OFFICE OF ATTORNEY GENERAL
STATE OF OKLAHOMA

ATTORNEY GENERAL OPINION
2012-18

The Honorable Brian Bingman
President Pro Tempore
State Senator, District 12
2300 N. Lincoln Blvd., Room 422
Oklahoma City, Oklahoma 73105

October 23, 2012

Dear Senator Bingman:

This office has received your request for an official Attorney General Opinion in which you ask, in effect, the following questions:

1. **Prior Attorney General Opinions have found that state contracts may not contain clauses that limit a private vendor's liability to the State in any manner or degree. Are state agencies prohibited by OKLA. CONST. art. X, § 23 from entering into contracts that limit a private vendor's liability to the State in any manner or degree?**

2. **Are state agencies prohibited from entering into contracts that limit a private vendor's liability to the State for (1) indirect, incidental, special, punitive and consequential damages; and (2) loss of profits, revenue, data and data use when the private vendor remains liable for direct damages under such contract in an amount not to exceed the amount received by the private vendor from the state agency under the contract?**

I.
BACKGROUND

You ask whether state agencies are prohibited from entering into contracts that contain limitation of liability clauses that limit a private vendor's liability to the State in any manner or degree. You raise the question of whether certain limitations may be proper, for instance, whether a contract may limit a private vendor's liability for indirect, incidental, special, punitive and consequential damages[1]

[1] "Indirect damages" and "consequential damages" are defined as "[l]osses that do not flow directly and immediately from an injurious act but that result indirectly from the act." BLACK'S LAW DICTIONARY 445-46 (9th ed. 2009). (continued...)

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and loss of profits, revenue, data and data use, when the private vendor remains liable for direct damages under such contract in an amount not to exceed the amount received by the private vendor from the state agency under contract.

Previous Attorney General Opinions, specifically Attorney General Opinions 06-11, 01-02 and 78-256, have addressed constitutional concerns with regard to certain types of limitation of liability clauses and indemnification clauses. These prior Opinions found these clauses to be in violation of the debt provision of Article X, Section 23 of the Oklahoma Constitution. You do not seek a reconsideration of the prior Opinions as to their conclusions regarding indemnification clauses, but ask that we reconsider the conclusions as to limitation of liability clauses. Your questions require an examination of these former Opinions.

Attorney General Opinion 78-256 considered a number of different contractual clauses including one which attempted to "immunize the private entity, contracting with the State, from suit based upon any act it may take in relation to the contract with the State." *Id.* at 597. The Opinion concluded the clause violated "a policy of express law, that administrative agencies are not to exceed their statutorily granted powers." *Id.* at 598.

Attorney General Opinion 01-02 concluded that a limitation of liability contract provision creates a "debt or obligation" prohibited by OKLA. CONST. art. X, § 23 unless funds have been appropriated to cover the resulting obligation at the time the contract is executed. The Opinion described a limitation of liability clause as one that would "hold a private entity (a vendor) harmless for his actions and limit the State's legal rights by capping the amount the State could receive as damages due to a vendor's negligence in the amount specified in the contract." A.G. Opin. 01-02, at 9. The Opinion concluded the obligation is contingent upon future events that may or may not occur and therefore, appropriation is impracticable. *Id.* at 11-12. In concluding a limitation of liability clause constitutes debt, the Attorney General relied in part on the Oklahoma Supreme Court's holding in *Wyatt-Doyle & Butler Engineers, Inc. v. City of Eufaula*, 13 P.3d 474 (Okla. 2000). *See* A.G. Opin. 01-02, at 10-11. A controlling factor was that limitation clauses, like the clause at issue in *Wyatt-Doyle*, create a contingent obligation. *Id.*

In the 2006 Opinion, A.G. Opin. 06-11, the Attorney General reaffirmed that OKLA. CONST. art. X, § 23, applicable to state agencies, and OKLA. CONST. art. X, § 26, applicable to municipalities and other political subdivisions, prohibit limitation of liability clauses in all state contracts unless funds have been appropriated and encumbered to pay for any contingent liability that may arise. That

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[1](...continued)
"Incidental damages" are defined as "[l]osses reasonably associated with or related to actual damages." *Id.* at 446. "Special damages" are "[d]amages that are alleged to have been sustained in the circumstances of a particular wrong." *Id.* at 448. "Punitive damages" are "[d]amages awarded in addition to actual damages when the defendant acted with recklessness, malice, or deceit[.]" *Id.* "Direct damages" are "[d]amages that the law presumes follow from the type of wrong complained of[.]" *Id.* at 446.

