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SUMMARY
September 23, 2021

2021COA125

No. 20CA0950, *Johnson v. MEP Engineering* — Contracts — Terms — Limitation of Liability Clauses — Ambiguity

As a matter of first impression, a division of the court of appeals holds that a limitation of liability clause, unlike an exculpatory agreement, in a commercial contract is not void merely because it is ambiguous. In addition, an ambiguous limitation of liability clause is construed using only principles of contract construction.

COLORADO COURT OF APPEALS **2021COA125**

Court of Appeals No. 20CA0950
City and County of Denver District Court No. 19CV32507
Honorable Christopher J. Baumann, Judge

Johnson Nathan Strohe, P.C., f/k/a JG Johnson Architects,

Plaintiff-Appellant,

v.

MEP Engineering, Inc.,

Defendant-Appellee.

JUDGMENT AFFIRMED IN PART AND REVERSED IN PART,
ORDER REVERSED, AND CASE REMANDED WITH DIRECTIONS

Division VI
Opinion by JUDGE BERGER
Richman and Welling, JJ., concur

Announced September 23, 2021

Cardi & Schulte, LLC, Timothy M. Schulte, Daniel V. Woodward, Greenwood Village, Colorado, for Plaintiff-Appellant

SGR, LLC, John D. Hayes, Denver, Colorado, for Defendant-Appellee

¶ 1 This case requires us to determine the validity of a limitation of liability clause in a contract between Johnson Nathan Strohe, P.C. (the architect) and MEP Engineering, Inc. (the engineer). The district court concluded that the limitation in favor of the engineer was clear and enforceable, capping the amount of recoverable damages in the architect's tort action against the engineer. The architect contends, as he did in the district court, that limitations of liability should be strictly construed in the same manner as exculpatory agreements, and that the provision in this case is void because it is ambiguous.

¶ 2 We conclude that the language of the limitation is ambiguous; therefore, we reverse the district court's contrary conclusion. But we also hold that limitations of liability are not subject to the same rules of construction and invalidity as exculpatory agreements, so the limitation here is not void simply because it is ambiguous. On remand, the district court must determine the meaning of the limitation of liability provision, using traditional methods of determining disputed issues of fact. Only then may the district court enter an appropriate judgment.

I. Relevant Facts and Procedural History

¶ 3 The architect designed an apartment building in Denver and, on behalf of the project, hired the engineer "to provide mechanical, plumbing and electrical professional engineering services" for the building under a signed agreement. The engineer drafted the contract, which was signed by the architect without any changes relevant here. In a section entitled "Risk Allocation," the contract states as follows:

> Limitation of Liability: In light of the limited ability of the Engineer to affect the Project, the risks inherent in the Project, and of the disparity between the Engineer's fees and the potential liability exposure for problems or alleged problems with the Project, the Client agrees that if the Engineer should be found liable for loss or damage due to a failure on the part of MEP-ENGINEERING, INC. such liability shall be limited to the sum of two thousand dollars ($2,000 or twice The Engineer's fee whichever is greater) as consequential damages and not as penalty, and that is liability exclusive.

¶ 4 The architect alleged that, as construction neared completion and the engineer was close to finishing its work, the owner and architect discovered substantial problems with the building's heating and hot water systems. According to the architect, the

engineer admitted that it erred in designing those systems. The engineer then designed and implemented repairs. Later, the architect discovered additional problems, which required additional repairs. The architect employed a different firm for those repairs.

¶ 5 The owner of the apartment building initiated an arbitration proceeding against the architect stemming from the errant design of the heating and hot water systems. The engineer was not a party to the arbitration, probably because the engineer was not a party to the arbitration agreement. The arbitrator awarded the owner $1.2 million in damages against the architect.

¶ 6 The architect then sued the engineer for its alleged negligence, seeking to recover the amount for which it was found liable in the arbitration. The architect moved under C.R.C.P. 56(h) for a legal determination of the validity of the limitation of liability provision. The architect contended that the limitation is "too vague, confusing, and ambiguous to be enforceable."

