift the burden of establishing the right to a forfeiture to the one claiming that right (*Horning v. Ladd* (1958) 157 Cal.App.2d 806, 810) and require the amount of evidence to establish forfeiture be much greater than that required to establish waiver, as waiver is inferable from the acts and conduct of the parties. *Loughan v. Harger-Haldeman* (1960) 184 Cal.App.2d 495, 502.

These courts require that the contract “clearly set out what negligent liability is to be avoided.” See, e.g., *Ingersoll-Rand Co. v. El Dorado Chem. Co.*, 283 S.W.3d 191 (Ark. 2008). This generally means that the courts require the exculpatory clause to be clear and unambiguous. For instance, if negligence is sought to be avoided, some courts require that the word “negligence” be specifically included and that the waiver explicitly state the type of negligence being waived to distinguish between losses resulting from inherent risks and those resulting from fault or wrongdoing. *Slowe v. Pike Creek Court Club, Inc.*, 2008 WL 5115035 (Del. Super. 2008). Thus, in such states, courts have found that where such provisions do not expressly reference negligence or tortious conduct, they only limit liability at most for passive negligence:

For an agreement to be construed as precluding liability for ‘active’ or ‘affirmative’ negligence, there must be express and

unequivocal language in the agreement which precludes such liability.

Burnett v. Chimney Sweep (2004) 123 Cal.App.4th 1057, 1066-1067. *See also, Salton Bay Marina, Inc. v. Imperial Irrigation Dist.* (1985 Cal. App. Ct.) 172 Cal.App.3d 914; *Peregrine Pharms, Inc. v. Clinical Supplies Mgmt.*, 2014 U.S. Dist. LEXIS 105756 at 44-42.

[Cases] which enforced liability limitation clauses against negligence claims – all include contractual provisions which expressly and unequivocally stated the parties’ intent to limit liability for negligence. [Citations omitted]. Because there is no similar expression of contractual intent in the MSA, the Court finds that the [LOL] clauses leave CSM open to unlimited liability for active negligence.

Id., at 44.

Burnett v. Chimney Sweep involves an example of how the case law applies the interpretation rules in the context of a commercial lease. In *Burnett v. Chimney Sweep*, there were two LOL provisions at issue. The first stated:

Lessor shall not be liable for injury or damage to the person or goods, wares, merchandise, or other property of Lessee, ... whether such damage or injury is caused by or results from fire, steam, electricity, gas, water or rain, or from the breakage, leakage, obstruction or other defects of pipes, fire sprinklers, wires, appliances, plumbing, air conditioning or lighting fixtures, or from any other cause, whether said injury or damage results from conditions arising upon the Premises or upon other portions of the Building of which the Premises are a part, from other sources or places, and regardless of whether the cause of such damage or injury or the means of repairing the same is accessible or not.

Burnett v. Chimney Sweep, supra, 123 Cal.App.4th at 1062. The second provision provided as follows:

Notwithstanding Lessor's negligence or breach of this Lease, Lessor shall under no circumstances be liable for injury to Lessee's business or for any loss of income or profit therefrom. (Emphasis added.)

Id. The *Burnett v. Chimney Sweep* Court noted the first provision did not expressly mention negligence, so the Court ruled it would not shield a contracting party from active negligence. It found the second provision effective to shield

defendants from the loss of profits claim. The Court distinguished active and passive negligence finding the pleadings stated a claim for active negligence when the defendant was aware of the problems and knowingly refused to remediate them. *Id.*, at 1067.

In another example, consider the case of *Ingersoll-Rand Co. v. El Dorado Chem. Co.*, (2008 Ark. S. Ct.) 373 Ark. 226. In this case, a manufacturer filed suit against a contractor and its shop superintendent for negligence in the repairing and rebuilding of equipment for the manufacturer's plant. The contractor asserted as a defense a limitation of liability clause in a faxed letter. The contractor faxed an agreement that asked the plaintiff to sign it and return after agreeing to the terms on the front and back side. The plaintiff signed and returned it, but nothing was on the back side of the fax. A second fax came with an LOL provision but the owner never signed and never returned it. A jury returned a verdict in favor of the manufacturer for \$ 9,796,218. The appeals court, strictly construing the agreement, declined to enforce it and upheld the plaintiff verdict.

