

Risk Management Essentials: Limitation of Liability

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HOWDEN



Today's Presenter



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- Over two decades providing contract review consulting
- Former National Practice Leader for Contract Review at Marsh & Aon
- Bachelor's degree: Major - Contracts & Acquisitions, Minor - International Business
- Develops contract review tools, templates & training to simplify and streamline review process and reduce clients' contractual risk
- Presented for The Institutes, In2Risk, RIMS, Employer Engagement Forum, Marsh, In-house Connect, and Lawline.

Disclaimer – guidance is presented from an insurance and risk-related (not legal) perspective. Please consult with legal counsel for legal advice on contract wording.

Agenda

01. Introduction: Learning Objectives
 - LOL Clauses: Definition, Purpose,
02. Relevance, Importance, Limitations, Types, Elements, Waiver of Consequential Damages, Direct & Indirect Damages & LOL Factors
03. Insurance Impact on LOL Strategies
04. Practice Session
05. Q&A

Introduction: Learning Objectives

Introduction

Learning Objective #1

Understand the impact of limitation of liability clauses on contractual risk.

Learning Objective #2

Learn types of LOL clauses, key elements, and strategies.

Learning Objective #3

Understand the impact of LOL clauses on insurance.

Learning Objective #4

Practice revising LOL clauses to be more in favor of Public Entities.



Limitation of Liability Clauses

What is liability?

Liability is a **responsibility to compensate for some failure to perform** according to an established stipulation.

What is a Limitation of Liability?

A clause in a commercial contract that **restricts the amount of compensation owed in case of performance failure.**



Limitation of Liability Clauses

Definition

- limit liability of one party for losses, damages, or injuries caused to another party for breach of contract or other legal issue
- cap financial liability between parties

Purpose

- help manage risk exposure
- ensure predictable financial outcomes for parties
- help control costs

Relevance

- often used in service contracts where damage scope may be broad or difficult to quantify

Importance

- Public agencies must understand LOL clauses to align them with indemnity, insurance terms, and public interests.
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Key Elements of Limitation of Liability Clause

Capping Liability

- Serve to allocate risk and protect a business from too much financial exposure
- Contract size, scope of work, &/or relative size of the two parties may guide if, how & what LOL's are used

Direct vs. Indirect Liabilities

- Clearly differentiate between these
- Consider which have higher risk
- More to come on these

Carve-outs

- LOL's usually exclude some types of claims due to the significant nature of these types of claims and relative risk to the business if such events occurred.
- Commonly excluded claims include: willful misconduct, gross negligence, IP infringement, data breaches, and indemnity obligations

Key Elements of Limitation of Liability Clause

Clear & Unambiguous

- Should be clearly written and specify any limits and exclusions.
- Use formatting like all caps, underlined, &/or in bold type.
- May need to be in a separate section - not in indemnity or insurance section.

Mutual Agreement

- Both parties to the contract must agree to terms.

Compliance with Law

- Clause must comply with all relevant laws and regulations.
- Uniform Commercial Code (UCC) allows terms that limit or exclude consequential damages 'unless the limitation or exclusion is unconscionable'
- Generally speaking, LOL must be reasonable and fair.

Key Elements of Limitation of Liability Clause

Indemnification Relationship

- Consider relationship between LOL clause and indemnity terms.
- Ensure negotiated liability limits don't undermine or conflict with indemnity terms or resulting contract could be ambiguous, unfair, or riskier than expected for one or both parties.

Mutual or Unilateral

- Clauses may be mutual (in both party's favor) or one-sided (only in one party's favor).
 - Company with more risk exposure may want LOL only in their favor.
 - Company with lower risk exposure may want no LOL or mutual LOL.
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Some LOL Limitations

LOL's may NOT be used to:

- limit one parties' liability for causing bodily injury or property damage to third parties (ex. general public)
- violate public policy
- limit liability for intentional misconduct or gross negligence

Be sure to check applicable state law(s)!