¶ 7 Rejecting the architect's contentions, the district court concluded that the limitation is unambiguous and enforceable: "[T]here is only one plausible interpretation of this clause – [the

engineer's] liability to [the architect] for any negligence on the part of [the engineer] is limited to $2,000 or twice [the engineer's] fee, whichever is greater." The district court interpreted the provision as follows:

> [T]he Court finds the parties entered into an agreement intending to allocate the risk of the project between them and to limit [the engineer's] liability. The heading of paragraph five of the "General Provisions" document states in all capital letters – RISK ALLOCATION. This language is straightforward and obvious. . . . In addition, the phrase immediately below this heading is "Limitation of Liability." Again, this language is straightforward and obvious and reflects the parties' desire in no uncertain terms to limit the liability of [the engineer]. The intent of the parties is further reinforced by the first full sentence immediately after this phrase. This sentence explains *why* the parties are allocating the risk between them and limiting [the engineer's] potential liability – [the engineer] has limited ability to affect the Project, there are inherent risks in the Project, and there is a disparity between [the engineer's] fees (i.e. $96,500.00) and its potential liability exposure (prophetically in this case at least $1.2 million).
>
> Finally, after outlining the reasons why they are agreeing to limit [the engineer's] liability, the parties set forth the actual terms of that limitation – "the Client agrees that if the [e]ngineer should be found liable for loss or

> damage due to a failure on the part of [the engineer], such liability shall be limited to the sum of two thousand dollars ($2,000.00 or twice [t]he [e]ngineer's fee whichever is greater) as consequential damages and not as penalty, and that is liability exclusive." In short, the amount of any damages to be recovered from [the engineer] is capped at a specific amount, constitutes the only permissible (i.e. exclusive) liability of [the engineer] to [the architect], and is not considered a "penalty" which could run afoul of the rule that stipulated contract damages cannot operate as a penalty.
>
> . . . .
>
> Bottom line, the Court concludes the language of the disputed provision reflects the intent of the parties to allocate the risk of the project between them, the provision is enforceable, and there is only one plausible interpretation of this clause . . . .

(Emphasis in original.)

¶ 8 The engineer then moved for leave to deposit $252,720, funds equaling twice its contractual fee (plus interest), into the court's registry and for dismissal with prejudice. In addition to continuing to contend that the limitation of liability is void, the architect opposed the motion on two grounds. First, the architect argued that the engineer's repairs fell outside the scope of the contract, so damages stemming from those repairs are not capped by the

limitation of liability. Second, the architect argued that the limitation does not address costs or fees. Therefore, the architect argued that the engineer's deposit of twice its fee into the court registry did not moot the case.

¶ 9 The court disagreed and granted the engineer's motion to dismiss the case with prejudice.

II. The Limitation of Liability is Ambiguous

¶ 10 The architect contends that the district court erred by concluding that the limitation of liability provision is clear and unambiguous. We agree.

A. Law

¶ 11 "The interpretation of a contract presents a question of law." *Sch. Dist. No. 1 v. Denver Classroom Tchrs. Ass'n*, 2019 CO 5, ¶ 11. Our review is therefore de novo. *Id.*

¶ 12 "Our primary aim in contract interpretation is to ascertain and implement the intent of the parties." *Fed. Deposit Ins. Corp. v. Fisher*, 2013 CO 5, ¶ 11. "We ascertain the parties' intent 'primarily from the language of the instrument itself.'" *Denver Classroom Tchrs.*, ¶ 12 (quoting *Rocky Mountain Expl., Inc. v. Davis Graham & Stubbs LLP*, 2018 CO 54, ¶ 59). We generally afford words in a

contract their plain meaning. *USI Props. E., Inc. v. Simpson*, 938 P.2d 168, 173 (Colo. 1997). But legal terms of art "and terms of a similar nature should be interpreted in accord with their specialized or accepted usage." *Antero Res. Corp. v. S. Jersey Res. Grp., LLC*, 933 F.3d 1209, 1218 (10th Cir. 2019) (citation omitted); *see People ex rel. Rein v. Jacobs*, 2020 CO 50, ¶ 43; *DISH Network Corp. v. Altomari*, 224 P.3d 362, 368 (Colo. App. 2009).