Thus, it is especially important to use careful, clear, unequivocal and specific language when preparing LOL provisions in agreements, and ensure it was expressly agreed upon. See, e.g., Steven B. Lesser, *The Great Escape, How to Draft Exculpatory Clauses that Limit or Extinguish Liability*, *The Florida Bar Journal*, November 2001, at 10.

C. Courts Generally Will Not Enforce LOL Provisions for Reckless, Willful, or Intentionally Wrongful Conduct

Whether by statute or on public policy grounds, courts will not enforce LOL provisions that seek to shield persons from intentional misconduct, fraud, “wonton” or reckless conduct. For instance, Alabama courts have noted LOL provisions, “although valid and consistent with public policy as to negligent conduct are invalid and contrary to public policy as to wanton or willful conduct.” *Barnes v. Birmingham Int’l Raceway*, (S. Ct. Ala. 1989) 551 So. 2d 929, 933; *See, also, Jones v. Dressel*, (S. Ct. Colo. 1981) 623 P.2d 370, 376 (“[i]n no event will an exculpatory agreement be permitted to shield against a claim of willful and wanton negligence.”); *Hanks v. Powder Ridge Rest. Corp.*, (Conn. S. Ct. 2005) 276 Conn. 314, 337 (Connecticut does not recognize degrees of negligence. But prohibits LOL provisions for reckless and intentional conduct).

Consistently, where left to common law in the courts, *Anderson v. McOskar Enters.*, (2006 Ct. App. Minn.) 712 N.W.2d 796, 801, recognized “any ‘term’ in a contract which attempts to exempt a party from liability for gross negligence or wanton conduct is unenforceable, not the entire [contract].” (quoting *Wolfgang v. Mid-American Motorsports, Inc.*, 898 F. Supp. 783, 788 (D. Kan. 1995) (which in turn quotes Restatement (Second) of Contracts § 195(1) (1981) (‘A term exempting a party from tort liability for harm caused intentionally or recklessly is unenforceable on grounds of public policy.’ (emphasis added))).” *Id.* at 182.

1. Statutory Prohibitions on LOL Provisions

As addressed above in In a case where the limitation of liability provisions barred consequential damages and limited recovery to “the total amount paid,” one California Court held “[Civil Code] section 1668 renders the [] limitation of liability unenforceable to the extent it would insulate Defendant from intentional tort liability.” See, *WeBoost Media S.R.L. v. LookSmart Ltd.* (N.D. Cal., June 12, 2014) 2014 U.S. Dist. LEXIS 80978, 2014 WL 2621465, at 9-10.

Louisiana has a statute that declares as null any clause that limits liability based on intentional fault or gross fault or for physical injury. See, La. Civ. Code Art. 2004; *Ostrowiecki v. Aggressor Fleet, Ltd.*, 965 So.2d 527 (La. App. 2007).

2. Intentional Torts and Fraudulent Conduct

As indicated above, jurisdictions are relatively uniform, either pursuant to statute or decisional law, in refusing to enforce LOL provisions in cases involving fraud or intentional misconduct. See, e.g., *Fuentes v. Owen* (Fla. 3d D.C.A. 1975) 310 So. 2d 458.

In the words of one court,

Unlike claims involving negligent violations of law under [Cal. Civil Code] Section 1668, there is no split in the caselaw regarding intentional torts. The cases uniformly hold that ‘limitation of liability clauses are ineffective with respect to claims for fraud and misrepresentation,’ regardless of whether the public interest is implicated. [Citing *Food Safety Net Svcs. v. Eco Safe Sys. USA, Inc.* (2012) 209 Cal.App.4th 1118, 1126; *Blankenheim, supra*, 217 Cal.App.3d at 1471-1473] [¶].... even where the clause amounts to a limitation on damages as opposed to an outright exemption.

