



BASIC GUIDELINE FOR USING LIMITATION OF LIABILITY CLAUSES IN COMPLEX INFORMATION TECHNOLOGY CONTRACTS

**Version 1.1
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This guide is designed for both program and project managers, as well as the upper management to whom they report. Procurement staff is encouraged to distribute this guide to appropriate staff at the beginning of acquisition planning. Procurement staff should also share this document with agency legal counsel and use it as a training resource. This guide should be used in conjunction with the Risk Analysis Framework for Service Contracts.

This document does not create a binding procedure or create rights or obligations for or against the State.

This guide has been tailored for use in procurements conducted by the Division of Procurement Services.

Using Limitation of Liability Clauses

Any contractor performing services finds itself at risk for becoming legally liable for harm arising out of its performance or non-performance. A janitor may be liable for personal injuries that result from an overly slick floor. Perhaps a cloud-services vendor is liable if it deletes all its customers' data. Just like the agency, contractors must identify, analyze, and manage risk. For the contractor, one way to manage risk is through clauses that (a) cap the liability for certain damages at a particular dollar value, (b) eliminate the contractor's liability for other types of liability (e.g. consequential and punitive damages), and/or (c) provide that the contractor has no responsibility for certain types of loss or harm (e.g. loss of data). Such clauses are usually characterized as a "limitation of liability clauses" or "LOL clauses."

The Division of Procurement Services' ("Division") model limitation of liability clause and the associated guidance appear in the Compendium. **Each agency must determine for itself whether the Division's model clause is appropriate for its needs on a case-by-case basis for each procurement.**

When to Use

Limitation of liability clauses should be used rarely. With two exceptions, the Division has found limitation of liability clauses unnecessary for the vast majority of its contracts. Risk is effectively allocated by our existing laws and by other contract terms. The exceptions are contracts for software licensing and complex IT services, such as cloud-based services or software development. In such contracts, limitation of liability clauses have become ubiquitous—to the point that many software and IT firms refuse to sign a contract without one. Accordingly, the Division strongly recommends that an agency consider including a limitation of liability clause in such contracts. Further, the decision to include a limitation of liability clause should be made *prior* to solicitation, because failure to include such a clause in the solicitation could (a) effectively prevent it from being added during negotiations and (b) potentially result in a failed procurement.

Before issuing the solicitation, the using agency should appraise the risks involved and consider other means of managing these risks, such as adjusting performance obligations, using other typical clauses, implementing effective contract management, and defining a milestone-based payment schedule.

A key purpose of a limitation of liability clause is to allow the contractor to avoid "bet the company" exposure for a catastrophic risk, while retaining the State's rights to recover for some losses resulting from the contractor's breach. Balancing these interests requires careful assessment of the risks involved and creative ways to allocate and manage those risks.

Before including the clause in any solicitation, procurement officers are strongly cautioned to consult with and obtain clause-specific prior written approval from the using governmental unit. Using agencies should be advised to study the model clause and associated guidance in the Compendium and to consult both its upper management and legal counsel before approving the use of a limitation of liability clause.

The Model Clause

No model clause works in every situation. For example, the model clause waives the agency’s right to recover consequential damages from a contractor. In appropriate circumstances you may consider eliminating this language or substituting it with a listing-by-type of the damages that cannot be recovered. Either approach has disadvantages. Never alter any of the terms without first consulting legal counsel.

The model clause for a single agency contract is found at **Attachment A**. The model clause for a multi-agency contract is found at **Attachment B**. The clauses are nearly the same, but the multi-agency clause also includes language stating that the limitation applies to each using governmental unit individually. (See multi-agency clause, subsection (1)).

Below is a breakdown of the single-agency clause.

Clause Text	Notes
<p>(1) Contractor’s liability for damages to the Using Governmental Unit shall not exceed [<i>a dollar amount</i>].</p>	<p style="text-align: center;"><u>Compendium Notes</u></p> <p>Use rarely. For most contracts, avoid this clause. It is often appropriate for software licensing and complex information-technology contracts, such as cloud services or large software-development projects.</p> <p>Always receive clause-specific written approval from the using governmental unit before including this clause in a solicitation.</p> <p>Do not modify this clause without first consulting legal counsel.</p> <p>YOU MUST INSERT A DOLLAR FIGURE THAT REPRESENTS THE CAP.</p> <p>When determining an appropriate cap for subsection (1), always perform a risk analysis that identifies the risks and analyzes the probability of the risk manifesting and the consequences of the harm. Also consider to what extent contractor insurance requirements (see clauses 07-7B056-2 and 07-7B058-1) may help determine how much risk must be covered under the cap.</p> <p>Never agree to limit the cap in subsection (1) to total contract price, absent careful consideration and compelling circumstances; doing so may effectively eliminate the recovery of any damages to the agency—leaving only a refund for something you may not have received. In some circumstances, doing so may undermine the contractor’s financial incentive to fully perform.</p>