Opinion described a limitation of liability clause as an "exculpatory" clause and defined it as "[a] contractual provision relieving a party from any liability resulting from a negligent or wrongful act." A.G. Opin. 06-11, at 77 (citation omitted). The Opinion found that limitation of liability clauses "require the State to bear the risk of the vendors' intentionally wrongful acts or negligence in addition to the State's own." *Id.* The Opinion commented, "The obligations thereby assumed by the State may be substantial if injured third parties assert claims against the State, because the limitation of liability clauses would foreclose the State from being awarded damages in a breach of contract suit against the vendor whose acts or omissions actually caused the injury." *Id.* at 77-78. The reasoning of that Opinion was that limitation of liability clauses constitute a debt unless at the time the contract is executed funds have been appropriated and encumbered to pay for any contingent liability that may arise. *Id.* at 78. That Opinion also concluded that a limitation of liability clause that creates an unfunded contingent liability is void as against public policy. *Id.* at 81.

II.

A CONTRACT BETWEEN A STATE AGENCY AND A PRIVATE VENDOR WHERE THE STATE AGREES NOT TO SEEK DAMAGES AGAINST THE VENDOR OR TO LIMIT THE DAMAGES IT SEEKS DOES NOT CONSTITUTE A VIOLATION OF OKLA. CONST. ART. X, § 23 AS THE CONTRACT DOES NOT CREATE A LEGALLY ENFORCEABLE OBLIGATION BINDING A FUTURE LEGISLATURE TO APPROPRIATE FUNDS.

You ask us to reexamine these prior Opinions as to limitation of liability clauses only, considering whether a limitation of a liability clause constitutes a "debt or obligation" within the meaning of the Oklahoma Constitution. At the outset, it is important to define what a limitation of liability clause is, and consequently, what it is not. Limitation of liability clauses may take many forms and must be evaluated on an individual basis to determine the exact nature of the clauses. For purposes of this Opinion, we define limitation of liability clauses as those clauses where the State agrees not to seek damages against another party to the contract or to limit the damages it seeks against the other party. We will refer to the other party to the contract as a private vendor.

In the type of limitation of a liability clause addressed in this Opinion, the State does not agree to reimburse the private vendor for any damages but agrees to forego seeking damages against the private vendor or to limit the damages it may seek. The agreement does not prohibit third parties from seeking damages against the private vendor. In such a situation, the practical effect of the limitation of liability clause is that the State may be responsible for its own damages that would otherwise be paid by the private vendor. The obligation is not to the private vendor but practically it would fall on the State to pay damages which, absent the limitation clause, would be paid by the private vendor. The damages the State agrees to forego may be indirect, incidental, special, punitive, consequential and may be for loss of profits, revenue, or data and data use. The question, then, is this: Does the State's agreement to forego seeking damages or to limit the damages it may seek from a private vendor constitute debt of the State in the constitutional sense?

This question has not been specifically answered by Oklahoma courts. The controlling constitutional provision, OKLA. CONST. art. X, § 23, states in pertinent part:

> The state shall never create or authorize the creation of any debt or obligation . . . against the state, or any department, institution or agency thereof, regardless of its form or the source of money from which it is to be paid, except as may be provided in this section and in Sections 24 and 25 of Article X of the Constitution of the State of Oklahoma.
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> . . . .
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> 9. Any department, institution or agency of the state operating on revenues derived from any law or laws which allocate the revenues thereof to such department, institution or agency ***shall not incur obligations in excess of the unencumbered balance of cash on hand.***

Id. (emphasis added). This provision has been referred to as establishing a "pay as you go" system, preventing "one legislative assembly from laying its mandate upon a future one." *Boswell v. State*, 74 P.2d 940, 945, 947 (Okla. 1937).

