BBG
CONSTRUCTION LAW

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Understanding The Limits of Contractual Liability Caps in Construction Contracts

In construction contracts, it has become commonplace to include limitation of liability clauses that attempt to impose caps on the amount of damages a party can be held liable for in a contract dispute or other legal claim. Clauses capping liability to a particular amount are found in all types of construction agreements, including but not limited to owner-contractor agreements, designer agreements, subcontracts, and purchase orders. Although these clauses are intended to reduce risk and offer a sense of security to the parties involved, enforcing them is ultimately subject to judicial scrutiny and interpretation. Without careful and strategic drafting and a clear understanding of their limitations, these clauses may offer little to no protection.

Liability Caps

Liability caps attempt to set a contractor's maximum financial exposure for legal actions or claims. These clauses commonly limit liability to the amount of compensation and fees paid under a contract, the extent of available insurance coverage, a predetermined agreed-upon amount, or some combination thereof. Inclusion of these clauses is not about avoiding responsibility, but rather about ensuring the parties' risk is clear, predictable, and manageable.

An example of such a clause is:

> ***Limitation of Liability****: Contractor's liability for any claims, damages, or losses arising out of or relating to this Agreement, other than for willful misconduct or bad faith, whether based on contract, tort (including negligence), strict liability, or any other legal theory, shall be limited to the total amount of the Contract Price. The Owner agrees that this limitation of liability is a material consideration in the pricing of the services provided under this Agreement.*

Enforceability of Liability Caps

The general rule in most jurisdictions is that clearly expressed, conspicuous and unambiguous limitation of liability caps in construction contracts will be enforced by the courts in the event of a dispute between the parties. When upholding the validity of these clauses, the courts generally cite the parties' freedom to contract and emphasize the relative sophistication of the business entities involved in the creation and negotiation of these contracts. However, there are exceptions to this general rule.

1. **Liability caps may be unenforceable when they attempt to limit liability for willful misconduct or bad faith.**

Most jurisdictions will not enforce liability caps that attempt to limit a party's liability for willful misconduct or bad faith. Willful misconduct involves a deliberate disregard for the rights or safety of others. For example, if a contractor knowingly cuts corners on a project, resulting in unsafe conditions, it could be considered willful misconduct. Bad faith refers to dishonest or unfair dealings in a contractual relationship, usually involving an intent to deceive, manipulate or take advantage of the other party. Indeed, the Federal Acquisition Regulations expressly prohibit enforcing liability caps where the damages at issue arise out of the enforcing party's willful misconduct or bad faith. *See* FAR 52.246-23(b).

2. Liability caps may be unenforceable if unreasonable or unconscionable.

Where the parties do not have relatively equal bargaining strength and the cap is objectively unreasonable and determined to be grossly unfair, liability caps may be considered unconscionable and a violation of public policy. Although this is not a commonly raised issue in construction contracting, larger contractors should be aware of the potential for this argument to be raised by smaller, less sophisticated subcontractors and suppliers.

3. Liability caps may be unenforceable when they are against public policy in the jurisdiction.

In some states, liability caps have been determined to be against public policy in certain situations and therefore unenforceable. For example, a Virigina statute provides "[a] subcontractor . . . may not waive or diminish his right to assert payment bond claims or his right to assert claims for demonstrated additional costs in a contract in advance of furnishing any labor, services, or materials." This statute was recently interpreted by a District Court in Virigina in *BAE Systems Ordnance Systems, Inc. v. Fluor Federal Solutions*, LLC, 2024 U.S. Dist. LEXIS 17020 (January 31, 2023) (hereinafter, "*BAE*") to render a $30 million liability cap null and void to the extent it limited a contracting party's ability to recover for additional costs arising under the changes clause of its subcontract.

Other examples involve statutes in Colorado and Alaska. In Colorado, the Homeowner Protection Act of 2007 bars liability caps in residential construction (including apartment construction). *See* C.R.S. § 13-20-806(7). In Alaska, courts have interpreted section 45.45.900 of the Alaska Code as prohibiting enforcement of liability caps covering professionals in design contracts. *See*, *e.g.*, *City of Dillingham v. CH2M Hill N.W., Inc.* 873 P.2d 1271, 1277-78 (Alaska 1994). This may create a "liability hole" in a design-build contract with an otherwise enforceable liability cap.

4. Liability caps may be unenforceable when they are subjugated to another clause in the contract.

Even if a particular jurisdiction generally enforces liability caps, if the clause in question prioritizes other parts of the contract which override the cap, then the clause may not limit liability at all. This issue also arose in the *BAE* decision. The liability cap provision began with the language: "except as otherwise provided in this Subcontract." The *BAE* court interpreted this language to narrow the scope of the liability cap because it implied there were exceptions to the cap provided elsewhere in the Subcontract. The court deferred to the Contract Changes provision which allowed

equitable changes to the contract price for changes to the scope of work, which the court determined overrode the limitations imposed by the cap.

Best Practices

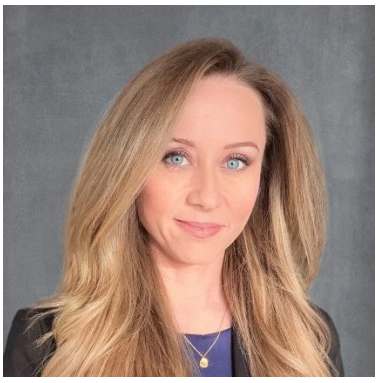
To determine whether a liability cap is likely to be enforced, you should consider the following when drafting and negotiating these types of provisions:

- Whether the clause is drafted to clearly and conspicuously state the parties' intention to limit liability;
- Whether the clause is attempting to cap liability for willful misconduct or bad faith;
- Whether the cap is reasonable in relation to the parties' relative bargaining strength;
- Whether any jurisdictional laws might inhibit the cap's enforcement; and
- Whether any phrases included in the clause might weaken enforceability.

Keep in mind the burden of proving the validity and applicability of a liability cap falls on the party seeking to enforce it and courts will strictly construe the provision against that party.

Conclusion

General contractors seeking to include liability cap protections in their contracts should approach the drafting and negotiation of these types of clauses with an awareness of their potential confines. Understanding these nuances can help you effectively protect your interests and manage your risk. BBG can help with this review and identify circumstances where the stated cap may be ineffective and suggest other avenues to limit risk.



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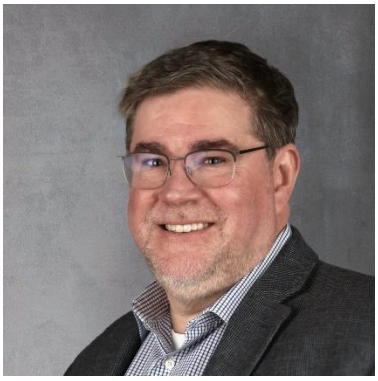

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