Limiting liability for professional firms

Introduction

Disputes can arise between providers of professional services and their clients or other (third) parties for a number of reasons. Limiting or excluding liability is one means by which firms can manage risk and the extent of their potential liability to clients and third parties when providing professional services. The purpose of this note is to explain the legal principles applicable to the limitation of liability, how they may apply to the surveyors’ market in particular, and to provide a checklist of points firms may wish to consider when seeking to exclude or limit their liability.

Professional negligence is by far the most common basis of claims against firms. This note focuses only on the limitation or exclusion of liability in relation to professional negligence. It does not deal with potential liability arising from other causes (for example, criminal acts, breaches of trust, breaches of statutory duty or breaches of contract other than the negligent performance of contract terms).

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A. Limiting liability: general legal principles

This section summarises the legal principles relevant to the limitation of liability. This is a complex area of law. Whether or not a limitation of liability is effective will depend upon the particular facts of each individual engagement.

Liability limitations must be incorporated in the contract

Any firm seeking to rely on an exclusion or limitation clause must first be able to establish that the clause was incorporated and formed part of the contract. In addition, the firm must be able to show that the clause relied on has been brought to the client’s attention sufficiently.

Liability limitations must be clear and unambiguous

Whether a clause purporting to exclude or limit liability for negligence is effective is a question of construction. In particular, the courts have emphasised that:

- Such exclusions or limitations must expressly, clearly and unambiguously exclude liability for negligence;
- Such clauses are construed "contra proferentem" – this means that they are interpreted strictly against the party that is seeking to rely on them (although the courts take a less rigid approach to clauses that seek to limit the damages recoverable in the event of negligence, rather than those that seek to exclude liability altogether).

Statutory restrictions on excluding or limiting liability

The effectiveness of an exclusion, limitation or disclaimer of liability is restricted by statute. The relevant statutes are:

- Unfair Contract Terms Act 1977
- Unfair Terms in Consumer Contracts Regulations 1999
- Financial Services and Markets Act 2000

Unfair Contract Terms Act 1977

The ability of firms to enforce terms that exclude or limit their liability is restricted by the Unfair Contract Terms Act 1977 (UCTA).

Terms to which UCTA applies

In the context of professional services, UCTA will apply to:
• Contractual terms that seek to exclude or restrict liability for negligence¹;
• Disclaimers that seek to prevent a duty of care arising where there is no contract²;
• An exclusion or limitation where one of the contracting parties "deals as a consumer or on the other's written standard terms of business"³.

In each case, the contract term will only be effective if it satisfies the requirement of reasonableness under UCTA.⁴

Firms are unable to exclude or limit their liability for death or personal injury resulting from negligence ⁵

Dealing as a consumer

A firm's client will deal "as a consumer" if the client does not make (or pretend to make) the contract in the course of a business and the firm (as the other contracting party) does make the contract in the course of a business. A client will “deal” with a firm if the client "makes a deal" with the firm, regardless of any negotiations.

Standard Terms of Business

There is no definition or guidance in UCTA of what is meant by "written standard terms of business". Traditionally, this was assumed to mean contracting on standard, pre-printed terms, perhaps appearing on the back of an invoice. It is now clear that, if standard terms are “effectively untouched” following negotiations, even if certain provisions are amended, they will still amount to standard terms⁶. A firm's use of pre-printed or ready-prepared terms, on a regular basis as a matter of policy and routine, are standard terms of business.

The UCTA "reasonableness test"

In order to satisfy the "reasonableness test" under UCTA, a contract term must be:

"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".⁷

Whether or not a firm’s exclusion or limitation is reasonable will therefore be determined by the particular circumstances. A firm claiming that the term is reasonable has the burden of demonstrating this. UCTA contains “Guidelines” on the factors that may be taken into account when considering whether a term is reasonable⁸. These include, in summary, the following:

(a) the strength of the parties’ relative bargaining positions;

