Capital Works Management Framework

Oifig um Sholáthar Rialtais
Office of Government Procurement

Guidance Note 1.6.4

Liability Caps

Application in the Standard Conditions of Engagement

COE1 and COE2

Liability Caps: Application in the Standard Conditions of Engagement CO1 & COE2
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Section 1: Introduction

1.1 Purpose of this Guidance Note

Published on 31 March 2023, the Standard Conditions of Engagement for Consultancy Services (Technical) and the Standard Conditions of Engagement for Archaeological Services each now contain a new sub-clause entitled “Limit on Liability”.

This new sub-clause provides that liability of a Consultant to the Client, as ascertained in any year, is limited to a monetary amount, as stated by the Client in Schedule A to the contract (“the Liability Cap”). The Liability Cap does not apply in all circumstances and is subject to certain exclusions, these are also set out in Schedule A (FTS9 or FTS10). Where the liability of a Consultant falls under one of the excluded circumstances, the Consultant will be liable in full to the Client for any losses or damages incurred.

This Guidance Note describes the Liability Cap and provides guidance on how to arrive at an appropriate amount at which to cap the liability of a Consultant under or in connection with a contract formed using the Standard Conditions of Engagements. (COE1 or COE2).

Terms used in this Guidance Note have the same meaning as in the Standard Conditions of Engagement, unless otherwise stated.

1.2 Background

For entities engaged to perform a contract, there will be a risk of incurring liability, both to the party who engaged them and to third parties. Liability may arise under various situations such as, a breach of contract (including a breach of the contractual standard of care), or in tort by negligence (i.e. breaching a duty of care), or a breach of a statutory duty. For an entity contemplating performing a contract, it can therefore be difficult to estimate the extent of potential liabilities, which in turn may lead to an unquantified level of financial exposure.

Where contracts do not have a cap on liability, it may result in reduced competition for the award of the contract. Entities may be reluctant, or unable (either by virtue of their size, financial capacity to carry high levels of insurance or by their corporate policies) to take on the commercial risk, particularly where the level of fee relative to the level of risk is perceived as disproportionate (“the risk/reward relationship”).

Alternatively, in return for taking on the risk, where entities do participate for the award of a contract, it may do so only on the basis that it includes risk premiums (and/or increased levels of insurance, where available) in the tendered price, in return for taking on the risk of unquantified financial exposure. Either or both, situations may lead to reduced competition and increased tender prices that may not deliver value for money outcomes for the party commissioning the contract.

Capping liability in a contract may offer entities a degree of assurance in performing the contract. It can enable entities to assess, with a greater degree of confidence, the level of risk of financial exposure associated with taking on the contract and make provision for taking it on. It may also increase competition and deliver better value for money outcomes for the party commissioning the contract.

The introduction of Liability Caps into the Standard Conditions of Engagement falls out of an ongoing review of the Capital Works Management Framework, and seeks to improve the overall risk/reward balance under the Standard Conditions of Engagement. It also seeks to encourage greater participation for the award of public services contracts and, in particular, facilitate the participation of small to medium enterprises in tendering opportunities for public service contracts.

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*It should be noted that the Liability Cap **does not** limit the liability of a Consultant to third parties.*

Section 2: Liability Caps in the Standard Conditions of Engagement

2.1 General

New sub-clauses have been incorporated in the standard conditions of engagement for Consultancy Services (Technical) (CoE1)/Archaeology Services (CoE2) and their respective forms of Tender and Schedule[1] published on or after 31 March 2023.

The new sub-clauses (2.17/2.18 (Limit of Liability)) provide that the Consultant's liability to the Client as ascertained in a calendar year commencing on 1 January arising out of or under the contract, is limited to the amount, and subject to the exclusions, as Scheduled.

Schedule A to the Agreement also contains new sub-clauses, where the amount of the Liability Cap to apply to the contract is stated, and the exclusions to its application. The Client states the monetary amount of the Liability Cap that applies to the contract when issuing the invitation to tender documentation.

2.2 Liability Cap Exclusions

The Liability Cap does not apply to all circumstances in which the Consultant may incur liability to the Client. Those liabilities excluded from the application of the Liability Cap are stated in Schedule A ("the Liability Cap Exclusions").

Where a Client's claim against the Consultant relates to any Liability Cap Exclusion, the liability of the Consultant to the Client is uncapped, and the Consultant is liable in full to the Client (the quantum of which would be calculated in accordance with well-settled legal principles). Any claim relating to a Liability Cap Exclusion does not reduce or exhaust the amount of the Liability Cap.

The Liability Cap does not apply to liability of the Consultant to the Client that relate to:

a) death, personal injury or illness;
b) fraud or fraudulent misrepresentation;
c) wilful default;
d) gross negligence;
e) third party property;
f) sub-clause 13.26 of this Agreement; or
g) any liability which the Consultant cannot lawfully exclude or limit.

