
Liability Briefing

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Managing liability through through financial caps

Every well-run business must manage the risks that it faces and there are many ways in which this can be done. Consultants protect themselves against the financial consequences of being sued with professional indemnity (PI) insurance. However, the insurance market is likely to harden and consultants are likely to be faced with increased premiums and excesses. There are also restrictions on the cover available. Consultants may therefore find themselves underinsured or uninsured in the event of a claim. As a result – more than ever – consultants cannot simply rely on their PI insurance: they must actively manage liability through other means.

Although liability can not be excluded or restricted in relation to damages for death or personal injury, parties to a contract can agree to limit any other liability that they may incur to each other, eg for breach of contract or negligence. This can be done in a variety of ways. One method – now accepted by many clients – is to agree a figure (a financial cap), beyond which the consultant will not be liable.

For all practical purposes there is no such thing as unlimited liability. Recovery from a limited company or limited liability partnership is limited to its insurance cover and the assets of the company or LLP; even in the case of an individual or partnership, recovery is in practice similarly limited – no individual or partner has unlimited funds. A cap therefore gives clients as well as consultants a degree of certainty they would not otherwise have.

Whenever practicable, the cap should be discussed and specifically agreed with the other party. This is discussed further below, see *Agreeing a cap*.

Any limitation of liability will have to satisfy the test of 'reasonableness' under the Unfair Contract Terms Act 1977 ('UCTA'). What is reasonable depends on the circumstances of each case. UCTA is discussed in more detail below.

Great care also needs to be taken in drafting clauses capping liability. In the event of a dispute any limitation of liability will be construed against the person seeking to rely on it. Legal advice should therefore be sought on the wording of the clause itself.

How does a financial cap work?

A financial cap on liability in a contract (for example, a consultant's appointment) operates to limit the damages payable by the consultant to the client under the appointment to the agreed amount. The scope of the cap depends on the terms of the contract and usually follows one of these options:

- The cap might apply to **each and every claim** so that each claim could be to the full value of the limit, for example: *The liability of the Consultant under or in connection with this Agreement shall be limited to £X in respect of each and every claim.*
- It might be drafted so that it applied on an **aggregated** basis. Here claims would be 'grouped' according to the particular event that caused the loss/damage, for example: *The liability of the Consultant for any claim or series of claims arising out of the same occurrence or series of occurrences shall not exceed the sum of £X.*
- It might apply as a **total** limit in which case, regardless of how many claims arose from the event that caused the loss/damage, the consultant's liability would not exceed the figure stated. This option offers the greatest certainty in relation to potential exposure. For example: *The total liability of the Consultant under or in connection with this Agreement shall not exceed £X.*

The total potential liability under a project needs to be taken into account. For example, a tenant collateral warranty might include a cap of, say, £250,000 in respect of all claims; but if a consultant has given warranties to three tenants, each one would be able to recover up to £250,000. Moreover, if all three tenants were able to recover as a result of the same act of negligence, that might constitute one claim under the consultant's PI policy – and one limit of indemnity would apply.

PI insurance v financial caps

A financial cap is not the same as the limit of indemnity under a consultant's PI policy. The policy will have a limit on the amount insurers will pay. Once this limit is reached, no further payments will be made by the insurer. In contrast, where a contract does not incorporate a cap and the consultant is sued for an amount which exceeds the amount recoverable under his insurance, this will expose the firm to uninsured loss. Because consultants generally have few assets beyond the PI insurance they carry, a claim in excess of the available insurance could be the end of the firm. For this reason, and because of the increasing restrictions being placed on insurance cover, it is in the consultant's interests to seek a cap. From a client's point of view, moreover, a claim against an overexposed consultant may well be worthless.

UCTA

As explained, it is not possible to exclude or restrict liability for death or personal injury resulting from negligence under English law (UCTA section 2(1)) and any such provision is void under Scots law (UCTA section 16(1)(a)). With regard to other

claims: under English law a person cannot so exclude or restrict his liability for negligence except insofar as the term or notice satisfies the requirement of reasonableness (UCTA section 2(2)); and under Scots law, where there is such a term in a contract or a given out notice it shall ... have no effect if it was not fair and reasonable to incorporate the term in the contract or, as the case may be, it is not fair and reasonable to allow reliance on the provision (UCTA section 16(1)(b)). This applies independently of any standard terms and whether or not one party deals as consumer.

The requirement of reasonableness under English law is: *that the term shall have been a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made* (UCTA section 11(1)). Under Scots law, in determining whether it is fair and reasonable to incorporate a term in a contract (the position in relation to non-contractual notices is similar): *regard shall be had only to the circumstances which were, or ought reasonable to have been, known to or in the contemplation of the parties to the contract at the time the contract was made* (UCTA section 24(1)). It is important therefore, that in determining the amount of a cap, the circumstances at the time the contract is made are considered. Where a person seeks to restrict his liability to a specified sum of money (a cap), regard shall be had to: *the resources which he could expect to be available to him for the purpose of meeting the liability ... and how far it was open to him to cover himself by insurance* (UCTA section 11(4) under English law with similar provisions in section 24(3) under Scots law).