¹ Section 2(2)
² Smith v Eric S Bush [1990] 1 AC 831
³ Section 3
⁴ Section 2(2), Section 3(2)
⁵ Section 2(1)
⁶ St Albans City and District Council v International Computers [1990] 4 All ER 481
⁷ Section 11(1)
⁸ Section 11(2) and Schedule 2. Note that the Schedule 2 Guidelines expressly apply only to the UCTA requirements for reasonableness in relation to sale and hire purchase contracts and contracts for goods, but the courts have nevertheless applied them more widely in relation to assessing the requirement for reasonableness in other parts of UCTA.
(b) whether the client was offered an inducement (such as a lower fee) to accept the term or whether the client had an opportunity to contract for similar services with another supplier without the term;

(c) whether the client knew or ought reasonably to have known of the existence and extent of the term;

(d) where the term excludes or restricts liability for non-compliance with a condition, whether it was reasonable when contracting to expect compliance with that condition;

(e) the resources available to the parties to meet the liability, including the existence or availability of insurance cover.

How the courts have applied the reasonableness test

Factors that the courts have taken into account when applying the UCTA reasonableness test, in the context of limitations and exclusions in professional contracts, include the following:

- Was the client a sophisticated, commercial entity? Such clients should know and understand that professional firms customarily limit their liability and are well able to discuss or negotiate the limitation, if they so choose. In these circumstances, the courts will be more willing to uphold a limitation on liability.

- Would it have been reasonably practicable to obtain the advice from an alternative source, taking into account considerations of cost and time? If so, the requirement of reasonableness would be more easily discharged.

- How difficult is the task being undertaken for which liability is being excluded? If the task is very difficult or dangerous, this would point towards the reasonableness of excluding liability as a condition of doing the work.

- What are the practical consequences of the decision on the question of reasonableness? The court will take account of policy matters, such as whether a decision not to uphold the exclusion clause would open the floodgates to potential claimants, the sums of money at stake, the availability of insurance and the justice of distributing the risk of the defendant’s negligence via insurance as opposed to forcing the claimant to bear it all himself.

- Whether the firm is the party best placed to cover a risk with insurance. In some circumstances, it might be easier for the client to insure against the risk of loss. For example, some professional indemnity insurance policies may not provide cover for liability for indirect or consequential loss. For firms with such policies, an exclusion of such liability in an engagement letter might be reasonable.

- Applicable market expectations or common practices in the profession in question.

Unfair Terms in Consumer Contracts Regulations 1999

Where a firm is engaged to provide services to a private individual, the client will fall within the definition of “consumer” in the Unfair Terms in Consumer Contracts Regulations 1999. These Regulations provide that a “consumer” is someone who “is acting for purposes which are outside his trade, business or profession”.

9 In Ampleforth Abbey Trust v Turner & Townsend Project Management Ltd [2012] EWHC a project manager’s cap on liability in its standard terms was held to be unreasonable in contravention of UCTA, primarily because the cap imposed was significantly lower than the level of professional indemnity cover required by the appointment.
The Regulations apply in relation to “unfair terms in contracts concluded between a seller or a supplier and a consumer”.

Unlike under UCTA, the Regulations do not render any terms automatically ineffective. The Regulations impose a test of fairness on almost all terms, not just exclusion clauses or limitations of liability.

A contract term that has not been individually negotiated will be unfair (and so not binding on the consumer client) if it causes a significant imbalance in the parties' contractual rights and obligations, to the detriment of the consumer. In cases of doubt, the interpretation most favourable to the consumer will prevail.

A term will be regarded as not having been individually negotiated where it has been drafted in advance and the consumer has not been able to influence the substance of the term.

If a term is found to be unfair within the meaning of the Regulations, the term ceases to bind the consumer, although the rest of the contract will continue to be effective.

**Financial Services and Markets Act 2000**

Firms which are authorised and regulated by the Financial Services Authority in relation to the performance of “regulated activities” under the Financial Services and Markets Act 2000 are prevented from limiting or excluding liability to their clients for any such regulated activities. For other services, an FSA authorised and regulated firm may not limit or exclude liability unless it is honest, fair and professional for it to do so.

