

## CAPS & GAPS- Professionals and the importance of Capped Liability

It is important for every business to manage potential risk or liabilities that may arise against them.

Ensuring suitable Professional Indemnity Insurance is in place is essential to manage this risk. Professional Indemnity insurance is designed to cover a business for errors and omissions associated with advice and design services provided to clients.

Importantly, Professional Indemnity Insurance provides for not just the damage caused by the error, but also legal costs and expenses associated with defending the insured against a claim. Legal costs can represent a significant portion of the overall claim and, without Insurance, would represent a headache for an advice giving professional, let alone the cost of damages for the error caused. Insurance Companies have a panel of solicitors well versed in Insurance Law and the policyholder's occupation waiting to defend the Insured party. Finding suitable legal advice independently and within your field of expertise can be both difficult and costly at short notice. When reading your policy wording a good place to start is the Exclusions section, which describes what you are *not* covered for, to get an appreciation of the sorts of thing excluded by the insurance.

In addition to a Professional Indemnity Insurance policy it is important to hold a General Liability policy, which incorporates both Public & Products Liability Insurance. This form of Insurance provides cover against legal liability arising from damage to property or bodily injury to third parties. General Liability policies exclude design and advice claims, which is why it is important to carry both Professional Indemnity and Public and Products insurance policies.

Without insurance we would not have an operational economy as people would not be willing to take the level of risk required to invest in infrastructure projects, provide advice or even take out a mortgage relevant to a domestic dwelling. Insurance reduces the risk in conducting business, however also carries a degree of risk itself which your Insurance Broker tries to minimise by negotiating terms and conditions. Having said that, it is essential to read your policy wording to know what you are covered for and what you are not covered for, first hand.

To further minimise risk, a cap on liability can also be utilised in addition to Insurance. A financial cap on liability clause in a contract between a Professional, such as an Architect or Engineer, and client operates to limit damages payable by the Professional to the client to an agreed total amount. It is essential that the liability cap is less than the Professional Indemnity policy limit. Under a Professional Indemnity policy, once the limit is reached, the insurer will make no further payments. Where a contract does not incorporate a cap and a Professional is sued for an amount in excess of the Professional Indemnity limit, the remaining portion of uninsured loss could be a devastating financial cost to a firm due to the unlimited liability.

Whilst parties can agree to limit liability to each other for breach of contract or negligence via a financial cap, liability cannot be excluded or restricted in relation to damages for death or personal injury to a person, breach of trust or fraud and dishonesty. Further, liability from claims made by third parties, not involved in the contract cannot be excluded, restricted or capped, as it can be for the client. This highlights the importance of coupling Professional Indemnity and Public & Products Liability Insurance with the cap to reduce likely gaps in cover.

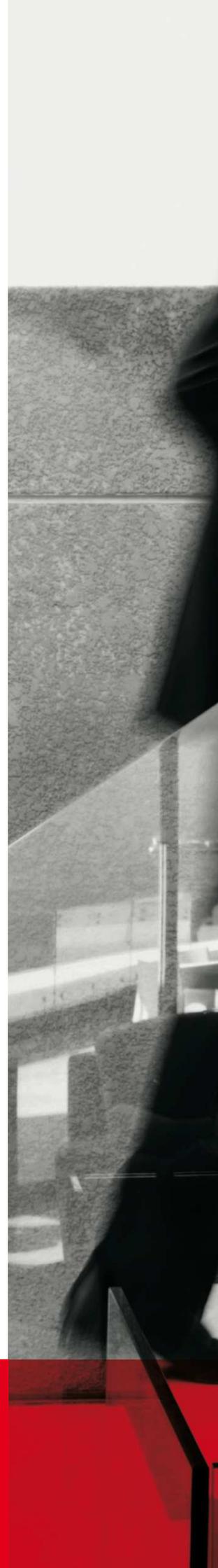
Further, liability cannot be restricted unless the clause or notice to the other party is reasonable. When determining the amount of a cap, the circumstances of the contract need to be considered, that is:

- the value of the contract;
- The financial position of the Professional and their ability to meet a loss;
- Whether Insurance is available.

A proposed cap should be drawn to the attention of the other party and discussions documented. If all parties are well aware of the cap it is harder for the cap to be challenged in a Court of Law.

Calculations of a cap should also be documented. Some thoughts to consider when calculating a cap:

- There is no one method of calculating a cap.
- Each project should be considered, taking into account the risk and complications likely to occur.
- Conduct an evaluation of the damages that may be payable in the event of a claim, for example the costs of repeating or rectifying work.



- Availability of resources of the Professional, such as an engineer or architect, to do rectification or repeat work.
- The financial strength of each party including relationships and previous dealings.
- The Professional Indemnity limit currently in place.

It can be suggested that up to five times the consulting fee may be appropriate, however in a UK case where the liability cap was found to be reasonable, a calculation of ten times the architects fee was utilised. A cap that is too small may not be considered reasonable in the event of a loss suffered by a client.

Whilst risk cannot be totally avoided (unless the job is not entered into in the first place!), Insurance combined with a reasonable cap negotiated, discussed and documented in the contract process between the Professional and client assists to manage risk and potential loss to the business.

This advice and comments are provided in the capacity as your insurance broker and should not be construed as legal advice. Separate legal advice relating to the interpretation and implication of this article for your individual contracts should be obtained.

Sara Mithen  
Claims Administrator – Austbrokers Countrywide  
B.Com (Ins Eco), LLB, Fellow ANZIIF (CIP), Dip. F.S (Brok) QPIB