Additional Discussion re: Damage Caps & Multipliers

See the section titled “The Cap,” below, for a discussion on how to analyze and quantify an appropriate liability cap. The model language contemplates the cap will be a dollar figure rather than a multiplier of the total contract value. A dollar figure, arrived at after a thorough risk analysis, is usually the better choice. Vendors, however, often want to use the total contract value, or a multiple of that value, as the cap. Although the Division discourages the use of a multiplier, one may be appropriate in certain circumstances. For example, consider using a multiplier when: (a) it is unknown how much of a given item or service will ultimately be procured; (b) it is foreseeable a subsequent change order might be issued to add additional goods or services; or (c) the term of the contract might be extended for many years such as where the contract provides the State with a short, initial term but multiple annual renewal options. In such circumstances, use of a multiplier will automatically increase the damage cap making it unnecessary for the procurement officer to try and re-negotiate an increase to the cap when the contract is extended, a change order is issued, etc. Notwithstanding the preceding sentence, when issuing a change order to add new goods or services, make sure they pose the same level or risk as the original goods/services set forth in the contract. Otherwise, it may be necessary to negotiate an entirely new damage cap.

See the section titled “Use of a Multiplier,” below, for a discussion of issues and risks associated with using a multiplier. If you use a multiplier, you are strongly encouraged to consider also using a fixed dollar amount to create a floor that offers a minimum layer of protection (i.e. the damage cap is the greater of: (i) [a fixed dollar amount]; or (ii) three times the contract value). If the limitation of liability contains only a multiplier and a change order reduces the contract’s value, the contractor’s exposure is likewise reduced. Using both a dollar figure and a multiplier in these situations helps to prevent such a scenario. **If you use a multiplier, you must perform a risk analysis as provided above BEFORE deciding on an appropriate multiplier. If you use both a multiplier and a fixed dollar amount as recommended, perform the risk analysis first, then determine the appropriate damage cap in**

	fixed dollars and finally select a multiplier based on the risk analysis and fixed dollar amount.
(2) The parties waive claims against each other for (i) exemplary or punitive damages and (ii) special or consequential damages.	Contractors may prefer to limit liability to direct damages. Likewise, contractors may wish to also exclude liability for specific sets of damages, such as loss of data or lost profits. Exercise caution! The existing clause provides contractors sufficient protection. Adding specifically-excluded categories can result in unintended consequences if they are drafted too broadly.
(3) The foregoing limitations shall not apply: (a) to claims for physical damage to real or tangible personal property, (b) to claims regarding bodily injury, sickness, disease or death, (c) to claims arising from reckless or intentional misconduct, (d) to amounts due or obligations under a clause (regardless of how named) providing for liquidated damages, or if such a clause is ruled unenforceable as a penalty, (e) to amounts due or obligations under the following clauses, if included: (i) Indemnification-Third Party Claims-General, (ii) Indemnification-Third Party Claims-Disclosure of Information, (iii) Indemnification-Intellectual Property, (iv) Information Security-Safeguarding Requirements, (v) Information Security-Location of Data, (vi) Information Use and Disclosure-Standards, or (vii) Service Provider Security Representations; (f) to amounts due or obligations under a clause imposing a duty to defend or indemnify, or (g) to any loss or claim to the extent the loss or claim is covered by a policy of insurance maintained, or required by this contract to be maintained, by contractor.	<p>This clause is meant to protect the State from certain events that are carved out from the liability limitation. In other words, there is no cap on the vendor's liability if one or more of the enumerated events occurs.</p> <p>Do not modify any of the exclusions in this clause without first consulting your supervisor and legal counsel.</p> <p>Regarding subsection (3)(c), without such language, the contractor in theory could intentionally destroy state property or cause other harm and still be protected from full liability.</p>
(4) The absence in any subcontract of a similar clause limiting contractor's liability shall not effectively increase the obligation of the Using Governmental Unit beyond what it would have been had the subcontract contained such a clause.	This is meant to protect the State in the event a subcontract does not limit liability to the same extent that the contract does.
(5) The Using Governmental Unit's liability for damages, if any, shall not exceed <i>[a dollar amount]</i> . Nothing herein shall be construed to waive any law or clause regarding the availability or appropriation of funds, sovereign immunity, or any other immunity, restriction, or limitation on payment or recovery provided by law.	<p>This subsection limits the liability of the State.</p> <p>YOU MUST INSERT A DOLLAR FIGURE. Prior to Solicitation delete the phrase "a dollar amount" and replace with an actual number. See the discussion of subsection (1) above, as well as the section below titled "Use of a Multiplier," for the appropriateness of using a multiplier.</p> <p>This cap on the agency's liability should never be greater than the cap on the contractor's liability set forth in subsection (1) above.</p>