Our goal in interpreting this constitutional provision is to give intent to the framers and the people adopting it. *Id.* at 942. The *Boswell* court looked to the natural and ordinary meaning of the term "debt" to determine whether a statute authorizing the State Highway Commission to borrow money and issue notes for the purpose of constructing roads and bridges constituted debt pursuant to OKLA. CONST. art. X § 23. The court defined "debt" as "***[t]hat which is due from one person to another***, whether money, goods, or services; ***that which one person is bound to pay to another***, or to perform for his benefit; thing owed; obligation; liability." *Boswell*, 74 P.2d at 943 (emphasis added) (citation omitted).

The terms "debt" and "obligation" have historically been defined by case law. Much of the body of law dealing with constitutional debt is in the area of bonds. While some of this law is peculiar to the unique nature of bonds, the cases establish some basic premises that are applicable here. In reviewing a proposed highway improvement bond issue in, *In re Oklahoma Capitol Improvement Authority*, 958 P.2d 759, 771 (Okla. 1998), the court focused on whether an enforceable obligation was created beyond the fiscal year. Because there was no pledge of future income, all the bond holders could expect to recover were actual appropriations made by individual legislative bodies. The court found that there was nothing to bind future legislative bodies to make the anticipated appropriations. The court stated:

> The fact that the Legislature might, under the highway program, feel some moral obligation to continue the agreement or to ensure that highways are provided for all

> citizens of this state does not mean that it is legally obligated, and therefore, the Okla. Const. art. 10, §§ 23, 24, and 25 are neither implicated nor applicable . . . .

Id. at 769.

The same language was used by the court in *Fent v. Oklahoma Capitol Improvement Authority*, 984 P.2d 200 (Okla. 1999) in considering the issuance of bonds to fund various government projects. The bonds did not on their face constitute obligations of the State of Oklahoma. The court said:

> Unquestionably, provisions obligating future legislatures are unconstitutional. However, here there is simply nothing to bind future legislative bodies to make the anticipated appropriations. Future revenues are not pledged . . . for retirement of the proposed bonds. The present Legislature's intent to appropriate the monies is not a binding commitment on future legislatures to do so.

Id. at 208 (citation omitted).

Here, the limitation of liability clause does not constitute an enforceable obligation against a party nor does it require the State to be indebted to a party. It does not bind future legislative bodies to appropriate money to pay damages. The fact that the State may be potentially responsible for damages that would otherwise be paid by a private vendor, does not create a debt as there is no binding obligation on the part of the State to pay another party pursuant to the contract.

For example, assume a contract with a state agency limited the damages of a private vendor to a contract such that the vendor was excluded from paying damages for consequential damages resulting from the purchase and installation of a network computer system. Nothing in the contract would bind the State to pay for damages to state equipment or to third parties if damages occurred or bind a future Legislature to appropriate monies for such damages. While practically the State may be responsible for damages to its own equipment, the terms of the contract do not obligate the State in the sense that future Legislatures are obligated to appropriate monies beyond the fiscal year.

The prior Attorney General Opinions concluding otherwise relied to a great extent on the Oklahoma Supreme Court's decision in *Wyatt-Doyle & Butler Engineers, Inc. v. City of Eufaula*, 13 P.3d 474 (Okla. 2000), to find that a limitation of liability clause creates a contingent liability. In *Wyatt-Doyle*, the City of Eufaula and the Eufaula Industrial Authority contracted with Wyatt-Doyle for engineering services for the development of an entertainment facility to be located in Eufaula. *Id.* 474. The City of Eufaula's liability was contingent on the Authority's failure to pay. The Authority paid to a certain point then filed bankruptcy. The City also failed to pay. *Id.* Wyatt-Doyle argued the contract did not constitute a debt in violation of Article X, Section 26 of the Constitution (the municipal counterpart to Article X, Section 23) because the obligation created by the contract was contingent on the default of the Authority. *Id.* at 477. The court rejected this argument, finding that "Wyatt-Doyle [was] incorrect in assuming that labeling its agreement with the City of Eufaula a contingent

obligation and not a debt would save the agreement from violating Article 10, § 26." *Id.* at 479. The court found "a municipality cannot create an obligation one year that results in a debt in a succeeding year without violating Article 10, § 26." *Id.*

Were we to find that a limitation of liability clause constitutes a debt to another party, the fact that the liability is contingent on future events would not take it outside the area of unconstitutional debt under the holding of *Wyatt-Doyle*. The distinction, however, and the reason we now conclude that *Wyatt-Doyle* is not controlling is that, in *Wyatt-Doyle*, an agreement existed between two parties which bound one party to pay another should certain contingencies arise. In the type of limitation of liability clause we consider in this Opinion, there is no affirmative promise on the part of the State to pay another party to the contract. This, rather than the contingent nature of the contract, is the distinguishing factor that prevents the decision in *Wyatt-Doyle* from controlling our conclusion.

