Report on a Case by the Board of Ethical Review

Case No. 67-5

Liquidated Damage Clause

Facts:
An engineer in private practice was offered a contract for engineering services by a state agency which contained the following clause:

> "It is understood that time is of the essence of this Agreement and it is therefore agreed by the parties hereto that in the event the Engineer does not meet the date of ( ) stated above, the Engineer hereby agrees that minimum liquidated damages in the amount of $20,000 shall be due the Agency. In the event that actual damages to the Agency may be proved to be greater than this amount then the higher amount of damages shall be due the Agency from the Engineer."

The date referred to in the clause was the date on which the Engineer would be obligated to submit his plans and specifications to the Agency.

Question:
Is it ethical for an engineer to sign a contract containing a liquidated damage clause?

References:
Code of Ethics-Section 1- "The Engineer will be guided in all his professional relations by the highest standards of integrity, and will act in professional matters for each client or employer as a faithful agent or trustee."

Discussion:
The contractual relationship between the Engineer and the Owner should be predicated on mutual trust and confidence that the parties will each perform according to his responsibilities. The best protection for the client is to select his engineer with care and diligence, considering all factors of qualification in terms of staff, background, experience, current workload, and the capacity to perform.

The client has, and should have, the right to look to the engineer for any losses which he may suffer if the engineer fails in his duty and damage to the client. This is a basic principle of common law. The inclusion of a liquidated damage clause serves only to try to define the amount of damage before it occurs.

It must be acknowledged that the Code of Ethics does not specifically deal with the question be fore us. However, we are constrained to note that a liquidated damage clause is contrary to the spirit of Section 1 of the Code. That provision requires the engineer to be guided by the highest standards of integrity and to act for his client as a

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faithful agent or trustee. A liquidated damage clause, on the other hand, is merely a device to define the client's financial interest if the engineer does not meet the contract completion date. We are concerned with this philosophy because the liquidated damage clause implies that the engineer may fail in his duty. A sounder concept, we believe, is to assume that the engineer will not fail in his duty.

In Case No. 66-12, raising a similar principle with regard to a performance bond, we said:

> "We are troubled by the agreement of the engineer to post a performance bond, but this condition is not specifically covered by the Code. It is not the practice for engineers or other professionals to post performance bonds to guarantee their professional services. The philosophical reason for this is found in Section 1 of the Code that the engineer will act for his client as a faithful agent or trustee and will perform in accordance with the highest standards of integrity. This fundamental requirement should be sufficient to protect the client's interests. The introduction of a performance bond is in conflict with professional principles by inter posing a third party between the professional and his client. Although we cannot say that the posting of a performance bond by an engineer is a direct violation of the Code, we conclude that such a practice is unprofessional."

In that case we found that the posting of a performance bond was not a direct violation of the Code, even though in some respects there was a stronger argument against the principle involved because it injected a third party relationship between the engineer and the owner. The third party element is not involved in the case of a liquidated damage clause. Nevertheless, we look with disfavor upon a liquidated damage clause as being unnecessary and a source of potential conflict and difficulty in maintaining the atmosphere of a professional relationship between the engineer and the client.

Conclusion:
A liquidated damage clause is professionally undesirable. It is not unethical for an engineer to sign a contract containing a liquidated damage clause inasmuch as it is not a specific violation of the Code of Ethics.

BOARD OF ETHICAL REVIEW CASE REPORTS: The Board of Ethical Review was established to provide service to the membership of the NSPE by rendering impartial opinions pertaining to the interpretation of the NSPE code of ethics.

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