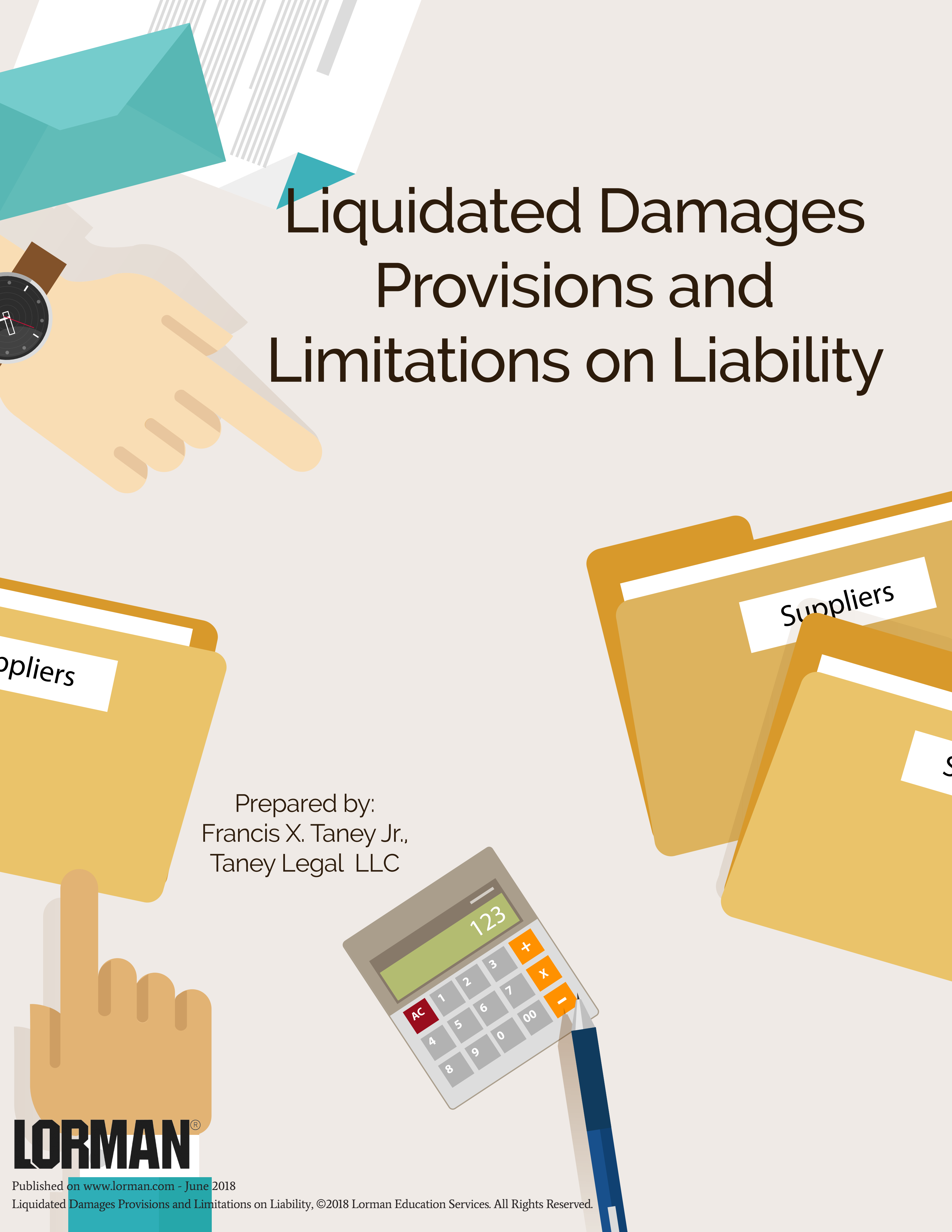

Liquidated Damages Provisions and Limitations on Liability

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The typical "American rule" with respect to damages is that absent a contractual limitation to the contrary, in the event of a contractual breach, the breaching party is liable for all damages that were foreseeable and that proximately flow from the breach. *See Atlas Truck Leasing, Inc. v. First NH Banks, Inc.*, 808 F.2d 902 (1st Cir. 1987). In light of this potential exposure, savvy vendors often ask for limitations on liability. Often these provisions will include limitations on consequential and/or punitive damages. Except in very limited circumstances, these provisions are enforceable, especially in the commercial contract context. *See, e.g., High Plains Natural Gas Co. v. Warren Petroleum Co., A Div. Of Gulf Oil Corp*., 875 F.2d 284 (10th Cir. 1989).

The task in addressing requests for limitation of contractual liability is to ensure that you retain appropriate remedies and recourse in the event of a breach. At the minimum, the contract should expressly require the vendor to repair and/or replace any defective work at the vendor’s expense. The customer should also retain the right to remove the vendor and have a replacement vendor complete the work in the event that the vendor cannot repair or replace defective work. The contract should also require the return of any fees charged for work that the vendor is unable to complete satisfactorily.

In instances where the vendor is earning a larger fee, it is more appropriate and more likely that a customer will be to obtain the right to recover some multiple of the vendor’s fees in the event that the vendor’s mistakes cause consequential damages. In addition, a customer should exclude damages caused by intentional misconduct from the scope of any damages limitation provisions.

In considering requests for damages limitations provisions, it will often be appropriate to consider potential exposure to claims by third parties arising from the vendor’s errors or omissions. These claims may come from your customers or clients damaged by the vendor’s mistakes, or from unrelated third parties.

The typical contractual tool to address these types of claims is an indemnification provision. In this context, the purpose of an indemnification provision is to require the breaching party to make the non-breaching party whole in the event that the non-breaching party faces claims from third parties because of the breaching party's errors or omissions. *Red Roof Inns, Inc. v. Scottsdale Ins. Co.,* 419 Fed.Appx. 325 (4th Cir. 2011). Common uses of indemnification provisions include protection from third party claims for intellectual property infringement, as well as claims arising from intentional misconduct, or from property damage or bodily injury.

Finally, a customer should keep in mind that in the event that a vendor lacks substantial resources, an indemnification provision may not afford as much practical recourse as would be ideal. For this reason, requiring the vendor to obtain appropriate insurance coverages may serve as an effective backstop in the event all else fails.

In some circumstances, it will be difficult or impossible to calculate the amount of damages that a breach will cause. Liquidated damages provisions are potentially useful in these situations.

Liquidated damages provisions are contract terms setting an artificial measure of damages. To be enforceable, courts typically require that they bear some kind of rational relationship to the size of the likely actual damages, and to not be the product of overreaching by one of the contractual parties. *Space*

Master Intern., Inc. v. City of Worcester, 940 F.2d 16 (1st Cir. 1991).

By using liquidated damages provisions appropriately, parties can avoid costly and difficult litigation over quantifying damages, and ensure the availability of a meaningful remedy in such situations.