¶ 13 "If the contract is complete and free from ambiguity, we deem it to represent the parties' intent and enforce it based on the plain and generally accepted meaning of the words used." *Denver Classroom Tchrs.*, ¶ 14. Contract language is ambiguous if it is fairly susceptible of more than one reasonable meaning. *Id.*; *Rhino Fund, LLLP v. Hutchins*, 215 P.3d 1186, 1190 (Colo. App. 2008).

¶ 14 "[T]he meaning of a contract is found by examination of the entire instrument and not by viewing clauses or phrases in isolation." *Fisher*, ¶ 11 (quoting *U.S. Fid. & Guar. Co. v. Budget Rent-A-Car Sys., Inc.*, 842 P.2d 208, 213 (Colo. 1992)). We review contracts in their entirety, "seeking to harmonize and to give effect to all provisions so that none will be rendered meaningless." *Copper*

Mountain, Inc. v. Indus. Sys., Inc., 208 P.3d 692, 697 (Colo. 2009) (citation omitted); *see also Rhino Fund*, 215 P.3d at 1190. "Each word in an instrument is to be given meaning if at all possible." *Budget Rent-A-Car*, 842 P.2d at 213.

B. Application

¶ 15 The district court did not review the limitation of liability provision in its entirety, nor did the court give effect to all parts of the provision. Nowhere in the court's analysis did it address the clause stating "such liability shall be limited . . . as consequential damages." This was error.

¶ 16 Accounting for the clause about consequential damages, as we must, we conclude that the provision is ambiguous. "Consequential damages" is a legal term of art that describes "[l]osses that do not flow directly and immediately from an injurious act but that result indirectly from the act." Black's Law Dictionary (11th ed. 2019); *see Vanderbeek v. Vernon Corp.*, 50 P.3d 866, 869 (Colo. 2002). Consequential damages are distinct from actual damages (also known as compensatory damages). *See Vanderbeek*, 50 P.3d at

869; *Gen. Steel Domestic Sales, LLC v. Hogan & Hartson, LLP*, 230 P.3d 1275, 1284 (Colo. App. 2010).

¶ 17 One (but not the only) reasonable interpretation of the clause "liability shall be limited to . . . twice [t]he [e]ngineer's fee . . . as consequential damages" is that the limitation only applies to consequential damages; it does not apply to *other* forms of damages. Another reasonable interpretation is that *all* damages caused by the engineer are consequential damages under the contract, for some unstated (and perhaps inexplicable) reason. Perhaps another interpretation is that the parties did not intend "consequential damages" to have its legal meaning, or that the use of the term was a simple mistake. But none of these interpretations are clear and unambiguous on the face of the contract.

¶ 18 Adding to the confusion is the clause "that is liability exclusive." Read as a whole, "as consequential damages and not as penalty, and that is liability exclusive" could mean that the provision is the architect's *exclusive* means of recovering *consequential* damages, while leaving other types of liability (say, for compensatory damages) unrestricted. In contrast, the district court

interpreted “that is liability exclusive” to mean the provision is the exclusive means of imposing *any* liability against the engineer. This is a reasonable interpretation of the parties’ intent, but, as shown, it is not the *only* reasonable interpretation. The provision is therefore ambiguous.

¶ 19 The engineer argues that the “consequential damages” and “liability exclusive” language is merely inartful phrasing that does not undo the clear intent of the parties to limit the engineer’s liability to twice its fee. Maybe so, but the procedural context in which this case is presented to us we are compelled to disagree. The intent that the engineer identifies might be clear if the language at the end of the provision is excluded. But we must construe the contract as a whole and give effect to all its parts. *See, e.g.*, *Copper Mountain*, 208 P.3d at 697. We therefore reverse the court’s conclusion that the limitation of liability has a clear and unambiguous meaning.

¶ 20 But that does not end our task. We must also address the architect’s claim that because the limitation of liability provision is ambiguous, it is void.

