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Preventing Limitation of Liability End-Runs

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Owners who are dissatisfied with their contractors' performance increasingly assert fraud-based claims in addition to breach of contract claims because fraud-based claims are not typically barred by contractual waivers and limits of liability. Fraud-based claims may also create the potential for punitive damages in addition to compensatory damages. Contractors and their counsel, however, can limit their potential exposure for fraud-based claims through careful contract drafting and thoughtful selection of the law to be applied to disputes.

When selecting the law to be applied to disputes, contractors should first consider the codified law of the jurisdiction where the project is to be built and of any jurisdiction whose law they are considering. They should first determine whether the state in which the project is located is one of the approximately 26 states that has a "home court rule" that deems void any choice of law clause that applies the law of another state to domestic construction projects. *See, e.g.,* Va. Code Ann. § 8.01-262.1; Tex. Bus. & Com. Code Ann. § 272.001; N.Y. Gen. Bus. Law § 757. If the state in which the project is located has such a statute, a contractor's selection of another state's law will likely not be enforced unless the parties agreed to arbitrate their disputes (in which case the Federal Arbitration Act [FAA] may supersede state law) or the project was located in a federal enclave, such as a military base (in which case state law does not apply). *See Ope Int'l LP v. Chet Morrison Contractors*, 258 F.3d 443 (5th Cir. Tex. 2001) (deeming preempted Louisiana's home-court rule as applied to an agreement to arbitrate subject to the FAA); *United States ex rel. Milestone Contractors, L.P. v. Toltest, Inc.*, No. 1:08-cv-1004-WTL-JMS, 2009 U.S. Dist. LEXIS 44382 (S.D. Ind. May 27, 2009) (Indiana home-court rule had no effect given that state law did not apply to training base of Indiana National Guard).

Another group of statutes that contractors should consider are those that regulate the availability of punitive damages. Approximately 25 states cap punitive damages at specified amounts or multiples of actual damages. For example, New Jersey caps punitive damages at five times compensatory damages or $350,000, whichever is greater, N.J.S.A. 2A:15-5.14; Ohio caps punitive damages at two times compensatory damages under most circumstances, O.R.C. 2315.21(D)(2)(a); and Nebraska does not permit punitive damages at all, *see* Neb. Const. art. VII, sec. 5, note 3 (citing *State ex rel. Cherry v. Burns*, 602 N.W.2d 477 (Neb. 1999)).

Contractors should also consider differences in common (aka judge-made) law. For example, in most jurisdictions, the economic loss rule bars plaintiffs from asserting tort causes of action to recover for "economic loss," typically defined as any loss other than personal injury or third-party property damage. Some jurisdictions, such as Missouri, include fraud among the tort causes of action for which plaintiffs may not recover for economic loss. *See Self v. Equilon Enters., LLC*, No. 4:00CV1903 TIA, 2005 U.S. Dist. LEXIS 17288 (E.D. Mo. Mar. 30, 2005). Wisconsin and Michigan apply the economic loss rule when the alleged fraud is interwoven with, as opposed to extraneous to, the contract. *See Kaloti Enters., Inc. v. Kellogg Sales Co.*, 699 N.W.2d 205 (Wis. 2005); *Huron Tool & Eng'g Co. v. Precision Consulting Servs., Inc.*, 532 N.W.2d 541 (Mich. Ct. App. 1995). California is among the many jurisdictions that exclude fraud entirely from the economic loss rule, citing concerns about deceitful contracting. *See Robinson Helicopter Co. v. Dana Corp.*, 102 P.3d 268 (Cal. 2004).

Pennsylvania's "gist of the action" doctrine is another example of a helpful common law rule. Similar to the economic loss rule, it precludes owners from asserting extra-contractual claims, including fraud-based claims, that "merely duplicate" their contractual claims. *See Bruno v. Erie Ins. Co.*, 106 A.3d 48 (Pa. 2014). In Washington, courts have dubbed the doctrine the "independent duty" doctrine, reasoning that a contracting party has a duty in tort to another contracting party only if that duty is independent of the agreement. *See Donatelli v. D.R. Strong Consulting Eng'rs, Inc.*, 312 P.3d 620 (Wash. 2013).

Most jurisdictions require plaintiffs asserting fraud claims to prove a multitude of factors — including materiality, intent, justifiable reliance and proximate cause — to a stringent standard of proof. Several jurisdictions, however, permit unique causes of action that present a lower barrier. South Carolina has a cause of action known as "breach of contract accompanied by a fraudulent act," which permits a jury to award punitive damages for a breach of contract so long as the plaintiff can prove that the breach was "accomplished with fraudulent intention" and "accompanied by a fraudulent act." *See, e.g., Maro v. Lewis*, 697 S.E.2d 684 (S.C. Ct. App. 2010). But, because breach of contract accompanied by a fraudulent act is a state-law, contract-based cause of action, contractors can avoid its application by selecting a different jurisdiction's law in their contracts. *See Palmetto Health Credit Union v. Open Solutions, Inc.*, No. 3:08-cv-3848-CMC, 2010 U.S. Dist. LEXIS 67768, at *17-19 (D.S.C. July 7, 2010).

The common law can also be a source of guidance on the language that contractors should employ in drafting their contracts. Courts in some jurisdictions, including Delaware, Illinois, New York and Texas, have held that so-called "non-reliance clauses," in which the parties expressly represent that they relied only on information within the agreement, bar plaintiffs from subsequently asserting fraud claims based on extrinsic representations. *See RAA Mgmt. v. Savage Sports Holdings*, 45 A.3d 107 (Del. 2012) (applying New York law, but concluding decision would have been the same under Delaware law); *Schraeger v. Bailey*, 973 N.E.2d 932 (Ill. App. Ct. 2012); *Danann Realty Corp. v. Harris*, 5 N.Y.2d 317 (1959); *Schlumberger Tech. Corp. v. Swanson*, 959 S.W.2d 171, 179 (Tex. 1997). A non-reliance clause is more specific than a standard integration clause, which merely recites that the contract is the sole agreement between the parties and replaces any prior agreements. A standard integration clause is generally insufficient to limit the parties' obligations to promises within the agreement. *See, e.g., Schraeger*, 973 N.E.2d 932. In any jurisdiction, the more clearly and precisely a non-reliance clause details the information the contracting parties rely on in forming their agreement, the more likely it is to be enforced. A non-reliance clause that is bargained for between sophisticated business entities is also more likely to be enforced than is one in a boilerplate consumer contract.

Contractors should also keep in mind that their choice of law will likely impact the conduct and cost of any litigation, as well as the best choice of outside counsel to handle the matter. Choice of law should also be coordinated with choice of venue; they need not be the same, but counsel should consider how likely courts in the chosen venue are too conscientiously and effectively apply the law of another state. Contractors should work closely with their counsel to select the law most appropriate for their projects.