Prior Attorney General Opinions focused on the contingent nature of limitation of liability clauses but did not fully analyze whether limitation of liability clauses where the State agrees not to seek damages against a private vendor, or to limit the damages it may seek, constitute debt. To the extent the prior Opinions found that limitation of liability clauses constitute debt, those Opinions are overruled.

However, the Opinions are reaffirmed as to indemnification clauses. The 2006 Opinion, discussed above, described indemnification clauses as those where the State agrees to hold the contracting party, a vendor, harmless from liability by requiring the State to bear the cost of any damages for which the indemnitee is held liable. A.G. Opin. 06-11, at 77. We reaffirm this, and other prior Opinions as to indemnification clauses as such clauses require the State, by contract, to pay a third party and therefore, constitute a debt pursuant to the authority cited above.

A contract between a state agency and a private vendor containing the type of limitation of liability clause discussed herein simply prevents the State from seeking damages against the private vendor or limits the damages the State may seek. This agreement by the State does not create an obligation on the part of the State to bind future Legislatures to fund any obligation. Therefore, such a clause does not constitute unconstitutional debt in violation of OKLA. CONST. art. X, § 23.

Because we have determined a limitation of liability clause where the State agrees not to seek damages, or limits the damages the State may seek against a private vendor does not constitute a debt, we need not consider whether state agencies may enter into contracts that limit liability for certain damages but provide that the vendor remains liable for direct damages in an amount not to exceed the amount received by the private vendor.

III.

A LIMITATION OF LIABILITY CLAUSE IN A STATE CONTRACT DOES NOT IMPLICATE OKLA. CONST. ART. V, § 53, WHICH PROHIBITS RELEASING OR EXTINGUISHING INDEBTEDNESS, LIABILITIES OR OBLIGATIONS OWED THE STATE.

Your questions also require an analysis of OKLA. CONST. art. V, § 53 that prohibits releasing or extinguishing indebtedness, liabilities or obligations owed the State. The provision states:

> Except as to tax and assessment charges against real property remaining delinquent and unpaid for a period of time as long or longer than that provided by law to authorize the taking title to real property by prescription, ***the Legislature shall have no power to release or extinguish, or to authorize the releasing or extinguishing, in whole or in part, the indebtedness, liabilities, or obligations of any corporation or individual, to this State***, or any county or other municipal corporation thereof.[2]

Id. (emphasis added) (footnote added). As we have concluded that a limitation of liability clause does not constitute a debt or obligation in the constitutional sense, we conclude this provision is not applicable to a limitation of liability clause. The limitation of liability clause considered in this Opinion defines the responsibilities the parties have to each other under the contract; it does not release or extinguish an existing debt owed to the State.

Additionally, we note that this provision is a limitation on the power of the Legislature to pass laws. The Oklahoma Supreme Court recognized such in *State ex rel. Commissioners of Land Office v. Sparks*, 253 P.2d 1070, 1073 (Okla. 1953), a case involving action by the Commissioners of the Land Office. The court stated with regard to OKLA. CONST. art. V, § 53, "This provision only restrains the legislative branch of the government to pass acts releasing or extinguishing debts due the State, and has no application here." *Id.* Similarly, your question does not implicate an act of the Legislature and a reviewing court could determine this provision to be inapplicable.

More importantly, there are no debts, liabilities or obligations against the State by virtue of a limitation of liability clause in a contract where the State agrees not to seek damages against a private vendor or agrees to limit the damages the State may seek. To the extent A.G. Opins. 06-11, 01-2 and 78-256, hold otherwise, those previous Opinions are overruled on this limited basis.

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[2] This provision was amended in 1954 by State Question No. 361, Legislative Referendum No. 107 to add the first sentence authorizing the releasing or extinguishing of taxes against real property.

IV.