(6) The State of South Carolina’s total liability for any obligation under any clause imposing any duty of confidentiality or non-disclosure shall not exceed an amount equal to fifty thousand dollars.	Vendor contracts often impose a duty of confidentiality on the State. Unlike private business, government is designed to be open and transparent. Without this paragraph, the State’s liability for an inadvertent disclosure might be uncapped.
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The Cap

Before agreeing to use a limitation of liability clause with a Cap, the agency must determine the dollar value at which it will agree to cap the contractor’s liability. This requires a meaningful analysis of the risk of loss involved in the contractor’s actions or inactions; the probability that those risks will manifest; the degree of harm the State would suffer for those risks; as well as the State’s ability to assume, eliminate, mitigate, insure, or transfer the risk. Consult the Division’s “Risk Analysis Framework for Service Contracts” to help with this process.

In calculating an appropriate cap, a using agency should do the following:

1. Identify the applicable risks.
2. Analyze the probability and severity of harm. What is the worst case scenario? (See the accompanying *Risk Analysis Framework for Service Contracts*)
3. Decide how to manage each risk—i.e., assume, eliminate, mitigate, insure, or transfer each risk (or a combination of two or more).
4. For insured risks, identify the risks to be insured by the contractor or the agency, and determine the coverage limits needed to do this appropriately.
5. For risks the agency expects the contractor to accept and mitigate, place a dollar value on the potential harm.
6. Consider the relationship between the value of the harm and the cost of the service. Is the contractor’s reward worth the risk you are asking them to accept? Vendors may not bid or may increase their fees significantly if the agency includes an unreasonably high damage cap.
7. Assess whether the cap is realistic for the market. For example, some reputable and financially secure vendors selling low-cost commodity services or software licenses will not agree to unlimited liability or to a high cap on liability.
8. **Resist the temptation to shortcut your analysis by simply using a multiplier of the contract value or single order value.** If you ultimately decide to use a multiplier, make sure you understand what is being multiplied, and make sure the total cap is appropriate. (See Section below titled “Use of a Multiplier”.)
9. Never agree to a cap so low that you undermine the contractor’s financial incentive to perform, even if such a low cap is otherwise acceptable to the agency given the overall risk profile and

strategy. The risk that the contractor will simply walk away can be greater if the cap is equal to or less than the total contract price.

10. Consider adjusting the cap downward if some of the risk has been managed elsewhere—e.g., an insurance clause that covers \$1,000,000 of the potential risk—or addressed through one of the “carve outs” in subsection (3) of the Model Limitation of Liability Clause.
11. Never agree to cap liability to “amounts paid,” “amounts actually paid,” or a multiple of the “amounts actually paid” because a breach occurring early in the performance of the contract will drastically lower the amount recoverable by the State.

Use of a Multiplier

Some vendors prefer the cap be set at a multiple of the contract value (e.g. 2x, 3x, 4x the total contract value) rather than a dollar amount. Historically, the Division has discouraged use of a multiplier, as they are often used to shortcut the appropriate risk analysis. **IN ADDITION, THEY TEND TO RESULT IN NEGOTIATIONS ABOUT THE SIZE OF THE MULTIPLIER, WHICH RESULTS IN EXPONENTIAL ADJUSTMENTS TO THE CAP, RATHER THAN SURGICAL CHANGES.** Also, when using a multiplier, change orders can affect “Aggregate Contract Price,” which means a change order may increase or *reduce* a contractor’s liability beyond what was anticipated during negotiations. A dollar figure is preferred. A multiplier, however, may be appropriate in some circumstances as outlined in the section of the Table above titled “Additional Discussion re: Damage Caps & Multipliers.” If use of a multiplier is prudent, then you are strongly urged to use both a multiplier and a fixed dollar value. The fixed dollar value will serve as a fixed minimum or floor for the damage cap in the event a change order is issued lowering the contract price. *If the agency uses a multiplier, consider the following language as a replacement for subsections (1) and (5) of the Single-Agency Model Clause and for subsections (1) and (6) of the Multi-Agency Model Clause.* **Again, if you use a multiplier, you must perform a risk analysis BEFORE deciding on an appropriate multiplier. If you use both a multiplier and a fixed dollar amount as recommended, perform the risk analysis first, then determine the appropriate damage cap in fixed dollars and finally select the multiplier based on the risk analysis and fixed dollar amount.**