III. The Limitation of Liability is Not Void Because of its Ambiguity

¶ 21 Normally, if a contract provision is ambiguous, its meaning becomes an issue of fact for the district court to resolve like any other issue of fact. *Denver Classroom Tchrs.*, ¶ 14; *Bloom v. Nat'l Collegiate Athletic Ass'n*, 93 P.3d 621, 625 (Colo. App. 2004).

¶ 22 But the Colorado Supreme Court has held that exculpatory agreements — clauses that completely shield one party from liability for its negligence — are *only* enforceable if they are expressed in clear and unequivocal language. *Heil Valley Ranch, Inc. v. Simkin*, 784 P.2d 781, 784 (Colo. 1989). Ambiguous exculpatory clauses are void. *See Chadwick v. Colt Ross Outfitters, Inc.*, 100 P.3d 465, 467 (Colo. 2004). The question, then, is whether we treat an ambiguous contractual limitation of liability — which exposes a contracting party to only a bargained-for level of liability — like an exculpatory clause, or like most other contractual provisions.

¶ 23 The district court reasoned that "the disputed clause is not an exculpatory agreement in that it does not shield [the engineer] completely (or nearly completely) from the consequences of its own

negligence." The court concluded that it should construe the provision using "ordinary principles of contract interpretation." The architect argues that this was error because contractual limitations of liability are like exculpatory clauses and should be analyzed with the same level of heightened scrutiny. We agree with the district court.

¶ 24 While contractual limitations of liability and exculpatory agreements both limit a party's liability, they are different in kind. *Taylor Morrison of Colo., Inc. v. Terracon Consultants, Inc.*, 2017 COA 64, ¶ 45; *U.S. Fire Ins. Co. v. Sonitrol Mgmt. Corp.*, 192 P.3d 543, 548 (Colo. App. 2008).

¶ 25 Exculpatory agreements are a complete bar to liability, so society's preference for holding persons responsible for their negligence is completely negated. When "freedom [of contract] expresses itself in a provision designed to absolve one of the parties from the consequences of his own negligence, there is danger that the standards of conduct which the law has developed for the protection of others may be diluted." *O'Callaghan v. Waller & Beckwith Realty Co.*, 155 N.E.2d 545, 546 (Ill. 1958). Thus,

“[a]greements attempting to exculpate a party from that party’s own negligence have long been disfavored.” *Heil Valley Ranch*, 784 P.2d at 783.

¶ 26 In contrast, “[a] limitation of liability provision is generally enforceable.” *Core-Mark Midcontinent, Inc. v. Sonitrol Corp.*, 2012 COA 120, ¶ 13. Limitations of liability leave the benefiting party exposed to a bargained-for level of liability, as recognized by a division of this court in *Taylor Morrison of Colorado*, ¶ 45: “While the clause in this case limited [defendant’s] total liability, it did not act as a waiver of any claim that [plaintiff] chose to bring.” Similarly, the New Mexico Court of Appeals concluded that “there is a significant difference between contracts that insulate a party from any and all liability and those that simply limit liability.” *Fort Knox Self Storage, Inc. v. W. Techs., Inc.*, 142 P.3d 1, 6 (N.M. Ct. App. 2006).

¶ 27 While divisions of this court have long recognized the differences between these clauses, no Colorado court has decided whether ambiguous limitations of liability are void. But the United States Court of Appeals for the Third Circuit has decided the

question. Like divisions of this court, the Third Circuit persuasively explained the differences between a limitation of liability and an exculpatory clause:

> The clause before us does not bar any cause of action, nor does it require someone other than [defendant] to ultimately pay for any loss caused by [defendant's] negligence. [Defendant] remains liable for its own negligence and continues to be exposed to liability up to a $50,000 ceiling. *Thus, the amount of liability is capped, but [defendant] still bears substantial responsibility for its actions.*

Valhal Corp. v. Sullivan Assocs., Inc., 44 F.3d 195, 202 (3d Cir. 1995) (emphasis added). Simply put, "[t]he difference between the two clauses 'is . . . a real one.'"[1] *Id.* (quoting *Posttape Assocs. v. Eastman Kodak Co.*, 537 F.2d 751, 755 (3d Cir. 1976)).