A LIMITATION OF LIABILITY CLAUSE BETWEEN THE STATE AND A PRIVATE VENDOR DOES NOT VIOLATE PUBLIC POLICY AS A MATTER OF LAW BUT EACH CONTRACT MUST BE VIEWED ON AN INDIVIDUAL BASIS TO DETERMINE WHETHER THE CONTRACT IS IN COMPLIANCE WITH OKLAHOMA LAW. OKLAHOMA LAW PROHIBITS CONTRACTS WHICH EXEMPT A PARTY FROM ITS OWN FRAUD, WILFUL INJURY OR A VIOLATION OF LAW, WHETHER WILLFUL OR NEGLIGENT.

We turn, then, to the question of whether an agreement by the State not to seek damages against a private vendor or to limit the damages it seeks violates public policy. Where both parties to a contract are private contractors, limitation of liability clauses in contracts have generally been found not to violate public policy. *Fretwell v. Prot. Alarm Co.,* 764 P.2d 149, 152 (Okla. 1988). The rationale is that the parties have equal bargaining power and contracts take into account the risks inherent in the marketplace. The applicable question, then, is whether this general law is applicable when the State is a contracting party.

We find no Oklahoma case law which holds that contracts where the State agrees not to seek damages against another party or to limit the damages it seeks violate public policy as a matter of law. In *Ball v. Wilshire Insurance Co.,* 221 P.3d 717, 726 (Okla. 2009), the Supreme Court recognized that the "sources of Oklahoma's public policy are her jurisprudence, state legislative or constitutional provisions, and those provisions in the federal constitution that prescribe a norm of conduct for the state." *Id.* Courts are reluctant to find a public policy violation. *Ball* stated:

> A contract violates public policy only if it clearly tends to injure public health, morals or confidence in the administration of law, or if it undermines the security of individual rights with respect to either personal liability or private property. Courts exercise their power to nullify contracts made in contravention of public policy only rarely, with great caution and in cases that are free from doubt.

Id. (footnote omitted). *See also Dayton Hudson Corp. v. Am. Mut. Liab. Ins. Co.*, 621 P.2d 1155, 1160 (Okla. 1980) ("Prejudice to the public interest must hence be clearly apparent before a court is justified in pronouncing a solemn agreement to be of no effect."); *Clark v. Frazier*, 177 P. 589, 590 (Okla. 1919) (citation omited) ("courts will not denounce a contract as being void and unenforceable unless it clearly and unequivocally contravenes . . . public policy").

When applying this authority to an agreement between the State and a private vendor, we cannot say as a matter of law that limitation of liability clauses violate public policy. The advantage of limitation of liability clauses is that the State is able to negotiate to increase the State's competitive bidding power and obtain lower prices for goods and services. The risk of such clauses is that they potentially require the State to absorb losses that would ordinarily be absorbed by the other party to a contract. These competing interests of the parties must be balanced to determine whether any

particular contract is in the best interest of the State. Each contract must be viewed on an individual basis to make this determination.

There are some situations, however, where limitation of liability clauses necessarily violate Oklahoma law and hence, public policy. One such situation is 15 O.S.2011, § 212 which specifically provides:

> All contracts which have for their object, directly or indirectly, to exempt any one from responsibility for his own fraud, or willful injury to the person or property of another or violation of law, whether willful or negligent, are against the policy of the law.

Id.

Courts have interpreted this provision to find a violation of public policy in certain instances. *See Satellite Sys., Inc. v. Birch Telecom*, 51 P.3d 585, 589 (Okla. 2002) (finding that attempts to limit liability for fraud either by tariff or fraud are unreasonable); *Branch v. Mobil Oil Corp.*, 772 F.Supp. 570, 570 (W.D. Okla. 1991) (finding that releases and easements that released an oil company and its successors from liability for future pollution and granted the right to deposit oil waste, saltwater, etc. in creeks were contrary both to express law and to public policy implicit in express law).

Courts have interpreted this provision in other instances and found no public policy violation. *See Manning v. Brannon*, 956 P.2d 156, 160 (Okla. Civ. App. 1998) (interpreting Section 212 to authorize contracts exempting liability for personal injury arising from ordinary negligence); *Elsken v. Network Multi-Family Sec. Corp.*, 838 P.2d 1007, 1010 (Okla. 1992) (finding that Section 212 does not prohibit a contracting party from limiting its liability for ordinary negligence in performance of the contract); *Trumbower v. Sports Car Club*, 428 F.Supp. 1113, 1116 (W.D. Okla. 1976) (noting the public policy of the State of Oklahoma does not, in all cases, prohibit contracts exempting liability for future damages resulting from damages of a party).

