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Focus

Make Sure Contractual Limits On Liability Are Enforceable

By Jeremiah Reynolds

The threat of liability is always a major concern for businesses in California, and with good reason: the risks and potential costs associated with litigation can be enormous.

A wide variety of businesses, ranging anywhere from local health clubs to Fortune 500 companies, attempt to limit their potential liability with express contractual provisions. While contractual limitations on liability or exculpatory clauses can sometimes be an effective way of reducing the threat of liability, not all such provisions will be enforced.

Whether a court will enforce a contractual limitation of liability depends upon two factors. First, does the contractual limitation on liability violate any California law or public policy? Second, has the contractual limitation on liability been drafted in such a way that it will be enforced?

Although a party can never limit its liability for intentional wrongdoing or willful misconduct (California Civil Code Section 1668), California courts will uphold contractual provisions limiting liability for breach of contract or ordinary negligence so long as the provision does not affect the "public interest" and no other statute expressly prohibits it.

In *Tunkl v. Regents of University of California*, 60 Cal.2d 92 (1963), the state Supreme Court set forth six criteria for determining when contractual limitations on liability affect the public interest:

■ The provision concerns a business generally thought suitable for public regulation.

■ The party attempting to limit liability performs a service of great public importance.

■ The party will perform the service for any member of the public.

■ The party seeking exculpation possesses a decisive advantage of bargaining strength against any member of the public.

■ The party uses a standardized adhesion contract to limit its liability.

■ As a result of the transaction, the party attempting to limit liability has control over the person or property of the other party.

An exculpatory clause does not have to satisfy all of the *Tunkl* criteria to be invalidated on public policy grounds. See *McCarn v. Pacific Bell Directory*, 3 Cal. App. 4th 173 (1992).

In the 42 years since the *Tunkl* decision, California courts on numerous occasions have considered whether contractual limitations on liability affect the "public interest." In making these determinations, courts have placed the most weight on whether the party attempting to limit liability possesses superior bargaining power (fourth *Tunkl* factor), whether the service is of great public importance (second *Tunkl* factor) and whether the party attempting to limit liability has control over the person or property of the other (sixth *Tunkl* factor).

Thus, when a contract containing a limitation of liability clause is negotiated in a commercial context between two entities of roughly equal bargaining power, it will likely be enforced. See, e.g., *Burnett*

Courts place significant weight on whether the party attempting to limit liability is performing a service of great public importance.

v. Chimney Sweep, 123 Cal.App.4th 1057 (2004) (enforcing exculpatory clause in a commercial lease); *Philippine Airlines Inc. v. McDonnell Douglas Corp.*, 189 Cal.App.3d 234 (1987) (enforcing limitation of liability provision in a contract between an aircraft manufacturer and an airline).

On the other hand, an exculpatory provision is less likely to be enforced when it is used in a noncommercial contract between parties of unequal bargaining power. See, e.g., *Henriouille v. Marin Ventures Inc.*, 20 Cal.3d 512 (1978) (refusing to enforce provision in a private residential lease releasing the owner from liability); *Cohen v. Kite Hill Community Association*, 142 Cal.App.3d 642 (1983) (finding that provision releasing a home owners association from liability to homeowners was unenforceable).

Courts also place significant weight on whether the party attempting to limit liability is performing a service of great public importance. Therefore, it is unlikely that an exculpatory clause contained in a contract involving health care services would ever be enforced.

See, e.g., *Westlake Community Hospital v. Superior Court*, 17 Cal.3d 465 (1978) (holding that provision in hospital's bylaws precluding staff from seeking any recovery for termination of staff privileges was unenforceable); *Tunkl* (refusing to enforce provision releasing a charitable research hospital from liability for future negligence).