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[1] The Third Circuit recognized that "an agreement setting damages at a nominal level may have the practical effect of avoiding almost all culpability for wrongful action," such that a contractual limitation on liability is, in effect, an exculpatory clause. *Valhal Corp. v. Sullivan Assocs., Inc.*, 44 F.3d 195, 204 (3d Cir. 1995). In the present case, however, the district court found that, "[n]otwithstanding that the arbitration award against [the architect] is approximately $1.2 million the court cannot find that $193,000.00 is a nominal amount of damages which would compel the Court to construe the limitation of liability agreement as an exculpatory agreement." The architect does not argue on appeal

¶ 28 Given these differences, the Third Circuit concluded that limitations of liability are not "disfavored or . . . tested by the same stringent standards developed for exculpatory, hold harmless, and indemnity clauses." *Id.*

¶ 29 The Third Circuit's reasoning is persuasive, and we follow it in this case. We hold that a limitation of liability in a commercial contract is not void merely because it is ambiguous. Like other ambiguous contract provisions, the meaning is a question of fact that courts must determine using ordinary methods of contract interpretation.

¶ 30 Our holding is limited to the facts before us: a limitation of liability in a contract between two sophisticated commercial entities. Colorado case law is rife with examples upholding the validity of contractual limitations of many kinds between sophisticated commercial entities. "Strong policy considerations favoring freedom of contract generally permit *business owners* to allocate risk amongst themselves as they see fit." *Constable v.*

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that the contractual limitation is invalid because it only permits nominal damages or is effectively an exculpatory clause.

Northglenn, LLC, 248 P.3d 714, 718 (Colo. 2011) (emphasis added); *see also Heil Valley Ranch*, 784 P.2d at 784; *Rhino Fund*, 215 P.3d at 1191 ("As a general rule, courts will uphold an exculpatory provision in a contract between two established and sophisticated business entities that have negotiated their agreement at arm's length.").

¶ 31 *Jefferson County Bank of Lakewood v. Armored Motors Service*, 148 Colo. 343, 366 P.2d 134 (1961), does not require or support a contrary holding. That case is materially different because it addressed a contractual limitation of liability in a contract of bailment. *Id.* at 344-45, 366 P.2d at 134-35.

¶ 32 While certain kinds of contractual provisions are disfavored (such as exculpatory clauses), liability-limiting provisions of all kinds are disfavored in contracts between *certain parties*. One example is a contract between a bailee and a bailor: "[T]he general rule [is] that limitations of liability in contracts of bailment for hire are against public policy." *Barker v. Colo. Region-Sports Car Club of Am., Inc.*, 35 Colo. App. 73, 79-80, 532 P.2d 372, 377 (1974) (citing *Jefferson County Bank*, 148 Colo. 343, 366 P.2d 134).

¶ 33 Recognizing this general rule, the supreme court concluded that a limitation of liability in a bailment contract is only enforceable if it is "expressed in clear and unmistakable language." *Jefferson County Bank*, 148 Colo. at 347, 366 P.2d at 136 (citation omitted). But that reasoning was premised on, and limited to, a contract of bailment. *See id.* (specifically referencing a "contract of bailment" and "[a] valid special contract of bailment" throughout). The supreme court's reasoning in *Jefferson County Bank*, therefore, does not bear on the case at hand.

¶ 34 The architect also cites a handful of out-of-state cases for the proposition that limitations of liability are subject to the same interpretive standards as exculpatory agreements, but none of those cases grapple with the fundamental differences between the clauses. *See, e.g.*, *J. A. Jones Constr. Co. v. City of Dover*, 372 A.2d 540, 553 (Del. Super. Ct. 1977) (addressing the differences between indemnity and exculpatory clauses, not limitations of liability).

¶ 35 The United States Supreme Court's decision in *Robert C. Herd & Co. v. Krawill Machinery Corp.*, 359 U.S. 297, 305 (1959), is not on point either. There, the Supreme Court held that the Carriage of

Goods by Sea Act did not shield stevedores[2] from liability for their negligence. The Court reasoned, "'[w]e can only conclude that if Congress had intended to make such an inroad on the rights of claimants (against negligent agents) it would have said so in unambiguous terms' and 'in the absence of a clear Congressional policy to that end, we cannot go so far.'" *Id.* at 302 (quoting *Brady v. Roosevelt S.S. Co.*, 317 U.S. 575, 584 (1943)).