Common LOL Types

Caps on Damages

- contract specifies maximum amount of damages that can be claimed
- fixed amount or multiple of fees paid under contract
- Ex. total liability of a party shall not exceed \$1M amount under the contract

Time Limits

- sets time frame during which claims must be made
- after specified period, any right to claim damages may be forfeited
- Ex. all claims must be brought within 12 months of loss

Consequential Damage Waivers

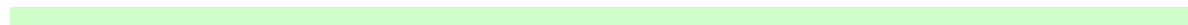
- clauses exclude liability for consequential or indirect damages, like business interruptions or lost profits.
- Ex. neither party shall be liable for any consequential damages arising from breach of contract

What are Consequential Damages?

These are **indirect losses** that occur as a result of **breach of contract**, but they are **not the direct cost of fixing the problem**.

What is a Waiver of Consequential Damages?

This is a type of LOL and a contract clause where **one or both sides agree if something goes wrong, they will not claim the indirect losses** from the other.



Some Examples of Direct vs. Indirect Damages

Direct Damages - compensation for value directly lost due to breach of contract and losses arising out of Vendor's performance	Indirect Damages - indirect losses arising from Vendor's breach of contract or other event
bodily injury to others arising from Vendor's operations	loss of profits
property damage to others arising from Vendor's operations	loss of customers
cost to hire another contractor to complete Vendor's work	penalties
cost to hire another contractor to correct Vendor's work	loss of future business opportunities
wages paid to workers because of a project delay	additional costs due to business interruptions
expenses for materials that are a direct result of delay in project schedule	punitive damages
customer's direct financial loss from having to extend construction loan due to project delay	lost rental income

More Examples of Indirect Damages

Indirect Damages - indirect losses arising from Vendor's breach of contract or other event

additional administrative costs

diminution in value

financing costs

rental expenses

reputational damage

Sample Mutual Waiver

Key Features:

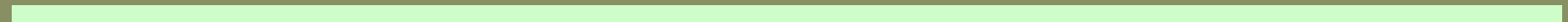
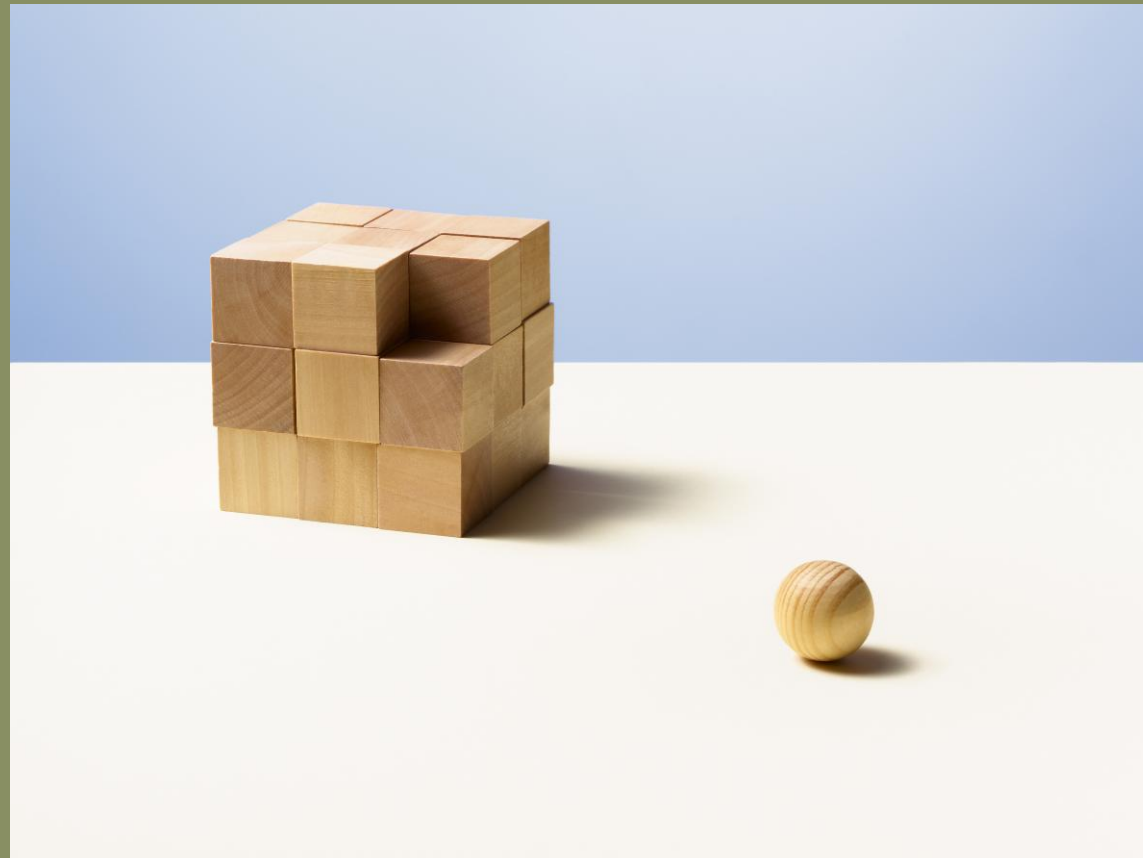
- **Legal compliance** - adds “to the fullest extent permitted by law” for enforceability
- **Mutual waiver** – applies to both parties
- **Broad coverage** - lists common examples like loss of profits
- **Foreseeability disclaimer** - applies even if damages were predictable

