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7th Circuit: No Need for Specificity in Contract Dispute Liability Cap

Earlier today, the Seventh Circuit Court of Appeals handed down its decision in *SAMS Hotel Group, LLC v. Environs, Inc.* In the case, the court had to weigh in on a yet to be clearly decided aspect of Indiana law. Specifically, the court had to determine whether the specificity requirement of exculpatory clauses in tort cases applies to a cap on damages in a claim rooted in a breach of contract. After a thorough analysis of Indiana cases, the court concluded that no such requirement exists – at least not in a contract between two sophisticated businesses.

The case stems from the negligent design of a hotel in Fort Wayne, Indiana. As part of the construction project, SAMS hired the services of Environs Architects/Planners to design the hotel. For the design, SAMS paid Environs $70,000 and executed a contract that included the following provision:

> The Owner [SAMS] agrees that to the fullest extent permitted by law, Environs Architects/Planners, Inc. total liability to the Owner shall not exceed the amount of the total lump sum fee due to negligence, errors, omissions, strict liability, breach of contract or breach of warranty.

As these things go, Environs negligently designed the structure. The flaws were not identified until the building was nearly complete and the county building

department condemned the structure. After trying to remedy the structural flaws, the building was ultimately demolished. SAMS calculated its total damages for the design defect to be $4.2 Million.

The case found its way into federal court on diversity jurisdiction. As we have previously discussed, in order for a federal court to have jurisdiction over a case on diversity grounds, the parties must be diverse – i.e. from different states – and the amount in controversy must exceed $75,000. The parties were diverse. And, on the face of this case, it would appear that the amount in controversy was easily met. However, as it turns out, the amount in controversy is a bit more of a sticky wicket. Even though SAMS may well have suffered $4.2 Million from the negligence of Environs, if the liability-limiting clause could be enforced, then the limit of damages recoverable was to be capped at the amount paid by SAMS to Environs – $70,000. Thus, the major issue was whether the clause was enforceable.

In federal cases that arise under diversity jurisdiction, it is state and not federal law that governs. In this case, the state whose law applies is Indiana. The case was originally brought as both a breach of contract and a negligence case. A negligence claim is a tort claim that stems from the carelessness of the defendant. It is the typical basis for a claim in an automobile accident. A breach of contract, on the other hand, is what the name suggests – a claim rooted in a violation of the terms of a contract.

After the case had been filed, the Indiana Supreme Court decided the case *Indianapolis-Marion County Public Library v. Charlier Clark & Linard, P.C.* The *IMCPL* case was a fairly important case that merits a blog post of its own. But to simplify the case for our purposes here, it is sufficient to summarize the case as holding:

> that the "economic loss rule" applies to construction contracts under Indiana law. Under that rule, a party to a contract cannot be liable under a tort theory for any purely economic loss caused by the party's negligent performance of the contract, absent any personal injury or damage to other property.

As a result of the *IMCPL* decision, the trial court granted summary judgment on the negligence claims in favor of Environs, thereby leaving only the breach of contract claim. In the same order, the trial court also found that the liability cap provision was enforceable and thus would limit the breach of contract claim to $70,000. After bench trial, the court awarded SAMS $70,000.

Before we delve into the 7th Circuit's decision on appeal, there is an issue

that merit discussion. It is related to the diversity jurisdiction. Though not discussed in either the appellate decision or the trial court's order, our more observant readers and frequent followers of the Hoosier Litigation Blog may well be wondering how a case that has become capped at $70,000 meets the amount in controversy requirement to be in federal court. The answer for this is simple, if not satisfying. As the 7th Circuit stated in *Grinnell Mutual Reinsurance Co. v. Shierk*,

> [E]vents occurring subsequent to the filing or removal of a case-whether one party changes its residence, thereby destroying complete diversity, or the amount in controversy drops below the jurisdictional amount-are not "defects" in the court's jurisdiction; these subsequent events do not affect a federal court's diversity jurisdiction at all.

Summarized a bit more succinctly in *Genenbacher v. CenturyTel Fiber Co. II, LLC*, "Diversity jurisdiction is determined at the time the complaint is filed."

If you are like me, this concept does not sit well with you. It is not because you have a case where a federal court started with jurisdiction and then some later act removed it. That is fairly common in federal question cases – i.e. cases based on federal law – where the federal law claim gets dismissed and the only thing left are state law claims. In those circumstances there are a host of factors to be examined as to whether the federal court will keep jurisdiction. No, to me the problem really stems from a unique attribute of Indiana civil procedure that is absent in federal law that would have really caused the amount in controversy analysis to be an issue. You see, under Indiana Trial Rule 9.2, any complaint arising from the terms of a written instrument, such as a contract, must have the written instrument attached to the complaint and thereby incorporated into it. If this had happened in this case, then the complaint itself – by incorporating the contract and its limiting provision – would not have met the amount in controversy by the face of the complaint.

