Report on a Case by the Board of Ethical Review

Case No. 71-6

Conflict of Interest - Nominal Ownership

Facts:
Engineer 'A' owns stock in a company which manufactures a product which is often specified by engineers.

Question:
May Engineer 'A' ethically specify the use of the product of the company in which he holds an ownership interest?

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:
Our decisions in Cases 69-8 and 69-13 have generated questions and comments from the profession, suggesting that we have gone too far in our holdings, or at least have failed to provide guidance on the degree of potential or actual conflict of interest which is permitted under the code.

In Case 69-8, we held that it was unethical for a group of engineer principals of a consulting firm to organize a separate corporation for the purpose of marketing products which are used in the construction of engineering projects and thereafter to specify the products of the separate corporation, even though the specification allowed for an "or equal" clause. In Case 69-13, we held that it was 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.

Our rationale in these holdings was that the code dictates that the engineer endeavor to avoid a conflict of interest. We specifically rejected the view that a conflict of interest is not present if the degree of prospective financial gain is so minimal that the judgment of the engineer would not be biased, ". . . because it is impossible to define that degree of financial gain which would ... be so small as to not prejudice his decision" (citing Case 69-13). However, in Case 69-8 we recognized that "there are many situations in which the engineer may be the owner of an interest in a company which produces equipment or material which the engineer might specify in the normal course of his practice. In

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these situations, a minimal or nominal degree of ownership may not represent a conflict of interest sufficient to influence or raise the inference of influence on the part of the engineer in specifying the equipment or material which he considers best for the interests of the clients." Our reference to permissible conflicts of this type was to a situation in which the engineer's ownership interest was through shares of a mutual fund, from which we drew the conclusion that there was no conflict because the engineer had no control over the investment decisions of the mutual fund managers and would likely not even know whether the mutual fund held shares in a company whose products he might specify at any particular point in time. "Under these circumstances the chance of Engineer 'B' being influenced to prefer the products of a particular manufacturing company is so remote that it can be disregarded."

With this background of earlier consideration, we are asked, in effect, to formulate more definite guidelines or criteria to guide engineers who face the problem through some degree of ownership of companies whose products they may specify. The most stringent concept would be to hold to the principle indicated in Case 69-13 that any degree of conflict would be a violation of the code. That this premise has some merit is indicated by the fact that at least one state has a law which makes it unlawful to employ or retain an engineer (or architect) on public works projects "who is in any way connected with the sale or promotion of or in the manufacture of any material or items used in the construction of such works, or who is a stockholder, officer, partner, or owner of any manufacturing concern, or of any sales organization, engaged in the manufacture or sale of such materials, or items, which may be used in the construction of such works." (Chapter 133, North Carolina General Statutes).

We believe that this concept goes too far in attempting to balance the equities between the paramount interests of the owner and the practical problems of engineers who have funds to invest. The effect of what we may call the "North Carolina philosophy" would seem to extend to a flat prohibition against an engineer investing in any company which produces any kind of material or equipment used in the construction of a facility. Thus, an engineer could not hold even a single share in companies engaged in many of the basic industries of the nation, such as steel, chemicals, electrical equipment, lumber, clay products, etc. We have already decided that it is not feasible to attempt to spell out any particular percentage of ownership which could be applied in a practical manner (69-13). Any such figure would be arbitrary and admit of unfairness and discrimination in a particular set of circumstances.

In the alternative, we return to a basic consideration of the meaning of the key words, "endeavor to avoid," in Section 8 of the code. Upon reconsideration of our previous opinion, we now feel that if it were intended that the quoted phrase meant a completely "puristic" approach the framers of the code would not have included Section 8(a), which recognizes that there may be some degree of conflict, in which case the duty of the engineer is to inform his client of all the facts. 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 interests of the client.

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In the particular case before us, we believe it would be proper for the engineer to make known to the client that he has an interest in the company which produces the product he proposes to specify. It is incumbent upon Engineer 'A' to make available to the client through his specifications the benefits of consideration of any comparable products. The thrust of this case is the duty of the engineer to fully advise his client of all relevant implications of his specifying a product in which he has a financial interest.

Conclusion*:
Engineer 'A' may ethically specify the use of products of the company in which he holds an ownership interest, provided he makes full disclosure to the client.

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Dissenting Opinion:
I disagree with the discussion and the conclusion in this case for both are predicated on giving "disclosure of conflict of interest" the same eminence as the admonition "to avoid conflicts of interest" and in so doing makes "disclosure" a substitute for "avoidance."

The discussion predicates the conclusion on the surmise that the framers of the code, by incorporating Section 8a in the code, did not intend a "puristic" intent for the phrase, "endeavor to avoid." It then develops the thought that the admonition to avoid conflicts applies only to the interests of a present client and neglects aspects of actions taken prior to the present. Such a surmise as to the implications of Section 8a would also indicate that the framers of the code included Sections 8 and 8a for this type of situation and ignores the possibilities of its application to other situations as well.

Section 8 intends that the engineer should avoid actions that would create conflicts of interests with not only present but future clients' interests. Thus, an engineer who designs water systems should not acquire an interest in a firm that manufactures pumps applicable to water systems, for this provides the engineer with a conflict of interest in connection with his services to a majority of his clients. Particularly where the potential of conflict is so apparent such conflict cannot be classed as unavoidable. Section 8 can also be interpreted to indicate that situations currently causing conflicts should be corrected.

The purpose of that portion of Section 8 that applies to "unavoidable" conflicts and Section 8a is to allow for and provide guidance when conflicts can not be foreseen. Such instances would include: real estate interests in an area to be affected by proposed municipal improvement; another client's interests in the same situation;

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previous or concurrent services for a client's competition; interest in a firm that manufactures products rarely specified by the engineer.

The implications of this case could have far-reaching effects in several other areas of potential conflicts. One that comes to mind is the reviewing by an engineer in a governmental capacity of his own work for a private client. Certainly "disclosure" is not an appropriate remedy for such a conflict.

The best interests of a profession require a certain amount of discipline as applied to the members of the profession. Discipline requires subservience to interests of the whole. This case appears to place the convenience of the members of the profession ahead of the interests of the profession and its ethical stature.

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