**Types of limitations on liability**

**Liability caps**

A cap on liability limits the amount of the firm's liability to its client. The amount of the cap can be expressed as a fixed sum; a percentage of the fee; by reference to the firm's professional indemnity insurance; or by some other formula.

The level of cap employed in any particular engagement should be determined by reference to the factors that the court takes into account in determining the reasonableness of any liability limitation. If a court is required to consider the reasonableness of a cap, the options available to the court are to uphold the cap, or declare it unreasonable and unenforceable. Under UCTA, the court is not entitled to substitute a limit that it does consider "reasonable". The cap is either reasonable and therefore enforceable, or unreasonable and therefore unenforceable.

**Disclaimers**

Liability for negligence can also be limited or excluded by the use of a disclaimer. This usually seeks to prevent any duty of care arising in the first place.

As with contractual exclusions, to be effective, a disclaimer must be brought to the attention of the client and must be expressed in clear and unambiguous terms.

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10 Regulation 5(1)
11 Regulation 5(2)
12 Regulation 8
Exclusions of particular categories of loss

It is possible to seek to exclude the firm's liability for specified types of loss. Common examples are:

- Exclusion of liability for indirect or consequential loss and/or loss of profits;
- Exclusion of liability arising from use of defective or deficient information provided by the client;
- Restriction or exclusion for certain types of liability that are also excluded under the firm's professional indemnity policy eg pollution and contamination, asbestos, terrorism.

Net contribution clauses

Net contribution clauses are also referred to as "proportionate liability" or "net liability" clauses. These clauses provide that, where a firm is jointly liable with one or more other parties for the same loss or damage, the liability of each party is limited to the amount that would be apportioned to that party by the court.

The objective is to limit the firm’s liability to its proportionate share of the blame for any loss incurred by the client, so that the firm is not liable for the loss and damage caused by others, such as other professional advisers or employees of the client, even where those other parties are unable to pay their share or are not a party to the dispute.

It is not always clear how a net contribution clause will interact with any other limitations of liability in the contract, such as a cap. For example, whether or not the net contribution clause is applied before or after a cap on liability can make a considerable difference to the extent of loss for which the firm may be liable. It may be advisable to specify in the contract how different limitation provisions are intended to interact, bearing in mind the requirements of fairness and reasonableness. For example, the contract may specify that a net contribution clause is always to be applied before a cap.

Liability to third parties

In some circumstances, third parties (ie those with whom the firm has no contract) may also want to rely on a firm’s work or work products, such as reports. Examples include survey and valuation reports or schedules of condition. Where firms are aware of this possibility when they accept the engagement, a third party may argue that the firm has assumed a duty of care and responsibility in law to the third party on a voluntary basis, thereby enabling the third party to make a claim against the firm. Since the third party will not be a party to the engagement letter, it will be difficult to argue that the third party is bound by any cap on liability or other protections contained in the firm’s engagement letter. The absence of any fee payment by the third party is not likely to be conclusive as to whether or not any duty is owed.

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13 See, for example, the case of Nationwide Building Society v Dunlop Haywards Ltd (2009) EWHC 254 in which a solicitor's contractual liability cap reduced its exposure in an apportionment of damages with a firm of surveyors.
14 For a discussion of the relevant factors see: Scullion v Bank of Scotland (Colleys) [2011] EWCA Civ 693 (under appeal to Supreme Court in April 2013)
B. Limiting liability to clients – a checklist of points to consider

1. **Overview**: Like many other providers of goods or services, firms may limit their potential liability to their clients by including limitations or exclusions of liability in their engagement letters. The validity of any limitation or exclusion clause will be subject to various legal restraints. Some uncertainty as to the effectiveness of any particular clause cannot be avoided.

2. **Fair and reasonable**: A limitation or exclusion clause may be unenforceable if it is not fair and reasonable. What is fair and reasonable will depend on all the circumstances, with particular regard to factors that are discussed in Section A above.

3. **Excluding liability**: Where a firm has performed work for a fee, it is not likely to be fair and reasonable for a firm to seek to exclude liability entirely to the client. A more common approach is to limit a firm’s liability in the engagement letter, to a fixed amount (often described as a “cap” on liability). A cap set at a higher level is more likely to be enforceable and to protect the firm than a very low cap.