But when the limitation of liability provision relates to recreational activities that do not have broad public importance — particularly when those activities involve obvious and assumed risks — courts are much more likely to give the clause full effect. See, e.g., *Benedek v. PLC Santa Monica LLC*, 104 Cal.App.4th 1351 (2002) (holding that provision releasing health club from liability for injuries to members was enforceable); *Guido v. Koopman*, 1 Cal.App.4th 837 (1991) (enforcing release of liability for injuries suffered during horse back riding); *McAtee v. Newhall Land & Farming Co. Inc.*, 169 Cal.App.3d 1031 (1985) (enforcing provision releasing the sponsor of a motor cross race from liability for any injuries suffered by participants).

Courts are also unlikely to enforce exculpatory provisions when the party attempting to escape liability was given control over the person or property of another. See, e.g., *Gardner v. Downtown Porsche Audi*, 180 Cal.App.3d 713 (1986) (refusing to enforce clause exempting an auto repair facility from liability to customer); *Vilner v. Croker National Bank*, 89 Cal.App.3d 732 (1979) (holding that provision releasing a bank from liability in connection with a night depositary was unenforceable); *Akin v. Business Title Corp.*, 264 Cal.App.2d 153 (1968) (refusing to enforce clause releasing escrow company from liability for negligence).

The Legislature has, however, passed special rules allowing some parties entrusted with the person or property of

another to limit their liability. See, e.g., California Civil Code Section 1840 (liability of depositary for negligence cannot exceed the amount he is informed by the depositor or has reason to suppose); California Civil Code Section 2174 (liability of common carrier for negligence can be limited by special contract); California Commercial Code Section 7204 (liability of warehouseman for negligence can be limited by contract).

Even if a contractual limitation of liability is found otherwise enforceable (that is, it does affect the public interest), courts will still scrutinize the clause to make sure it has been properly drafted. In terms of visual appearance, any limitation on liability must be easily readable; typeface smaller than eight-point is unsatisfactory. See *Conservatorship of Link*, 158 Cal.App.3d 138 (1984). (Practice pointer: limitations of liability should be written in at least 12-point font or greater.)

An exculpatory provision can also be invalidated if it is buried in the middle of a lengthy document, hidden among other text, or so encumbered with other provisions that it is difficult to find. See *Leon v. Family Fitness Center*, 61 Cal.App.4th 1227 (1998). (Practice pointer: a limitation on liability should be segregated or clearly differentiated from other sections of the contract. Thus, the limitation of liability should be prepared in a font that is different than any other provision, with large section headings indicating that it is a release of liability. Ideally, the parties should be required to separately initial any contractual limitation on liability.)

In terms of content, the contractual limitation of liability must be drafted so that an ordinary layperson would clearly understand they are releasing the other party from liability. This is not an easy task,

as the court in *Hohe v. San Diego Unified School District*, 224 Cal.App.3d 1559 (1990) noted: “A draftsman of such a release faces two difficult choices. His Scylla is the sin of oversimplification and his Charybdis a whirlpool of convoluted language which purports to give notice of everything but as a practical matter buries its message in minutia.”

The drafter of a contractual limitation of liability must make certain to use “releasing language,” such as “release,” “discharge,” or “waive,” which will give the signatory clear notice that it is releasing the other liability from liability. See *McAtee*.

In addition, in those situations where the signatory is going to engage in inherently risky activities, the contractual limitation on liability should clearly state that the party “expressly assumes the risk” of those activities. See *Scoggs v. Coast Community College District*, 193 Cal.App.3d 1399 (1987).

If a party is attempting to limit its liability for negligence, the contractual limitation on liability should specifically state that it is a release for that party’s “negligence.” There is a line of cases holding that a release that does not specifically use the word “negligence” will only exempt a party from “passive negligence,” not “active negligence.” See, e.g., *Ferrell v. Southern Nevada Off-Road Enthusiasts Ltd.*, 147 Cal.App.3d 309 (1983).

A well-drafted contractual limitation of liability can make the difference between a business incurring millions of dollars in liability or facing no liability at all. With so much at stake, take the time to make sure your client uses a contractual limitation on liability that is likely to be enforced.

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