Agreeing a cap

Where possible, any proposed cap should be drawn to the attention of the other party to the contract. Preferably it should be discussed and specifically agreed. If this is done, it is much more difficult for the other party to successfully challenge the cap in court. In the case of a contract of appointment, the consultant should explain to the client how the cap will operate and how it is calculated; these discussions should then be recorded in detail (preferably in a letter). In the case of a collateral warranty, the negotiations may be with the client rather than the beneficiary of the warranty; however the cap should still be discussed, and the discussion recorded. Where repeat work is undertaken for the same client, any cap should be negotiated and agreed for each commission. Records of the discussion as well as any correspondence should be retained, particularly where the other party is not legally represented. It is helpful to include a note of how the cap was calculated.

How do you calculate a reasonable cap?

There is no simple answer or formula. It is sometimes suggested that a multiple of the fee is appropriate. However, each project has to be looked at on its merits. A number of factors should be taken into account, for example:

- the likely nature and extent of the risks of the project, having regard to its size, complexity etc;

- an assessment of the damages that would be payable in the event of a claim in negligence (eg the cost of repeating the work/construction costs);
- the resources that the consultant could be expected to have available to meet any liability;
- any previous dealings between the parties;
- the amount and cover available to the consultant under his PI policy.

The case of *James Moores v Yakeley Associates Ltd* helpfully illustrates what is 'reasonable'. James Moores employed Yakeley Associates as architects, and their contract (on the terms of the RIBA Standard Form of Agreement 1992), included a cap of £250,000. The architects' fee was 8.5% of the construction cost, subject to a minimum of £19,125 and assuming a construction cost of £225,000.

The court held that the financial cap on the architects' liability was reasonable on the basis that:

- Both the client and his solicitor were aware of the existence of the clause imposing the cap and both had said that they were happy with the proposed agreement.
- The cap was not an arbitrary figure. It was based on the architects' assessment of the likely cost of the works. The judge accepted that it was a reasonable figure: 'It would take some quite exceptional circumstance, beyond the reasonable contemplation of the parties, to give rise to a liability for damages in a sum greater than the total estimated cost of the project itself,' he said.
- The client had accepted in giving evidence that if the cap was roughly sufficient to cover the total building cost, that would be 'fair enough'.
- The cap was more than ten times the amount of the architects' fee.
- The client was in a stronger bargaining position than the architects; not only was there a recession and architects were chasing work, but the client was not in any hurry to enter into the contract and had a solicitor to protect his interests in negotiations.
- A comparison of the parties' resources showed that the architects had none, whereas the client was very wealthy.

The judge said that he was obliged to have regard to how far it was open to the architects to cover themselves by insurance. In this case, the architects had in place insurance of £500,000 which was in excess of the cap but was not determinative. He accepted the architects' explanation that the figure of £250,000 was considered reasonable having regard to the estimated cost of the project. In any event, they were concerned that they ought to leave some allowance in case they had to meet legal costs.

A contrast can be made with the case of *St Albans City and District Council v International Computers Ltd* where a cap on ICL's liability of £100,000 was not considered reasonable. ICL were engaged to write and operate a computer program to calculate the level of community charge; due to an error in the system, the council suffered losses estimated at £1.17 million. There was no evidence to show that it was fair and reasonable to limit liability to £100,000. The court also had regard to the fact that ICL had liability insurance cover of £50 million.

Third party claims

Liability in relation to claims made by third parties (eg end users or adjoining owners) cannot be excluded or restricted in the absence of a contract between them (subject to the point below). In such a case therefore the consultant's liability to third parties is unlimited, even where the liability to the client has been capped.

Where a consultant enters into a collateral warranty with a third party, the consultant's liability to the third party can be limited. Standard forms of warranty – such as the CIC consultant warranties – limit the consultant's liability to the costs of repair and include a net contribution clause; some forms of warranty also impose a financial cap on the damages recoverable. In a contract subject to English law, if a third party has been given the right to enforce a term of a contract between a consultant and a client under the Contracts (Third Party Rights) Act 1999, the parties to the contract can limit the liability to the third party, in the same way that liability can be limited in a warranty. If it is anticipated that third party claims might exceed an agreed cap, in appropriate circumstances, the consultant may wish to seek an indemnity from the client. The 1999 Act does not extend to Scotland. However there is an equivalent common law right under Scots law known as the *jus quaesitum tertio* (right vested in, or acquired by, a third party), although because of its common law origins is less well defined, or as certain in its enforceability and effect, as the statutory rights established by the 1999 Act in England.

This *Liability Briefing* is for general guidance only and legal advice should be sought to cover any particular situation.

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