Paradigm

INTERNATIONAL SOCIETY OF PRIMERUS LAW FIRMS

FALL 2013

Finding the Best Lawyer for You

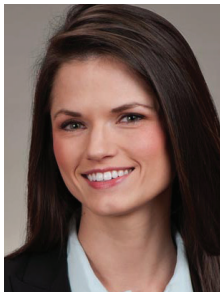
Helping Clients Find the Right Lawyer: Innovation in Client Service

Current Legal Topics:

North America • Europe, Middle East & Africa

Latin America & Caribbean • Asia Pacific

Joey McCue



Logan Wells

I Liked It When I Signed It – But I Don't Like It Now: Limitation of Liability Clauses

Generally, everyone is happy when the contract is signed. Goods or services are sold, and money changes hands. Everything is good – until it is not. That is when we, as lawyers, get involved. That is also the point at which people reread, or worse, read for the first time, the contracts they signed.

Our society can neither function nor prosper without the use of contracts. Accordingly, the freedom of contract endures as a bedrock legal principal. An equally important, corresponding legal principal is that, barring extenuating circumstances, parties are bound by the terms of those contracts they freely enter into. This general principle, however, is not without exceptions. This article explores the application of one of those exceptions, the doctrine of unconscionability, to limitation of liability clauses in the context of a contract many of us will be a party to at least once in our lifetime, the home inspection contract.

Unconscionability is the "absence of meaningful choice on the part of one party, due to one-sided contract provisions, together with terms that are so oppressive that no reasonable person would make them and no fair and honest person would accept them." *Simpson v. MSA of Myrtle Beach, Inc.*, 644 S.E.2d 663, 668 (S.C. 2007). *But see Lucier v. Williams*, 841 A.2d 907, 911 (N.J. Super. Ct. App. Div. 2004) ("There is no hard and fast definition of unconscionability."). "The doctrine [of unconscionability] is not one to be applied to disturb the agreed allocation of risk, even if it should result from superior bargaining power of one party, but rather to prevent oppression and surprise." *Coker Int'l, Inc. v. Burlington Indus., Inc.*, 747 F. Supp. 1168, 1172 (D.S.C. 1990).

In a recent decision, *Gladden v. Boykin*, 739 S.E.2d 882 (S.C. 2013), the South Carolina Supreme Court upheld the limitation of liability clause in the Palmetto Home Inspection Services, LLC ("Palmetto") inspection contract. Finding the provision, which limited Palmetto's liability to the $475.00 Mrs. Gladden paid for the home inspection, was not unconscionable, the court stated:

> Courts should not refuse to enforce a contract on grounds of unconscionability, even when the substance of the terms appear grossly unreasonable, unless the circumstances surrounding its formation present such an extreme inequality of bargaining power, together with factors such as lack of basic reading ability and the drafter's evident intent to obscure the term, that the party against whom enforcement is sought cannot be said to have consented to the contract.

739 S.E.2d 882, 884-85. In *Gladden*, the home inspector was self-employed, operating out of his home, while Mrs. Gladden was trained as a real estate agent. It was undisputed that Mrs. Gladden read the contract prior to signing

Joey McCue is a senior shareholder and is the Chair of the firm's Construction Law Practice Group. His practice primarily focuses on construction, transportation, premises liability and pesticide litigation. He also has 10 years of experience in sales and as a business owner.

Logan Wells joined the firm in 2009 and practices in the areas of insurance coverage and professional liability. She also writes about insurance coverage issues and trends in the South Carolina Insurance Law Blog.

Joey McCue and Logan Wells represented Palmetto in Gladden v. Boykin.

Collins & Lacy, P.C.
1330 Lady Street, Sixth Floor
Columbia, South Carolina 29201
803.381.9933 Phone
803.771.4484 Fax
jmccue@collinsandlacy.com
lwells@collinsandlacy.com
www.collinsandlacy.com

and paying for the home inspection services. There was no allegation that Mrs. Gladden was uneducated or unable to protect her own interests. Quite the reverse, Mrs. Gladden negotiated with numerous parties throughout the process of purchasing the home and specifically sought Palmetto's services, passing on a different home inspector described as "harder but best." *See Jordan v. Diamond Equip. & Supply Co.*, 207 S.E.3d 525 (Ark. 2005) (finding an exculpatory clause enforceable in part because the plaintiff had sought the services of the defendant).