Attorney General Opinion 06-11 concluded that limitation of liability clauses violate public policy as a matter of law. The reasoning behind this conclusion was that state entities are entrusted with public funds and spending those funds must serve the public interest. *Id.* at 80. The Opinion concluded that "[a] limitation of liability provision which releases a vendor from responsibility for damages caused by its own negligence or intentionally wrongful acts puts the vendor's interest above that of the public." *Id.* at 81. The Opinion then concluded the clause was "not only constitutionally suspect but void as against public policy." *Id.* The prior Opinion interpreted the clause in question as one that allowed a vendor to be released from liability for wrongful acts. To the extent that A.G. Opin. 06-11 holds the state may not contract to release a private party from its own acts in violation of the law, we reaffirm the conclusion in A.G. Opin. 06-11 as such a clause would violate 15 O.S.2011, § 212 and the State's public policy. However, not all limitation of liability clauses operate in this manner. Thus, the terms of each clause must be reviewed individually to determine the effect of a such a limitation.

Whether any particular limitation of liability clause, regardless of how it is labeled, violates Oklahoma law requires an analysis of the specific terms of the contract. A contract clause may be labeled a limitation of liability clause but may contain language which exempts a party from its own fraud, wilful injury or violation of law. If the effect such a clause is to exempt a party from its own fraud, wilful injury or a violation of the law, the clause is in violation of state law and against the public policy of the State.

State agencies must exercise caution in entering into contracts containing limitation of liability clauses to establish whether the terms of the contracts in fact only apply to forego seeking or limiting damages a State may seek against a private vendor. A clause may be labeled a limitation of liability clause yet its terms may require the State to indemnify a private vendor for the vendor's own damages or may violate public policy, including a provision of state or federal law. State agencies must be ever mindful not to enter into contracts that bind future Legislatures to appropriate money to pay damages to another party.

It is, therefore, the official Opinion of the Attorney General that:

1. **A limitation of liability clause where the State agrees not to seek damages against a private vendor or agrees to limit the damages it may seek does not violate OKLA. CONST. art. X, § 23 as the contract does not constitute an obligation that binds future Legislatures beyond the fiscal year. To the extent that prior Attorney General Opinions, specifically A.G. Opins. 06-11, 01-2 and 78-6, hold otherwise, those Opinions are overruled on this limited basis. These Opinions are reaffirmed as to the conclusions reached as to indemnification clauses.**

2. **As a limitation of liability clause defines the responsibilities of the parties but does not constitute debt in the constitutional sense, the State may enter into a contract containing such a clause without violating OKLA. CONST. art, V, § 53, which prevents the Legislature from extinguishing or releasing debt. To the extent that prior Opinions, specifically A.G. Opins. 06-11, 01-2 and 78-6, hold otherwise, those Opinions are overruled on this limited basis.**

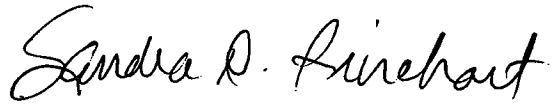
3. **A contract containing a limitation of liability clause where the State agrees to not seek damages against a private vendor or agrees to limit the damages it seeks is not inherently violative of public policy. There may be instances, however, where a particular contract violates Oklahoma's "jurisprudence, state legislative or constitutional provisions, and those provisions in the federal constitution that prescribe a norm of conduct for the state." *Ball v. Wilshire Ins. Co.,* 221 P.3d 717, 726 (Okla. 2009). To the extent that prior Attorney General Opinions, specifically A.G.**

Opins. 06-11, 01-2 and 78-6, hold otherwise, those Opinions are overruled on this limited basis.

4. **A contract with the State that excuses a vendor from the vendor's own fraud, willful injury to person or property or violation of law, whether willful or negligent, is null and void. 15 O.S.2011, § 212. A limitation of liability clause that violates this provision constitutes a violation of public policy and is null and void.**

5. **State agencies must exercise caution in entering into contracts containing clauses labeled as limitation as liability clauses to establish that such clauses do not in fact require the State to indemnify another party for that party's own damages.**

E. SCOTT PRUITT
ATTORNEY GENERAL OF OKLAHOMA



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