<p><u>Single-Agency Clause</u></p>	<p>(1) Contractor’s liability for damages to the Using Governmental Unit shall not exceed the greater of [<i>a dollar amount</i>] or an amount equal to [<i>a multiple of</i>] the Aggregate Contract Price. As used in this clause, the term “Aggregate Contract Price” means the total price for the Initial Term and all Renewal Terms of this Contract.</p> <p>(5) The Using Governmental Unit’s liability for damages, if any, shall not exceed the greater of [<i>a dollar amount</i>] or an amount equal to [<i>a multiple of</i>] the Aggregate Contract Price. Nothing herein shall be construed to waive any law or clause regarding the availability or appropriation of funds, sovereign immunity, or any other immunity, restriction, or limitation on payment or recovery provided by law.</p>
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<p>Multi-Agency Clause</p>	<p>(1) Contractor’s liability for damages to the Using Governmental Unit shall not exceed the greater of [a dollar amount] or an amount equal to [a multiple of] the Aggregate Contract Price. As used in this clause, the term “Aggregate Contract Price” means the total price for the Initial Term and all Renewal Terms of this Contract.</p> <p>(6) The Using Governmental Unit’s liability for damages, if any, shall not exceed the greater of [a dollar amount] or an amount equal to [a multiple of] the Aggregate Contract Price. Nothing herein shall be construed to waive any law or clause regarding the availability or appropriation of funds, sovereign immunity, or any other immunity, restriction, or limitation on payment or recovery provided by law.</p>
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Overlooked Terms

Do not let your attention to a limitation of liability clause distract you from other contract terms that may be as or more important. Many contractors attempt a multi-layered approach to avoiding liability, including liability for non-performance. Some common approaches include provisions that (a) define an exclusive remedy (e.g., repair, replace, refund, or service credit); (b) narrowly define an express warranty, with all other warranties disclaimed; (c) impose limiting conditions on an express warranty; (d) contain narrow or vague performance obligations; (e) expressly disclaim an obligation; (f) or impose unreasonably broad obligations on the agency. Thus, do not view the limitation of liability clause in isolation—the contractor may have a “gotcha” elsewhere in the contract. Review each risk allocation term proposed by the contractor to ensure you do not assume more risk than you intended. Think about what the agency is giving up.

Summary

Limiting liability can entice otherwise reluctant vendors—particularly in the information technology industry—to do business with the State, giving them comfort that a remote risk will not bankrupt their company. In the commercial world, many vendors are accustomed to contracts with limitations on liability. Without such limitations, larger IT firms may simply refuse to bid, thereby reducing the pool of competent vendors and reducing competition. On the other hand, the State must ensure that its interests are appropriately protected, and that it can adequately protect its citizens in the event the contractor’s actions cause substantial losses. Any risk-allocation device, including a limitation of liability, requires a balance between these two competing interests.

No list of considerations can be complete, but when determining whether and how to use a limitation of liability clause, consider the following recommendations:

1. Always—
 - a. Make the decision whether to include a limitation of liability clause ***prior*** to issuing the solicitation
 - b. Perform a risk analysis before determining an appropriate cap
 - c. Determine which risks may be insured by the contractor before determining an appropriate cap
 - d. Receive clause-specific written approval from the using governmental unit before including a limitation of liability clause in a solicitation
 - e. Review each exclusion proposed by the contractor to ensure the State does not exclude more than it intended; always think about what the agency is giving up
 - f. If using a multiplier for the Cap, absent a compelling reason, use both a multiplier and a fixed dollar amount and establish the fixed dollar cap first (but only after performing the risk analysis)