Peregrine Pharms., Inc. v. Clinical Supplies Mgmt. (C.D. Cal., July 30, 2014) 2014 U.S. Dist. LEXIS 105756, pp. 53-55; 2014 WL 3791567; *Food Safety Net Services v. Eco Safe Systems USA, Inc.* (2012) 209 Cal.App.4th 1118, 1126; *Blankenheim, supra*, 217 Cal. App. 3d at p. 1471–1473.

In a case where the limitation of liability provisions barred consequential damages and limited recovery to “the total amount paid,” the Northern District of California held “[Cal. Civil Code] section 1668 renders the [] limitation of liability unenforceable to the extent it would insulate Defendant from intentional tort liability.” See, *WeBoost Media S.R.L. v. LookSmart Ltd.* (N.D. Cal., June 12, 2014) 2014 U.S. Dist. LEXIS 80978, 2014 WL 2621465, at 9-10.

3. Gross Negligence May Render an LOL Provision Unenforceable

The California Supreme Court and other courts interpreting exculpation and LOL provisions have concluded they are ineffective to shield a party from liability for gross negligence. *See, City of Santa Barbara v. Sup. Ct.* (2007) 41 Cal.4th 747, 754-755; *Frittelli, supra*, 202 Cal.App.4th 35, 52-54. Gross negligence involves pleading negligence and alleging extreme conduct that shows “either a ‘want of scant care’ or ‘an extreme departure from ordinary standard of conduct.’” *Frittelli, supra*, 202 Cal.App.4th 35, 52. Gross negligence usually presents a question of fact. *Id.* Further, establishing a standard of care and testimony about the extent of departure therefrom most likely involves expert testimony. *See also, e.g., Rest. (Second) of Contracts* § 195(1) (1981); *Barnes v. Birmingham Int’l Raceway*, (S. Ct. Ala. 1989) 551 So. 2d 929, 933; *Jones v. Dressel*, (S. Ct. Colo. 1981) 623 P.2d 370, 376; *Hanks v. Powder Ridge Rest. Corp.*, (Conn. S. Ct. 2005) 276 Conn. 314, 337; *Anderson v. McOskar Enters.*, (2006 Ct. App. Minn.) 712 N.W.2d 796, 801; *Wolfgang v. Mid-American Motorsports, Inc.*, 898 F. Supp. 783, 788 (D. Kan. 1995).

V. Implications of Laws Restricting Enforcement of LOL Provisions on the Theory of “Efficient Breach”

Often times LOL provisions are aimed at limiting exposure for negligence, but not always, and not in the context of damage limitation provisions and waivers of consequential damages that apply in contract claims. Where purely economic damages are at issue, LOL provisions can have significant implications on the concept of “efficient breach,” which is controversial in legal scholarly circles. *See, Gregory Klass, Efficient Breach, The Philosophical Foundations of Contract Law*, at p. 362 (Oxford: Oxford Univ. Press, G. Klass, G. Letsas & P. Saprai, eds., 2014). Centered on theories of expectation damages in contract law and “freedom of contract,” efficient breach posits that a promisor must provide the promisee the full benefit of the bargain, but nothing more. Barry E. Adler, *Efficient Breach Theory Through the Looking Glass*, *New York University Law Review*, Vol. 83, No. 6 (Dec. 2008), p. 1679, 1688.

Professor Adler explains the concept by example as follows:

[F]or example, [] if a contractor agrees to paint a house for \$10,000 and then reneges, the contractor must pay the homeowner the difference between the value of performance and \$10,000. Suppose that the value of the paint job to the homeowner exceeds \$14,000, which is the amount the contractor’s competitor would charge to do comparable work. The contractor would thus owe the homeowner \$4000. [Fn. 31]

Id., at 1688-1689 (Fn. 31 states: “This calculation implicitly incorporates the promisee’s duty to mitigate...”). However, this concept is rarely this simple in

connection with construction contracts. To make it more realistic, we add to the example three additional facts: (1) competing paint companies were not available to do the work until one year after termination, and (2) the delay resulted in the homeowner losing \$5000 in profit from a renter that was promised a newly painted home at which to host a wedding but canceled due to the terrible look of the paint job, and (3) the contractor was aware of the rental and wedding, such that the contract had a “time of the essence” provision setting a completion date well ahead of the wedding. With these additional facts, the homeowner asserts damages of \$10,000 (\$4000 difference in cost of the work, \$5000 in lost profit from the rental agreement (consequential damages in many jurisdictions), and \$1000 in delay damages). The contractor, due to more lucrative projects elsewhere, may still chose to cancel the contract and walk away, paying the \$10,000 in damages or some other negotiated amount under the theory of “efficient breach.”