“Waiver of Consequential Damages.

To the fullest extent permitted by law, each party waives any claim against the other for consequential, incidental, or indirect damages arising out of or relating to this Agreement. This waiver includes, but is not limited to, loss of use, loss of profits, loss of business opportunities, or loss of revenue, regardless of whether such damages were foreseeable or whether either party was advised of the possibility of such damages.”

Some Factors to Consider When Negotiating LOL Clauses

- Remember – LOL clauses are not “one-size-fits-all”
 - suggest tailor to each contract
 - avoid copy/paste from other contracts
- Consider level of risk involved and potential impact of damage or loss
- Determine risk appetite
 - What are you willing to accept with regards to LOL terms?
- Financial size and resources of contracting parties
 - larger, more financially stable vendors - suggest push for higher LOL
 - smaller vendors - may need to accept lower LOL and add carve outs for indemnity and insurance

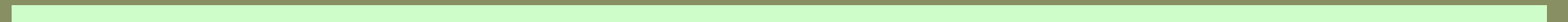


Some Factors to Consider When Negotiating LOL Clauses

- Consider broader context of your relationship with other party
 - for long-term, strategic business relationships - consider using a collaborative approach when negotiating

Suggest focus on ways to reduce risk for both parties rather than just limiting liability, such as:

- developing contingency plans for use when things go wrong
- sharing information about risk management practices
- conducting joint risk assessments





Some Factors to Consider When Negotiating LOL Clauses

- Successfully negotiating limitation of liability clauses in contracts with vendors requires a careful balance of risk and reward.
- A best practice is to focusing on each vendor's financial strength, size, and business relationship when negotiating terms that maximizes protection for your organization while preserving benefits of the contract.
- **Pro Tip!** - Suggest have early meeting with other party to explain why public entity can't agree to certain conditions.

Insurance Impact on LOL Strategies

Strategy 1: No LOL in Favor of Vendor



Avoid Vendor-Favored LOL Clauses

Refusing LOL clauses that favor vendors protects agencies by ensuring vendors are fully liable for damages.

Protect High-Risk Contracts

Strategy ideal for high-risk or high-value contracts with potential for high damages.

Promote Accountability

No LOL sets strong precedent for accountability and effective risk management.

Pro Tips! – Start with your own contract template. Require Vendors to submit template exceptions with bids. For projects over \$150K, mention adding LOL would make it an unlevel playing field.