¶ 36 True, the Court went on to analogize statutory interpretation to contract interpretation:

> [C]ontracts purporting to grant immunity from, or limitation of, liability must be strictly construed and *limited to intended beneficiaries*, for they "are not to be applied to alter familiar rules visiting liability upon a tortfeasor for the consequences of his negligence, unless the clarity of the language used expresses such to be the understanding of the contracting parties."

Id. at 305 (emphasis added) (quoting *Bos. Metals Co. v. The Winding Gulf*, 349 U.S. 122, 123-24 (1955) (Frankfurter, J., concurring)). But this statement has little bearing on the present case because

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[2] A stevedore is a person or company that manages the loading or unloading of a ship. Black's Law Dictionary (11th ed. 2019).

the Supreme Court was analyzing whether certain parties were included in, and thus protected by, a liability-limiting provision. *See id.* The Court did not address whether, as here, a liability-limiting provision could be enforced against a clearly identified party.[3]

¶ 37 In conclusion, we reverse the portion of the district court's judgment finding that the agreement's limitation of liability was clear and unambiguous, and we remand to the district court to determine the meaning of the disputed provision as an issue of fact, employing ordinary methods of contract interpretation. *Denver Classroom Tchrs.*, ¶ 14; *see also Bloom*, 93 P.3d at 625.

IV. Remaining Issues

¶ 38 The architect argues in the alternative that even if the limitation of liability is enforceable, it does not apply to damage stemming from the repairs because, according to the architect,

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[3] To the extent that this statement has any bearing on our case, for the reasons stated in the opinion, we decline to follow it. The Supreme Court's reasoning is not binding on us because contract interpretation, absent underlying constitutional concerns, is a matter of state law. *See Radil v. Nat'l Union Fire Ins. Co. of Pittsburg*, 233 P.3d 688, 692 (Colo. 2010).

those services were outside the scope of the contract. The architect also argues that the limitation does not apply to fees and costs (apparently, both the fees and costs from this action as well as those incurred during the arbitration proceeding). The district court impliedly rejected these arguments when it dismissed the case with prejudice.

¶ 39 Because we are remanding to the district court to determine the meaning of the limitation of liability, we do not decide whether the limitation covers the alleged extra-contractual services, fees, or costs. The court must address these issues on remand.

V. Conclusion

¶ 40 The judgment is affirmed in part and reversed in part, and the case is remanded for further proceedings consistent with this opinion. We reverse the judgment dismissing the case with prejudice and the order authorizing the deposit of funds into the court registry. We also reverse the court's conclusion of law that the limitation of liability is unambiguous. But we affirm the court's conclusion that it must employ ordinary methods of contract

interpretation to determine the meaning of the limitation of liability clause.[4]

¶ 41 On remand, the court must determine the meaning of the limitation of liability clause as an issue of fact.

JUDGE RICHMAN and JUDGE WELLING concur.

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[4] *Cheyenne Mountain Sch. Dist. No. 12 v. Thompson*, 861 P.2d 711, 716 (Colo. 1993), describes the process to be used by district courts in this context: "Because Thompson's employment contract is ambiguous on the issue of compensation for unused vacation time, the parties will be free to introduce at trial evidence extrinsic to the four corners of the document. *Radiology Professional Corp. v. Trinidad Area Health Ass'n, Inc.*, 195 Colo. 253, 577 P.2d 748 (1978). Parol evidence will be admissible to assist the trier of fact in determining whether the parties intended that Thompson be compensated for the unused vacation time. *See McNichols v. City of Denver*, 120 Colo. 380, 209 P.2d 910 (1949). In case of doubt, a contract is construed most strongly against the drafter. *Christmas v. Cooley*, 158 Colo. [297, 302, 406 P.2d 333, 336 (1965)]."