Report on a Case by the Board of Ethical Review

Case No. 76-2

Conflict of Interest—Engineer Ownership of Construction Firm

Facts:
Example 1: Richard Roe, P.E., is the principal stockholder of Roe Engineering Consultants, Inc. Roe Engineering Consultants, Inc., owns all of the stock and assets of the Ajax Construction Co., Inc.

The Roe engineering firm is retained to design a project, and also to provide professional services during the construction phase to ascertain that the project is built in accordance with the plans and specifications, including approval of changes required due to conditions encountered during construction. Following the preparation of the plans and specifications by the Roe firm, public bids are taken for the construction.

Example 2: Under the same circumstances, Roe's firm will do the design only, and it will not participate in the bidding procedure, and will not have any role during the construction phase.

Questions:
Example 1: Would it be ethical for Roe to allow Ajax to bid on the construction contract?

Example 2: Would it be ethical for Roe to allow Ajax to bid on the construction contract under these circumstances?

References:
Code of Ethics – Section 8 – "The Engineer will endeavor to avoid a conflict of interest with his employer or client, but when unavoidable, the Engineer shall fully disclose the circumstances to his employer or client."

Section 8(a) – "The Engineer will inform his client or employer of any business connections, interests, or circumstances which may be deemed as influencing his judgment or the quality of his services to his client or employer."

Discussion:
To dispose of an initial question not specifically raised by these facts, it is worth repeating that the code does not prohibit an engineer or a firm he controls from engaging in both engineering and nonengineering activities. As we noted in Case 74-6, the ethical duty of the engineer under §8(a) is to inform the client of those business connections or interests which may influence the judgment or the quality of the engineering services. That case also cited from an earlier opinion in Case 68-5 that it would be poor practice for an engineering firm to operate a commercial business under the name and title of an engineering firm, and that there should be a separate identity to avoid confusion as to the

nature of the engineering firm's operations and areas of professional practice. That latter test has been met in the case before us.

The facts as submitted, however, do not tell us if the owner of the project had full notice as to the ownership connection between the Roe engineering firm and the Ajax company. If such disclosure was not made to the owner prior to Ajax's entry into the bidding for the construction contract the procedure was clearly unethical under §8(a) in both examples and we need go no further.

But the facts before us raise further important ethical issues if we assume that the owner was made aware of the relationship and accepted it. In Case 71-6 we traced some of the complexities and shades of meaning in conflict of interest cases. Case 69-8 held it unethical for a group of engineer principals of a consulting firm to organize a separate corporation for the purpose of marketing products used in the construction of engineering projects and thereafter to specify the products of the separate corporation, even though the specifications allowed for an "or equal" clause. Case 69-13 held it unethical for an engineer partner in a consulting firm to specify the products of a company in which he owned a small amount of stock.

Those cases turned on an interpretation of the duty to "endeavor to avoid" a conflict of interest. Thereafter in Case 71-6 we attempted to more narrowly refine the "endeavor to avoid" test, and concluded that §8(a) permits some degree of conflict if the engineer fully informs his client of the facts. Then we said: "In this light we now conclude that the duty to 'avoid' a conflict of interest means to refrain from taking action or making decisions which may adversely affect the interest of the client." One member of the board dissented in that case, holding the view that §8 should be read literally to bar any conflict of interest which is avoidable without regard to disclosure of the facts. Under that rationale the conflict of interest in this case is certainly avoidable.

With the facts of Example 1, the conflict of interest is not related to a small degree of self-interest, such as owning a minor number of shares of the total of a company which manufactures products which the engineer may specify. The conflict is total. It is apparent that Roe is in a position to dictate whether the construction does or does not comply with the plans and specifications; he may thus allow inferior material or equipment or workmanship to be used and thereby increase the profit of the construction company.

In view of the broad and extensive dangers inherent in this arrangement under Example 1, we think it is not sufficient for Roe to make full disclosure to the owner. Even with such full disclosure the owner's interest is jeopardized by the possibility that Roe may provide a design to enable his controlled construction company to be in a favorable position to bid on the project, to control the bidding process, or, as previously noted, to exercise functions during the construction phase to enrich Roe's interest to the detriment of the owner.

We recognize that what has been said here might be construed to apply to engineers engaged in a design/build or turnkey operation. In that situation, however, there is no pretense of a separation of design and construction-related decisions. It is clear from the start that the owner is accepting a total package integrating both functions. The owner thereby is not put in a position of being compromised by a purportedly independent evaluation which is inherent to the purpose of the traditional relationship between the design engineer acting as an agent of the owner and the construction function by an unrelated third party.

With regard to Example 2, Roe has substantially minimized his apparent conflict of interest by disassociating himself from participating in the bidding process and during construction. His position is analogous to that of an elected official disqualifying himself from voting on a matter in which he may have a personal interest. (See Case 75-7.)

We recognized in the discussion under Example 1 that there is some danger that the design firm could influence the award of the construction contract by its design, particularly when the design firm and the construction firm are under common ownership. While this danger would still exist to some extent, when the design firm is eliminated from the bidding and construction phases, the degree of danger is reduced to the point that it may be regarded as minimal. This relatively low degree of danger can be tolerated when the project is subject to public bidding and other bidders would be in a position to expose any type of favoritism through the design process.

Conclusions:*
Example 1: It would not be ethical for Roe to allow Ajax to bid on the construction contract.

Example 2: It would be ethical for Roe to allow Ajax to bid on the construction contract under these circumstances.

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