Strategy 2: Add Mutual Waiver of Consequential Damages Instead of Full LOL

Balanced Risk Management

Mutual waiver excludes indirect damages but preserves responsibility for direct damages, balancing risk fairly.

Vendor Acceptability

Waiver approach often more acceptable to vendors, easing contract negotiations.

Public Agency Considerations

Public agencies must ensure critical damages related to operations are not excluded in the waiver.



Strategy 3: LOL with Carve-Out for Insurance & Indemnity



LOL Clause with Insurance & Indemnity Carve-Out

Including carve-out ensures vendor insurance coverage and indemnity obligations are not limited by contract's liability cap.

Protecting Recovery Rights

Protects agency's ability to recover damages up to vendor's insurance limits and indemnified amount.

Contract Verification

Agencies should ensure carve-out is clearly defined and vendor maintains adequate insurance.

Strategy 4: LOL with Carve-Out for Required Insurance Limits & Indemnity

Balance Risk and Vendor Capacity

LOL clauses with carve-outs balance risk management with vendor financial capabilities effectively.

Recovery up to Required Insurance Limits

Promotes recovery up to specified, available insurance limits despite overall liability limits.

Suitable for Smaller Vendors

Helpful for smaller vendors who maintain appropriate insurance but cannot accept unlimited liability.



Strategy 5: LOL Cap Equal to Insurance Limits



Align Liability with Insurance

For larger vendors, setting the LOL cap to the insurance limits aligns vendor liability with their coverage, ensuring clear risk boundaries.

Simplified Contract Negotiations

Matching LOL cap with insurance limits simplifies negotiations by providing enforceable and consistent contract terms.

Confirm Adequate Coverage

Agencies must verify insurance limits sufficiently cover service risks to maintain proper protection.

Practice Session

Sample Pro-Vendor LOL

“Limitation of Liability.

Vendor shall not be liable to Customer for any indirect, incidental, exemplary, punitive or consequential damages arising out of or related in any way to this Agreement, including, but not limited to, lost profits and other commercial losses, even if Vendor has been notified of the possibility of such damages. Under no circumstances shall Vendor’s total liability for any and all claims in the aggregate exceed the total amount paid by Customer to Vendor for the affected products and/or support during the three (3) month period preceding the event giving rise to the initial claim.

How to make LOL more in Public Entity's favor

If Vendor won't agree to remove LOL, then suggest use MICE techniques:

- (1) make the provision **mutual**
 - (2) have the damages cap apply to **individual** claims rather than aggregated claims
 - (3) extend the scope of the damages **cap** or better yet have no time limit
 - (4) **exclude** certain types of claims, indemnity, and insurance
-

Sample Balanced LOL

“Neither party shall be liable to the other party for any indirect, incidental, exemplary, punitive or consequential damages arising out of or related in any way to this Agreement, including, but not limited to, lost profits and other commercial losses, even if the parties have been notified of the possibility of such damages. Under no circumstances shall a party’s total liability for any single claim exceed the total amounts paid and owing by Customer to Vendor under this Agreement. This provision shall not apply to (a) either party’s indemnification and insurance obligations under this Agreement, (b) a breach of either party’s confidentiality obligations under this Agreement, (c) either party’s gross negligence or willful misconduct, or (d) a breach of Vendor’s obligations under this Agreement.”

Sample Pro-Public Entity LOL

“Limitation of Liability.

Vendor acknowledges and agrees that nothing in this Agreement shall limit or restrict Customer’s rights or remedies available under law, including recovery of all direct, indirect, consequential, or incidental damages resulting from Vendor’s breach, negligence, or willful misconduct. Vendor’s liability shall include, without limitation, costs of correction, delay damages, loss of use, and any other damages reasonably incurred by Customer. Any limitation of liability or exclusion of damages shall apply only to Customer’s liability to Vendor and shall not apply to Vendor’s liability to Customer.”



Q&A

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