The *Gladden* court further explained, "Limitations of liability and exculpation clauses are routinely entered into. Moreover, they are commercially reasonable in at least some cases, since they permit the provider or offer service at a lower price, in turn making the service available to people who otherwise would be unable to afford it." 739 S.E.2d 882, 884 (citing *Head v. U.S. Inspect DFW, Inc.*, 159 S.W.3d 731 (Tex. App. 2005) (noting courts uphold limitations of liability in burglar and fire alarm system contracts and finding limitation of liability clause in home inspection contract commercially legitimate for the same reasons)). Accordingly, the court found the clause was not unconscionable.

Courts in other jurisdictions have also found similar home inspection contracts, pursuant to which the home inspecting company's liability for any loss or damages arising out of the inspection and report would be limited to the fee paid for its services, were enforceable and not unconscionable. *See, e.g., Moler v. Melzer*, 942 P.2d 643 (Kan. App. 1997) (Clause in home inspection contract limiting inspector's liability to cost of inspection, was not unconscionable, as clause was not hidden, and record gave no indication of an inequality of bargaining or economic power, nor any indication that purchaser could not have sought a different inspection company.); *Head*, 159 S.W.3d 731 (Clause in home inspection contract, which limited home inspector's liability to the amount of the fee paid for the inspection, was not unconscionable, where purchaser was free to choose another inspection service, she was represented by an attorney in the transaction, and without the limitation clause, the inspector was subject to significant risk, which would likely cause the cost for inspection services to increase.).

Still, other courts have refused to enforce limitation of liability clauses in home inspection contracts. In those cases, however, it appears that, unlike South Carolina, the states in which those courts sit have well-documented public policies indicating home inspectors' liability should not be so limited. For example, in *Lucier v. Williams*, 841 A.2d 907, the court rejected a limitation of liability clause in a home inspection contract, relying heavily on a New Jersey statute requiring home inspectors to maintain errors-and-omissions insurance of at least $500,000 a year. The court also refused to enforce a limitation of liability clause in a home inspection contract in *Pitts v. Watkins*, 905 So.2d 553 (Miss. 2005); however, as in New Jersey, Mississippi requires home inspectors to carry general liability insurance and errors-and-omissions insurance of at least $250,000.

Correspondingly, the test applied in determining whether an exculpatory clause contravenes public policy is also significant. In South Carolina, courts have generally held that considerations of public policy prohibit a party from limiting liability for its negligence in the performance of a duty of public service, or where a public duty is owed, or public interest is involved, or when the parties are not on roughly equal bargaining terms. *Pride v. S. Bell Tel. & Tel. Co.*, 138 S.E.2d 155 (S.C. 1964). Courts applying the standards from *Tunkl v. Regents of University of California*, 383 P.2d 441 (1963), in evaluating exculpatory clauses tend to view such provisions in a harsher light. *See, e.g., Carey v. Merritt*, 148 S.W.3d 912 (Tenn. App. 2004) (applying *Tunkl* factors to find exculpatory clause in home inspection contract violated public policy).

Therefore, in light of courts' varied treatment of limitation of liability clauses in home inspection contracts, it is helpful to consider the following in determining whether such a clause is enforceable:

1. Is the contract one of adhesion?
2. What is the relative disparity in the parties' bargaining power?
3. What is the parties' relative sophistication?
4. Was the inclusion of the challenged clause a surprise?
5. Is the clause conspicuous?
6. Does the clause conflict with established public policy?

While this article deals with limitations of liability provisions in the home inspection context, the same analysis would likely be used by courts when evaluating such provisions in other professional contracts, e.g., pest control companies and appraisers. In this broader context, one must consider whether the exculpatory clause is reasonable and appropriate given the service it concerns. There should be a correlation between the amount charged for the service and the liability the provider is undertaking when those services are performed. P