4. **Negotiating limitations or exclusions of liability**: When negotiating limitations or exclusions, firms need to balance the importance of limiting liability against the risk of any limitation or exclusion being held to be unfair or unreasonable. In particular, firms should avoid taking unfair advantage of clients who might be unsophisticated or not commercially aware. In deciding what negotiating position to adopt, firms should take into account the nature of the client and the engagement and the overall commercial risk and reward analysis.

5. **Caps on liability**: A cap on liability that has been discussed and negotiated is generally more likely to be regarded as reasonable than a non-negotiated cap. Where a cap on liability is accepted without discussion, it is not necessary for firms to try to compel negotiation by clients, but where possible, the client should be given sufficient time to consider the matter and/or take legal advice, if desired. It should be made clear whether the cap is an aggregate limit on liability, or applies separately to each breach or each claim. It may be appropriate for the cap to reflect the wording of any aggregation provision in the firm’s professional indemnity insurance.

6. **Documenting negotiations**: It is good practice to document any negotiations concerning liability limitation and to retain a record of them on the relevant file. In particular, it is worthwhile recording any concessions made by the firm, for example, any upward adjustment to a limitation amount initially proposed.

7. **The engagement letter**: Any limitation of liability agreed with the client should be set out clearly in the engagement letter. Where a firm’s engagement letter comprises the firm’s standard terms, together with a covering letter, it would be sensible to draw attention to the cap on liability by referring to it in the covering letter.

8. **Formulating the limitation of liability clause**: It is likely that firms will wish to take their own legal advice on the formulation of any clause in the engagement letter that purports to limit liability. The following points of principle may assist firms:

   - A limitation or exclusion clause should be drafted to capture clearly any basis upon which a claim might be made, including breach of contract and negligence;
- If a formula is to be used for determining a limitation of liability, the basis for calculation should be made clear;
- Avoid using a formula that may appear to be inherently arbitrary because, for example, it does not take account of the nature of the client or the engagement;
- Avoid seeking to exclude or limit liability for loss that cannot legally be excluded or limited, such as liability arising from a firm’s fraud;
- Set out terms containing limitations or exclusions in separate parts of the engagement letter, so that any provisions that are subsequently considered to be unreasonable may be removed without affecting the enforceability or sense of the wording that remains;
- Avoid using a wording that is broader than the law will allow. For example, the clause could specify that an exclusion or limitation will apply to the fullest extent that the law will permit, and/or state that liability for a firm’s fraud is not excluded or limited.

9. **Exclude liability for certain types of loss**: It may be appropriate to seek to exclude liability for certain types of loss altogether. Common examples are:

- Restriction or exclusion of certain types of liability that are also excluded under the firm's professional indemnity policy, provided this is not inconsistent with the duties for which the firm is being engaged;
- Exclusion of liability for indirect or consequential loss and/or loss of profits. Some firms may feel that the possibility of indirect or consequential loss presents a risk that cannot be managed because it might be of an unforeseeable catastrophic nature. An exclusion of liability for such loss can be controversial and clear language is needed in defining such losses;
- Exclusion of liability arising from use of defective or deficient information provided by the client. Note that such an exclusion will be unlikely to be deemed fair or reasonable where the scope of work requires the accuracy or completeness of the information to be checked by the firm;
- Exclusion of joint and several liabilities. These clauses are also referred to as "proportionate liability", "net liability" or "net contribution" clauses. The objective of such a clause is to limit the firm’s liability to its proportionate share of the blame for loss incurred by the client, so that the firm is not liable for the loss and damage caused by others, such as other professional advisers or employees of the client, even where those others are unable to pay or are not a party to the dispute.

This note, prepared by RPC LLP, reflects the state of the law as at October 2012. For any further advice, or any specific queries, please contact either Simon Chandler (simon.chandler@rpc.co.uk) or Alexandra Anderson (alexandra.anderson@rpc.co.uk).