[1] i.e. FTS-9 and FTS-10

Death, personal injury or illness

The Liability Cap Exclusion in a) above relates to circumstances where a Client incurs a liability to any party for death, personal injury or illness arising from a breach of contract or negligence by the Consultant. Where these circumstances apply, the Consultant's liability to the Client is uncapped, on the basis that the Client should not be held liable for any difference between the extent of its liability to any person, and that of the Consultant's Liability Cap.

Fraud or fraudulent misrepresentation, wilful default, gross negligence

The Liability Cap Exclusions under b) to d) above are behavioural and prevent the Consultant being released from any liability in circumstances where the Client's claim (be it for its own losses or a liability it might incur to a third party) arises from acts/behaviour that are not mere negligence or breach of the contractual standard of care.

Third party Property; Sub-clause 13.26 of the Agreement

The Liability Cap Exclusions in e) and f) are for loss of or damage to a third party's property and infringement of a third party's intellectual property rights under sub-clause 13.26 of the Agreement. Where the Client is caused a liability to a third party in relation to either their property rights or intellectual property rights, the Consultant's liability to the Client is uncapped.

Any liability which the Consultant cannot lawfully exclude or limit

The final category of excluded liabilities relates to any liability, which under law, cannot be excluded.

2.3 Setting the Amount of the Liability Cap

There is no standard approach in relation to setting a limit on liability for contracts. The approach recommended in this Guidance Note is that the monetary amount of the Liability Cap should reflect a combination of the level of risk to the Client associated with the provision of the required services balanced, where relevant, with value for money considerations.

The risk based amount may be arrived at by firstly conducting an assessment of potential loss to the Client, and the likelihood of loss arising, as a result of a breach or negligence by the Consultant in performing the contract. Depending on the project circumstances, it may also be appropriate to take into consideration commercial factors that may influence value for money outcomes.

At an early stage in preparing the contract for tender, the Client should arrange that an assessment of the risks associated with the occurrence of a breach of the contract or negligence be carried out. Expert advice should be sought if necessary. The assessment should:

- identify the risks that may arise from a failure to comply with the contract (in the sense of a breach of the contractual professional standard of care in performing the services and/or negligence);
- estimate the financial loss should the risk occur; (the impact)
- estimate the likelihood that the risk could occur; (the likelihood)
- assess the resultant severity of the risk to the Client (the risk rating).

Essentially, if the Consultant does not properly do what it was meant to do under the contract, the Client should seek to estimate the likely level of financial loss that could be incurred. The exercise could look at different aspects, for example, based on a breach of the contract and damage that might only arise once, but which could be quite serious, and one or more breaches which could arise several times during the course of the contract, or one or more which could emerge after the project is completed.

The Client would seek to estimate what would it cost to put things right and to put the Client financially in the place it would have been had the contract not been breached. Inflation, which previously was not a factor with a cap on liability for many years, will now have to be considered and added to the cost estimate.

So, in essence the risk assessment should look at the following elements:

- What could realistically go wrong?
- How long could it take a problem to emerge?
- How much might it cost (including inflation) the Client?
- What is the realistic likelihood that it will happen?
- Can the risk be mitigated (i.e. are there any control or mitigation measures that can reduce the outcome on the Client?)
- What is the resulting financial consequence of the treated risk?
- What is the resulting likelihood of the occurrence of the treated risk?

Conventional risk matrices[2] may be used to categorise and score the magnitudes of financial loss (i.e. the impact) and the likelihood of the loss occurring (i.e. the probability that the risk could occur). By multiplying the impact score by the likelihood score, the outcome of the risk falls into rated categories (e.g. such as low, medium, high for a 3 by 3 risk matrix.). The risk outcomes judged to be of most relevance to the project circumstances are selected to form the basis for the Liability Cap. The cost estimates for the individual risks within the risk ratings category or categories are selected, and aggregated to arrive at an estimate for the amount of losses (that may be ascertained in any year) for the Liability Cap.

During the tender document preparation stage, the outcome of the risk assessment should be kept under review, both to factor in new information as it becomes available, and to

[2] (Guidance Note 1.1 contains further guidance on conducting risk assessments). See Appendix I for a sample

identify risk treatment measures and inform the preparation of the tender documentation. For instance risk treatment measures may be incorporated into the Services or inform the use of selection or award criteria.

Risk/Reward Relationship and Value for Money

Where appropriate, consideration may also be given as to whether the estimated risk based amount (as described above) represents a commercially acceptable risk for those entities likely to tender for the contract and, in turn, deliver a value for money outcome. Some relevant commercial factors include the availability and cost of professional indemnity insurance (PII) to respond to liability and the relationship between the amount of the Liability Cap and the fee amount. Technical merit criteria, and the weightings applied to them, signal to tenderers where the contracting authority's priorities lie and give confidence to tenderers to price the true cost of their service.

