# Limiting liability to non-audit clients

*A checklist of points to consider*

Like many other providers of goods or services, professional accountancy firms often seek to limit their potential liability to their clients by including limitations or exclusions of liability in their engagement letters. This is good risk management practice – as long as it is done carefully and effectively. Not everyone is aware of the extent to which they are able to restrict or exclude liability – and the danger is, get it wrong, and you may have any unreasonable contractual provisions struck out leaving you with unrestricted liability.

Moreover the recent Consumer Rights Act has also introduced new restrictions on 'consumer' contracts (ie to those other than with sophisticated commercial or corporate clients).

You should ensure your terms of engagement meet the requirements of this recent legislation. As such we recommend that you consider the important matters below to check whether your client engagement letters are working properly for you:

### Terms to be fair and reasonable

A limitation or exclusion clause may be regarded as being unenforceable if it is not fair and reasonable. What is fair and reasonable will depend on all the circumstances. The Consumer Rights Act (s57) requires that you do not limit your liability below the value of your fees for a particular matter. This is a good benchmark to use as a minimum standard for all client engagements.

### Exclusion of liability

Firms cannot seek to exclude liability entirely to the client. A more common approach is to limit a firm's liability in the engagement letter to a fixed amount (often described as a 'cap' on liability). A cap set at a higher level is more likely to be enforceable and to protect the firm than a very low cap, and should be proportionate to the nature of the transaction and potential client loss (in some cases, the loss may well be capable of being higher than a multiple of the fees you charge).

### Negotiating limitations or exclusions of liability

When negotiating limitations or exclusions, firms need to balance the importance of limiting liability against the risk of any limitation or exclusion being held to be unfair or unreasonable. In deciding what negotiating position to adopt, firms should take into account the nature of the client, the appointment and remit and the overall commercial risk analysis.

In the case Dennard vs Price Waterhouse the court accepted that a relatively low limit of liability was reasonable given that the clients were experienced business people who were aware of their ability to shop around.

### Cap(s) on liability

A cap on liability that has been discussed and negotiated is likely to be regarded as more reasonable than a non-negotiated cap. Where a cap on liability is accepted without discussion, it is not necessary for firms to try to insist upon negotiation by clients, but where possible, the client should be given sufficient time to consider the matter and/or take legal advice.

It should be made clear whether the cap is an aggregate limit on liability, or applies separately to each breach or each claim. It may be appropriate for the cap to reflect the wording of any aggregation provision in the firm's professional indemnity insurance.

### Documenting negotiations

It is good practice to document any negotiations concerning engagement terms and to keep a record of them on the relevant file. In particular, it is worthwhile recording any concessions made by the firm, for example, any upward adjustment to a limitation amount that was initially proposed. In the recent case Halsall & others v Champion Consulting & others the fact that the engagement terms had been negotiated enabled the accountants to demonstrate that their limitation of liability was reasonable.

### The engagement letter

Any limitation of liability agreed with the client should be set out clearly in the engagement letter. Where a firm's engagement letter comprises the firm's standard terms, together with a covering letter, it would be sensible to draw attention to the cap on liability by referring to it in the covering letter.

### Drafting the limitation of liability clause

Firms should consider taking their own legal advice on the drafting of any clause in the engagement letter that purports to limit liability. The following points of principle may assist firms:

- a limitation or exclusion clause should be drafted to capture any basis upon which a claim might be made, including breach of contract and negligence
- if a formula is to be used for determining a limitation of liability, the basis for calculation should be made clear
- avoid using a formula that may appear to be inherently arbitrary because, for example, it does not take account of the nature of the client or the engagement
- avoid seeking to exclude or limit liability for loss that cannot legally be excluded or limited, such as liability arising from a firm's fraud or from FCA regulated activity
- set out terms containing limitations or exclusions in separate parts of the engagement letter so that any provisions that are subsequently considered to be unreasonable may be removed without affecting the enforceability or sense of the wording that remains
- avoid using a wording that is broader than the law will allow. For example, the clause could specify that an exclusion or limitation will apply to the fullest extent that the law will permit and/or state that liability for a firm's fraud is not excluded or limited
- don't forget that clarifying the identity of your client and the precise work that you are doing for the client can be every bit as important as the liability cap itself.

### Exclude liability for certain types of loss

It may be appropriate to seek to exclude liability for certain types of loss altogether.

Common examples are:

- restriction or exclusion of certain types of liability that are also excluded under the firm's professional indemnity policy, provided this is not inconsistent with the duties for which the firm is being engaged
- exclusion of liability for indirect or consequential loss and/or loss of profits. Some firms may feel that the possibility of indirect or consequential loss presents a risk that cannot be managed because it might be of an unforeseeable catastrophic nature. An exclusion of liability for such loss can be controversial and clear language is needed to exclude such losses
- exclusion of liability arising from use of defective or deficient information provided by the client. Note that such an exclusion will be unlikely to be deemed fair or reasonable where the scope of work requires the accuracy or completeness of the information to be checked by the firm
- exclusion of joint and several liabilities. These clauses are also referred to as 'proportionate liability', 'net liability' or 'net contribution' clauses. The objective of such a clause is to limit the firm's liability to its proportionate share of the blame for loss incurred by the client, so that the firm is not liable for the loss and damage caused by others, such as other professional advisers or employees of the client, even where those others are unable to pay or are not a party to the dispute
- exclusion of advice or services provided by third party advisers or specialists. The purpose of such a clause is to make it clear that your firm is not responsible for advice provided by others especially where you may have introduced your clients for specialist or a specific piece of advice. This can be particularly important in relation to tax scheme advice.

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