2. Never—
 - a. Alter the model clause terms without first consulting legal counsel
 - b. Agree to limit liability to total contract price absent careful consideration and compelling circumstances; doing so may effectively eliminate the recovery of any damages to the agency—leaving only a refund for something you may not have received
 - c. Limit liability to direct damages, or exclude liability for specific sets of damages such as lost profits or loss of data, absent consideration and compelling circumstances
 - d. Modify the exclusions, or “carve outs,” without first consulting legal counsel
 - e. Limit liability arising from intentional or reckless conduct

Attachment A

Model Limitation of Liability Clause (Single Agency Clause)

LIMITATION OF LIABILITY – SINGLE AGENCY (DEC 2020)

(1) Contractor's liability for damages to the Using Governmental Unit shall not exceed [*a dollar amount*].

(2) The parties waive claims against each other for (i) exemplary or punitive damages and (ii) special or consequential damages.

(3) The foregoing limitations shall not apply: (a) to claims for physical damage to real or tangible personal property, (b) to claims regarding bodily injury, sickness, disease or death, (c) to claims arising from reckless or intentional misconduct, (d) to amounts due or obligations under a clause (regardless of how named) providing for liquidated damages, or if such a clause is ruled unenforceable as a penalty, (e) to amounts due or obligations under the following clauses, if included: (i) Indemnification-Third Party Claims-General, (ii) Indemnification-Third Party Claims-Disclosure of Information, (iii) Indemnification-Intellectual Property, (iv) Information Security–Safeguarding Requirements, (v) Information Security-Location of Data, (vi) Information Use and Disclosure–Standards, or (vii) Service Provider Security Representations; (f) to amounts due or obligations under a clause imposing a duty to defend or indemnify, or (g) to any loss or claim to the extent the loss or claim is covered by a policy of insurance maintained, or required by this contract to be maintained, by contractor.

(4) The absence in any subcontract of a similar clause limiting contractor's liability shall not effectively increase the obligation of the Using Governmental Unit beyond what it would have been had the subcontract contained such a clause.

(5) The Using Governmental Unit's liability for damages, if any, shall not exceed [*a dollar amount*]. Nothing herein shall be construed to waive any law or clause regarding the availability or appropriation of funds, sovereign immunity, or any other immunity, restriction, or limitation on payment or recovery provided by law.

(6) The State of South Carolina's total liability for any obligation under any clause imposing any duty of confidentiality or non-disclosure shall not exceed an amount equal to fifty thousand dollars. [07-7B117-1]

Attachment B

Model Limitation of Liability Clause (Multi-Agency Clause)

LIMITATION OF LIABILITY – MULTI-AGENCY (DEC 2020)

- (1) Contractor's liability for damages to any Using Governmental Unit shall not exceed [*a dollar amount*].
- (2) The foregoing limitation shall apply to each Using Governmental Unit independently.
- (3) The parties waive claims against each other for (i) exemplary or punitive damages and (ii) special or consequential damages.
- (4) The foregoing limitations shall not apply: (a) to claims for physical damage to real or tangible personal property, (b) to claims regarding bodily injury, sickness, disease or death, (c) to claims arising from reckless or intentional misconduct, (d) to amounts due or obligations under a clause (regardless of how named) providing for liquidated damages, or if such a clause is ruled unenforceable as a penalty, (e) to amounts due or obligations under the following clauses, if included: (i) Indemnification-Third Party Claims-General, (ii) Indemnification-Third Party Claims-Disclosure of Information, (iii) Indemnification-Intellectual Property, (iv) Information Security–Safeguarding Requirements, (v) Information Security-Location of Data, (vi) Information Use and Disclosure–Standards, or (vii) Service Provider Security Representations; (f) to amounts due or obligations under a clause imposing a duty to defend or indemnify, or (g) to any loss or claim to the extent the loss or claim is covered by a policy of insurance maintained, or required by this contract to be maintained, by contractor.
- (5) The absence in any subcontract of a similar clause limiting contractor's liability shall not effectively increase the obligation of the Using Governmental Unit beyond what it would have been had the subcontract contained such a clause.
- (6) The Using Governmental Unit's liability for damages, if any, shall not exceed [*a dollar amount*]. Nothing herein shall be construed to waive any law or clause regarding the availability or appropriation of funds, sovereign immunity, or any other immunity, restriction, or limitation on payment or recovery provided by law.
- (7) The State of South Carolina's total liability for any obligation under any clause imposing any duty of confidentiality or non-disclosure shall not exceed an amount equal to fifty thousand dollars. [07-7B118-1]