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Litigation Update: Arizona Supreme Court Rules on Contract Provisions Capping Damages Against Construction Professionals

By Christopher L. Callahan and Stephen P. Brower

Professional service contracts often include provisions that limit the service providers' liability to the amount received under the contract. In a decision earlier this year, the Arizona Court of Appeals ruled that, under the Arizona constitution, the decision whether and how to enforce such provisions must be made by the jury, rather than the judge. *1800 Ocotillo, LLC v. The WLB Group, Inc.*, No. 1 CA-CV 07-0037. In reaching this conclusion, the Court of Appeals analogized the provision to the defense of "assumption of risk," which, under the Arizona Constitution, must be submitted to the jury. Fennemore Craig addressed this decision in a litigation update on February 25, 2008. In that update we noted that, "[i]t will be challenging for defendants, seeking to rely upon such provisions, to persuade juries to apply them in situations where the injured party's damages greatly exceed the limit in the contract."

The Arizona Supreme Court granted review of the Court of Appeals' decision and reinstated the trial court ruling, holding "that the liability-limitation clause is neither contrary to public policy nor subject to Arizona's constitutional requirement that the defense of assumption of risk always be submitted to a jury." The underlying dispute between a developer and a survey company alleged that the survey company was negligent in failing to identify an existing right-of-way resulting in delays and modifications to the development. A provision in the contract between the developer and the survey company limited the developer's recoverable damages for the survey company's negligence to the "total fees actually paid" to the survey company. The trial court granted partial summary judgment in favor of the survey company, holding that this provision was enforceable. The court of appeals reversed on the grounds that, under the Arizona Constitution, issues regarding the enforcement of the provision should have been resolved by a jury and that the trial court was wrong in deciding the issue on summary judgment.

The Arizona Supreme Court disagreed with the "assumption of the risk" analogy, stating 'assumption of risk' as used in [the Arizona Constitution] . . . refer[s] only to defenses that effectively relieve the defendant of any duty." The Court concluded the limitation of liability clause was not such a defense and, therefore, the issue of its validity and enforceability did not require determination by the jury.

The Supreme Court also discussed the benefits of such provisions in a manner to suggest it supported their judicial enforcement. The Court noted these provisions "may desirably allow the parties to allocate as between themselves the risks of damages in excess of the agreed-upon cap, which could preserve incentives for one party to take due care while assigning the risk of greater damages to another party that might be better able to mitigate or insure against them." The Supreme Court did, however, recognize potential defenses to the enforceability of these provisions. Specifically, the Court noted that a cap on damages could be challenged by showing that the parties had not negotiated the provision, that the provision was applied in a manner contrary to the parties' reasonable expectations, that the provision would cap damages at a dollar amount so low as to effectively eliminate the incentive to take precautions, or that the provision resulted from coercive or otherwise improper bargaining.

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Fennemore Craig has extensive experience in negotiating and litigating clauses involving limitations on liability. If you are involved in matters that may involve the negotiation or enforcement of such clauses, we can help. For more information, call Christopher Callahan, John Kofron or Stephen Brower.

Christopher L. Callahan chairs the firm's business and personal injury torts practice. He practices in the areas of environmental, toxic tort and complex commercial litigation. Mr. Callahan has also represented clients in litigation with insurance carriers seeking coverage for environmental and toxic tort claims. In the commercial context, he has defended banks and mortgage lenders in actions under the Real Estate Settlement Procedures Act and in actions for breach of various types of loan contracts. He has represented a broad spectrum of commercial entities on claims involving breach of contract and various business torts. He has extensive experience in class action litigation. He earned his B.S. (1981) from Arizona State University and his J.D. (1984) from the University of California at Los Angeles.

Stephen P. Brower focuses his practice in the areas of general civil litigation with special emphasis in the areas of real estate and business litigation. He earned his B.S. (2003) from Arizona State University and his J.D. (2006) from the University of California at Los Angeles.



Christopher L. Callahan
Director
602.916.5310
ccallahan@fclaw.com



Stephen P. Brower
Associate
602.916.5398
sbrower@fclaw.com