Returning to the decision. The argument put forth by SAMS was that the liability limiting provision failed to explicitly mention that the limiting provision applied to Environ's own negligence. In formulating the argument, SAMS looked to Indiana law governing exculpatory provisions for tort claims. Under exculpatory provisions, Indiana law requires that the party seeking the waiver "clearly and unequivocally manifest a commitment by [the plaintiff], knowingly and willing[ly] made, to pay for damages occasioned by [the defendant's] negligence.'" I have briefed this issue so many times, including a case to the Indiana Court of Appeals, that I am going to give you a brief explanation without a laundry list of cases backing me up. Put simply, the general rule is that the exculpatory clause needs to either explicitly mention the defendant's own negligence or have descriptive enough

language so as to essentially paint a mental image of what is being waived.

In this case, the issue was whether this concept of tort law was applicable to a breach of contract action. Remember, the trial court had already dismissed the negligence claims from the case. So that was not the issue. In a case where a federal court is applying state law, the court is duty bound to apply the law as it has been established by the state's highest court. Typically, even if the state's highest court has not addressed the issue, the federal court will apply a decision by the intermediary appellate court. Though, it is an important note that technically, the federal court need only apply the decision of the highest court and in the absence of such a decision must apply what it thinks the highest court would apply even if that means contradicting a state court of appeals decision. In this case, the issue had not been directly addressed by any Indiana court.

After analyzing lines here and there from Indiana cases and the fact that the Indiana Supreme Court made certain to distinguish a breach of contract action from negligence in its discussion in the *IMCPL*, the court determined that under Indiana law, this provision was enforceable. The court closed its opinion with a reminder from a prior Indiana case, "[T]he general rule of freedom of contract includes the freedom to make a bad bargain."

Interestingly, much of the opinion focuses on the fact that the two parties to the contract were businesses who were sophisticated in this industry. Indeed, the opinion drops a footnote giving us the backstory of the president and managing member of SAMS having previously negotiated with Environs while a member of a different business. However, the ultimate holding of the case does not make clear whether the sophistication of the parties impacts the analysis. Thus, it is quite difficult to understand the bounds of applicability of this case. That is, it is difficult to understand its applicability to inferior federal courts. This is because, as a federal decision, it is not binding upon any Indiana state court. Though, mind you, it will certainly be cited whenever possible by opportunistic defense counsel as persuasive authority.

Something to keep in mind as far as applying this federal decision to Indiana state courts is that, while this decision is most certainly not binding on a state court, the author – Judge David Hamilton – is not without experience in Indiana law. Not only was he a practitioner in Indiana prior to joining the bench, but he was the Chief Judge of the Southern District of Indiana; meaning that he may well have a better feel for the Indiana Supreme Court than most Seventh Circuit judges. In my opinion, utilizing this fact, were I tasked with citing this decision to an Indiana state court, I would make certain to lead my discussion with the statement, "As Judge Hamilton wrote . . ."

Ultimately, the marquee take away from this case is that where two sophisticated parties enter into a contract, they are almost certainly to be bound by the mutually agreed upon cap on liability. Thus, this case stands as a reminder for the importance of reading an agreement before you sign it and making certain to fully consider the repercussions of anything in a contract that would limit your right to later bring suit.

Join us again next time for further discussion of developments in the law.

Sources

- *SAMS Hotel Grp., LLC v. Environs, Inc.*, ___ F.3d ___, No. 12-2979 (7th Cir. May 31, 2013).
- *Indianapolis-Marion Cnty. Pub. Library v. Charlier Clark & Linard, P.C.*, 929 N.E.2d 722 (Ind. 2010).
- *SAMS Hotel Grp., LLC v. Environs, Inc.*, No. 1:09-CV-930-TWP-TAB, 2011 WL 809048 (S.D. Ind. Mar. 2, 2011), *aff'd*, ___ F.3d ____, No. 12-2979 (7th Cir. May 31, 2013).
- *SAMS Hotel Grp., LLC v. Environs, Inc.*, No. 1:09-CV-00930-TWP, 2012 WL 3139765 (S.D. Ind. Aug. 1, 2012) , *aff'd*, ___ F.3d ____, No. 12-2979 (7th Cir. May 31, 2013).
- *Grinnell Mut. Reinsurance Co. v. Shierk*, 121 F.3d 1114, 1117 (7th Cir. 1997).
- *Genenbacher v. CenturyTel Fiber Co. II, LLC*, 500 F. Supp. 2d 1014, 1015 (C.D. Ill. 2007).
- Indiana Trial Rule 9.2 – requirement to attach contract to complaint.
- *Indiana Bell Tel. Co. v. Mygrant*, 471 N.E.2d 660, 664 (Ind. 1984).
- For an interesting discussion on the need to curtail the expansion of the Economic Loss Rule, *see* Gennady A. Gorel, *The Economic Loss Doctrine: Arguing for the Intermediate Rule and Taming the Tort-Eating Monster*, 37 Rutgers L.J. 517 (2006).

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