On the other hand, what if the contractor has a “no damage for delay” provision, a waiver of consequential damage provision, and a dollar limitation of liability in the amount of \$1000. May the contractor rely on these LOL provisions and safely walk away from the contract based on its “calculated” determination it will be better off doing more profitable projects for others? As described above, especially if the homeowner is a sophisticated home rental business for wedding venues who contracts regularly with contractors, many states would enforce the LOL provision and obligate the contractor to pay no more than \$1000.

Note should be made, however, that some state jurisdictions seems to preclude completely the scenario where LOL provisions allow a contractor to choose an economic breach and maintain the protections of its LOL provisions. As set forth above, in California, for instance, Civil Code Section 1668 renders void and unenforceable provisions that “directly or indirectly, to exempt anyone from responsibility for his [or her] own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent ...”

For a real case example, consider *Civic Ctr. Drive Apts. Ltd. P'ship. v. Southwestern Bell Video Servs.* (N.D. Cal. Nov. 19, 2003), 295 F. Supp. 2d 1091. In Civic Center, an apartment owner contracted with a cable installer who installed faulty cable. The cable installer discovered its non-conforming work before the interior was drywalled and complete, at a time when the cost of repair was considerably less than after completion because by then apartments were rented to residents, who had to be accommodated at great cost. In discovery, the cable installer admitted it discovered its faulty installation before walls were drywalled, but apparently decided to conceal the decision, perhaps believing it could choose payment of the LOL provision amounts which would be less than the cost of repair and delay damages. The trial court denied summary judgment to the cable installer on the LOL provision, concluding the LOL provisions were void as against public policy even in a breach of contract (only) case, because the plaintiffs had presented evidence which, if believed, could lead to the conclusion

that their consequential damages resulted from defendant's fraudulent concealment of the installment of faulty cable.

Even without concealment involved, under California Contractors State Licensing laws, the following are unlawful:

Cal. Bus. & Prof. § 7107. Abandonment of contract.

Cal. Bus. & Prof. § 7109. Departure from accepted trade standards; Departure from plans or specifications

Cal. Bus. & Prof. § 7110. Disregard or violation of statutes (including building codes)

Cal. Bus. & Prof. § 7113. Failure to complete project for contract price

Cal. Bus. & Prof. § 7119. Failure to prosecute work diligently

These state licensing statutes, combined with California Civil Code section 1668 precluding an LOL provision from being enforced if the LOL provision conflicts with other statutes describing illegal actions, would seem to completely negate any protection otherwise available to a contractor who might choose to abandon a job, fail to provide proper manpower, fail to complete it for the price, or fail to correct known non-conforming work or code violations even if the contractor were completely up-front and honest about it at a time when the owner could mitigate its damages. Thus, the combination of these statutes appear to negate any option of efficient breach by a contractor in California in such circumstances.

VI. Conclusion

As the construction industry continues to manage significant risk, it should be wary of relying on LOL provisions in certain circumstances. LOL provisions should afford relief in most jurisdictions against innocent, negligent conduct (especially passive negligence – or an omission) and may also reach active negligence (an error through active conduct) and intentional breaches to the extent breach of contract damages are the sole issue, but gross negligence, willful or wanton behavior, fraud and other intentional misconduct will likely cost the contractor any protection of any hard fought, negotiated LOL provisions. In some states, like California, violation of statutory laws regulating contractor conduct may also render an otherwise “efficient breach” outside the boundaries of protection from LOL provisions.

■ END