For consultants, PII represents the primary mechanism to insure for liability for breach of contractual duty and/or negligence in the course of providing services. The availability and cost of obtaining PII may be of relevance when assessing the level of commercial risk the Liability Cap represents. In practice, where a liability is not covered by insurance, (because either it is uninsurable, or the cost to insure against would be prohibitive) a Client's ability to recover financial losses will be limited to the financial capacity of the entity to respond to liabilities (e.g. balance sheet assets/guarantees etc.). However, high levels of uninsured liability may pose a commercial risk to entities.

Whilst the Liability Cap amount should not be set by reference to the fee level for the services, (and a risk assessment as described above should always be used) their relative relationship may, depending on the project circumstances, serve to assess the relative level of commercial risk that the Liability Cap represents to an entity in taking on the contract.

In the round, Clients should judge as to whether the initial estimate for the Liability Cap is likely to lead to a value for money outcome, and refine the estimates as may be appropriate to respond to commercial factors to arrive at an appropriate amount to enter into the Schedule.

For instance, it may be assessed that using some risks in the assessment rated as high impact with a low probability of occurrence may not lead to value for money outcomes and consideration may be given to excluding them from the risk assessment in order to reduce the level of commercial risk.

In practice, high value Liability Caps, unless justifiable by the particular circumstances, may not result in value for money outcomes. Clients should strive to arrive at an amount that represents an amount derived from a reasoned risk assessment of losses in the event of a breach/negligence and, for an entity taking on the contract, represents return for a commercially reasonable level of risk in return for the fee earned by performing the contract.

*The risk assessment **does not** need to include liabilities that arise in relation to the Liability Cap Exclusions, as liability for these liabilities remains uncapped.*

Section 3: Other Considerations

3.1 The Default Amount for the Liability Caps

Paragraph 2.17 in the Schedule also provides in circumstances where an amount is not stated for the Liability Cap, €1,500,000 (one million five hundred thousand euro) applies. The objective of providing a default amount is to ensure that where the Client does not state an amount, the default amount applies, so that in such instances a Liability Cap applies to the contract (as opposed to unlimited liability).

However, in all instances, Clients should take care to carry out the risk assessment described previously to arrive at the appropriate amount of the Liability Cap, and should not rely on the default amount, unless it represents an appropriate amount for the Liability Cap given the circumstances of the project.

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*The Liability Cap default amount of €1,500,000 is **not** a recommended, or a standard norm, for the Liability Cap.*

Contracting Authorities should not rely upon it as an alternative to carrying out an assessment of risk (as described Section 2.3 of this guidance note).

In the absence of a considered assessment, the use of the default amount may not result in an appropriate amount of the Liability Cap to apply for a contract.

When contracting authorities elect to use the default amount, its relationship to the level of PII sought under the contract must be considered.

3.2 Professional Indemnity Insurance

The amount of the Liability Cap should not be set lower than the amount sought for the professional indemnity insurance, as it may mean that the full benefit of the PII may not be realised (in the event of a claim for liability to which professional indemnity insurance is intended to respond).

3.3 Liability Caps for Sub-Consultants

If the project requires the use of a Sub-Consultant, the Contracting Authority may wish to request a Collateral Warranty. Model Form 2.3 *Collateral Warranty for Sub-Consultants* contains a Cap on the Sub -Consultant's Liability to the Client in the annual aggregate to the

amount inserted in Clause 10.1 of MF 2.3. Identical exceptions to the Liability cap apply for the Sub-consultant as in the Main contract.

The same consideration and risk assessment should be taken in the Collateral Warranty as in the Main Contract. These may include:

- Consideration of the role of the Sub-consultant in the overall delivery of the service should determine the level of the liability cap that is set.

- The level of the liability cap set for the Sub-consultant should not exceed the level set in the Main Contract but it may, where appropriate to the importance of the role of the Sub-consultant, be set at the same level.

It is important to note that the Sub-consultant may not have any cap on liability set within the conditions that have been agreed between the Consultant and the Sub-Consultant. The Collateral Warranty does not purport to set a liability cap between the Consultant and Sub-consultant.

Appendix 1

Example of a Risk Matrix

	Risk Matrix	<---------- IMPACT ---------->				
		A	B	C	D	E
		Minor	Moderate	Major	Critical	Catastrophic
100%	5 - Almost certain	**Low**	**Medium**	**High**	**High**	**High**
80%	4 - Likely	**Low**	**Medium**	**Medium**	**High**	**High**
50%	3 - Possible	**Low**	**Medium**	**Medium**	**High**	**High**
10%	2 - Unlikely	**Low**	**Low**	**Medium**	**Medium**	**High**
2%	1 - rare	**Low**	**Low**	**Low**	**Medium**	**Medium**

[END]